

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 262	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4		File No.* SR - 2017 - * 806	Amendment No. (req. for Amendments *) 1
Filing by Fixed Income Clearing Corporation Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934				
Initial * <input type="checkbox"/>	Amendment * <input checked="" type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>
			Section 19(b)(3)(B) * <input type="checkbox"/>	
			Rule	
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(6)
Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010			Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934	
Section 806(e)(1) * <input checked="" type="checkbox"/>		Section 806(e)(2) * <input type="checkbox"/>	Section 3C(b)(2) * <input type="checkbox"/>	
Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>			
<b>Description</b>				
Provide a brief description of the action (limit 250 characters, required when Initial is checked *).				
<input type="text"/>				
<b>Contact Information</b>				
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 *	Rosa	Last Name *	Chang	
Title *	Executive Director and Associate General Counsel			
E-mail *	rchang1@dtcc.com			
Telephone *	(212) 855-4985	Fax	<input type="text"/>	
<b>Signature</b>				
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.				
(Title *)				
Date	06/28/2018	Managing Director and Deputy General Counsel		
By	Nikki Poulos	<input type="text"/>		
(Name *)				
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.				
<input type="button" value="npoulos@dtcc.com"/>				

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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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.

**Exhibit 1 - Notice of Proposed Rule Change \***

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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)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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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)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

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.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

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.

**Exhibit 4 - Marked Copies**

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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.

**Exhibit 5 - Proposed Rule Text**

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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.

**Partial Amendment**

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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 Advance Notice**

(a) This advance notice of Fixed Income Clearing Corporation (“FICC”) consists of proposed modifications to FICC’s Government Securities Division (“GSD”) Rulebook (“GSD Rules”) and Mortgage-Backed Securities Division (“MBSD” and, together with GSD, the “Divisions” and, each, a “Division”) Clearing Rules (“MBSD Rules,” and collectively with the GSD Rules, the “Rules”),<sup>1</sup> annexed hereto as Exhibit 5. The proposed rule change would amend provisions in the Rules regarding loss allocation as well as make other changes, as described in greater detail below.

(b) Not applicable.

(c) Not applicable.

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

The filing of this advance notice with the Securities and Exchange Commission (“Commission”) was approved by FICC’s Board of Directors on October 18, 2017.

**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 Advance Notice Received from Members, Participants, or Others**

Written comments relating to this proposal have not been solicited or received. FICC will notify the Commission of any written comments received by FICC.

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

Not applicable.

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<sup>1</sup> Capitalized terms not defined herein are defined in the GSD Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_gov\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf), and the MBSD Rules, available at [www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_mbsd\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf).

**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 Exchange Act**

Not applicable.

**10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act of 2010**

*Description of Amendment No. 1*

This filing constitutes Amendment No. 1 (“Amendment”) to advance notice SR-FICC-2017-806 (“Advance Notice”) previously filed by FICC on December 18, 2017.<sup>2</sup> This Amendment amends and replaces the Advance Notice in its entirety. FICC submits this Amendment in order to further clarify the operation of the proposed rule changes on loss allocation by providing additional information and examples. In particular, this Amendment would:

- (i) Clarify which Tier One Netting Members and Tier One Members would be subject to loss allocation with respect to Defaulting Member Events (as defined below and in the proposed rule change) and Declared Non-Default Loss Events (as defined below and in the proposed rule change) occurring during an Event Period (as defined below and in the proposed rule change). Specifically, pursuant to the Amendment, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that each Tier One Netting Member or Tier One Member, as applicable, that is a Tier One Netting Member or Tier One Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member (as defined below and in the proposed rule change)) and each Declared Non-Default

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<sup>2</sup> See Securities Exchange Act Release No. 82583 (January 24, 2018), 83 FR 4358 (January 30, 2018) (SR-FICC-2017-806).

Loss Event occurring during the Event Period. Proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would also make it clear that any Tier One Netting Member or Tier One Member, as applicable, for which FICC ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day, would be deemed to be a Tier One Netting Member or Tier One Member, as applicable, on the first day of that Event Period.

- (ii) Clarify the obligations and Loss Allocation Cap (as defined below and in the proposed rule change) of a Tier One Netting Member or a Tier One Member, as applicable, that withdraws from membership in respect of a loss allocation round. Specifically, pursuant to the Amendment, proposed Section 7b of GSD Rule 4 and MBSD Rule 4 would provide that the Tier One Netting Member or Tier One Member, as applicable, would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under GSD Rule 4 or MBSD Rule 4, as applicable; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap as fixed in the round for which it withdrew.
- (iii) Clarify that a member would be obligated to FICC for all losses and liabilities incurred by FICC arising out of or relating to any Defaulting Member Event with respect to the member. Specifically, pursuant to the Amendment, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that each member would be obligated to FICC for the entire amount of any loss or liability incurred by FICC arising out of or relating to any Defaulting Member Event with respect to such member.
- (iv) Clarify that, although a Defaulting Member would not be allocated a ratable share of losses and liabilities arising out of or relating to its own Defaulting Member Event, it would remain obligated to FICC for all such losses and liabilities. Specifically, pursuant to the Amendment, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that no loss allocation under GSD Rule 4 or MBSD Rule 4, as applicable, would constitute a waiver of any claim FICC may have against a GSD Member or MBSD Member, as applicable, for any loss or liability to which the GSD Member or MBSD Member is subject under the GSD Rules or MBSD Rules, as applicable, including, without limitation, any loss or liability to which it may be subject under GSD Rule 4 or MBSD Rule 4, as applicable.

In addition, pursuant to the Amendment, FICC is making other clarifying and technical changes to the proposed rule change, as proposed herein.

#### *Nature of the Proposed Change*

The primary purpose of this proposed rule change is to amend GSD's and MBSD's loss allocation rules in order to enhance the resiliency of the Divisions' loss allocation processes so that each Division can take timely action to address multiple loss events that occur in succession during a short period of time (defined and explained in detail below). In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of

The Depository Trust & Clearing Corporation (“DTCC”), namely The Depository Trust Company (“DTC”), National Securities Clearing Corporation (“NSCC”), and FICC (collectively, the “DTCC Clearing Agencies”), so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the loss allocation rules by enhancing their readability and clarity, (iii) amend language regarding FICC’s use of MBSD Clearing Fund, and (iv) make conforming and technical changes.

(i) Background

Central counterparties (“CCPs”) play a key role in financial markets by mitigating counterparty credit risk on transactions between market participants. CCPs achieve this by providing guaranties to participants and, as a consequence, are typically exposed to credit risks that could lead to default losses. In addition, in performing its critical functions, a CCP could be exposed to non-default losses that are otherwise incident to the CCP’s clearance and settlement business.

A CCP’s rulebook should provide a complete description of how losses would be allocated to participants if the size of the losses exceeded the CCP’s pre-funded resources. Doing so provides for an orderly allocation of losses, and potentially allows the CCP to continue providing critical services to the market and thereby results in significant financial stability benefits. In addition, a clear description of the loss allocation process offers transparency and accessibility to the CCP’s participants.

Current FICC Loss Allocation Process

As CCPs, FICC’s Divisions’ loss allocation processes are key components of their respective risk management processes. Risk management is the foundation of FICC’s ability to guarantee settlement in each Division, as well as the means by which FICC protects itself and its members from the risks inherent in the clearance and settlement process. FICC’s risk management processes must account for the fact that, in certain extreme circumstances, the collateral and other financial resources that secure FICC’s risk exposures may not be sufficient to fully cover losses resulting from the liquidation of the portfolio of a member for whom a Division has ceased to act.<sup>3</sup>

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<sup>3</sup> GSD is permitted to cease to act for (i) a GSD Member pursuant to GSD Rule 21 (Restrictions on Access to Services) and GSD Rule 22 (Insolvency of a Member), (ii) a Sponsoring Member pursuant to Section 14 and Section 16 of GSD Rule 3A (Sponsoring Members and Sponsored Members), and (iii) a Sponsored Member pursuant to Section 13 and Section 15 of GSD Rule 3A (Sponsoring Members and Sponsored Members). MBSD is permitted to cease to act for an MBSD Member pursuant to MBSD Rule 14 (Restrictions on Access to Services) and MBSD Rule 16 (Insolvency of a Member). GSD Rule 22A (Procedures for When the Corporation Ceases to Act) and MBSD Rule 17 (Procedures for When the Corporation Ceases to Act) set out the types of actions FICC may take when it ceases to act for a member. Supra note 1.

The GSD Rules and the MBSD Rules each currently provide for a loss allocation process through which both FICC (by applying up to 25% of its retained earnings in accordance with Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4) and its members would share in the allocation of a loss resulting from the default of a member for whom a Division has ceased to act pursuant to the Rules. The GSD Rules and the MBSD Rules also recognize that FICC may incur losses outside the context of a defaulting member that are otherwise incident to each Division's clearance and settlement business.

The current GSD and MBSD loss allocation rules provide that, in the event the Division ceases to act for a member, the amounts on deposit to the Clearing Fund from the defaulting member, along with any other resources of, or attributable to, the defaulting member that FICC may access under the GSD Rules or the MBSD Rules (e.g., payments from Cross-Guaranty Agreements), are the first source of funds the Division would use to cover any losses that may result from the closeout of the defaulting member's guaranteed positions. If these amounts are not sufficient to cover all losses incurred, then each Division will apply the following available resources, in the following loss allocation waterfall order:

First, as provided in the current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4, FICC's corporate contribution of up to 25 percent of FICC's retained earnings existing at the time of the failure of a defaulting member to fulfill its obligations to FICC, or such greater amount as the Board of Directors may determine; and

Second, if a loss still remains, use of the Clearing Fund of the Division and assessing the Division's Members in the manner provided in GSD Rule 4 and MBSD Rule 4, as the case may be. Specifically, FICC will divide the loss ratably between Tier One Netting Members and Tier Two Members with respect to GSD, or between Tier One Members and Tier Two Members with respect to MBSD, based on original counterparty activity with the defaulting member. Then the loss allocation process applicable to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members will proceed in the manner provided in GSD Rule 4 and MBSD Rule 4, as the case may be.

Specifically, the applicable Division will first assess each Tier One Netting Member or Tier One Member, as applicable, an amount up to \$50,000, in an equal basis per such member. If a loss remains, the Division will allocate the remaining loss ratably among Tier One Netting Members or Tier One Members, as applicable, in accordance with the amount of each Tier One Netting Member's or Tier One Member's, as applicable, respective average daily Required Fund Deposit over the prior twelve (12) months. If a Tier One Netting Member or Tier One Member, as applicable, did not maintain a Required Fund Deposit for twelve (12) months, its loss allocation amount will be based on its average daily Required Fund Deposit over the time period during which such member did maintain a Required Fund Deposit.

Pursuant to current Section 7(g) of GSD Rule 4 and MBSD Rule 4, if, as a result of the Division's application of the Required Fund Deposit of a member, a member's actual Clearing Fund deposit is less than its Required Fund Deposit, it will be required to eliminate such deficiency in order to satisfy its Required Fund Deposit amount. In addition to losses that may result from the closeout of the defaulting member's guaranteed positions, Tier One Netting

Members or Tier One Members, as applicable, can also be assessed for non-default losses incident to each Division's clearance and settlement business, pursuant to current Section 7(f) of GSD Rule 4 and MBSD Rule 4.

The Rules of both Divisions currently provide that Tier Two Members are only subject to loss allocation to the extent they traded with the defaulting member and their trades resulted in a liquidation loss. FICC will assess Tier Two Members ratably based on their loss as a percentage of the entire remaining loss attributable to Tier Two Members.<sup>4</sup> Tier Two Members are required to pay their loss allocation obligations in full and replenish their Required Fund Deposits as needed and as applicable. The current Rule provisions which provide for loss allocation of non-default losses incident to each Division's clearance and settlement business (i.e., Section 7(f) of GSD Rule 4 and MBSD Rule 4) do not apply to Tier Two Members.

### Overview of the Proposed Rule Changes

#### A. Changes to Enhance Resiliency of GSD's and MBSD's Loss Allocation Processes

In order to enhance the resiliency of GSD's and MBSD's loss allocation processes, FICC proposes to change the manner in which each of the aspects of the loss allocation waterfall described above would be employed. GSD and MBSD would retain the current core loss allocation process following the application of the defaulting member's resources, i.e., first, by applying FICC's corporate contribution, and second, by pro rata allocations to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members. However, GSD and MBSD would clarify or adjust certain elements and introduce certain new loss allocation concepts, as further discussed below. The proposal would also retain the types of losses that can be allocated to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members as stated above. In addition, the proposed rule change would address the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time, also as described below.

Accordingly, FICC is proposing five (5) key changes to enhance each Division's loss allocation process:

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<sup>4</sup> GSD Rule 3B, Section 7 (Loss Allocation Obligations of CCIT Members) provides that CCIT Members will be allocated losses as Tier Two Members and will be responsible for the total amount of loss allocated to them. With respect to CCIT Members with a Joint Account Submitter, loss allocation will be calculated at the Joint Account level and then applied pro rata to each CCIT Member within the Joint Account based on the trade settlement allocation instructions. Supra note 1.



(1) Changing the calculation and application of FICC's corporate contribution.

As stated above, Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4 currently provide that FICC will contribute up to 25% of its retained earnings (or such higher amount as the Board of Directors shall determine) to a loss or liability that is not satisfied by the defaulting member's Clearing Fund deposit. Under the proposal, FICC would amend the calculation of its corporate contribution from a percentage of its retained earnings to a mandatory amount equal to 50% of the FICC General Business Risk Capital Requirement.<sup>5</sup> FICC's General Business Risk Capital Requirement, as defined in FICC's Clearing Agency Policy on Capital Requirements,<sup>6</sup> is, at a minimum, equal to the regulatory capital that FICC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended (the "Act").<sup>7</sup> The proposed Corporate Contribution (as defined below and in the proposed rule change) would be held in addition to FICC's General Business Risk Capital Requirement.

Currently, the Rules do not require FICC to contribute its retained earnings to losses and liabilities other than those from member defaults. Under the proposal, FICC would apply its corporate contribution to non-default losses as well. The proposed Corporate Contribution would apply to losses arising from Defaulting Member Events and Declared Non-Default Loss Events (as such terms are defined below and in the proposed rule change), and would be a mandatory contribution by FICC prior to any allocation of the loss among the applicable Division's members.<sup>8</sup> As proposed, if the Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period by one or both Divisions, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following two hundred fifty (250) Business Days in order to permit FICC to replenish the Corporate

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<sup>5</sup> FICC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of FICC's critical operations, and (iii) an amount determined based on an analysis of FICC's estimated operating expenses for a six (6) month period.

<sup>6</sup> See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-FICC-2017-007).

<sup>7</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>8</sup> The proposed rule change would not require a Corporate Contribution with respect to the use of each Division's Clearing Fund as a liquidity resource; however, if FICC uses a Division's Clearing Fund as a liquidity resource for more than 30 calendar days, as set forth in proposed Section 5 of GSD Rule 4 and MBSD Rule 4, then FICC would have to consider the amount used as a loss to the respective Division's Clearing Fund incurred as a result of a Defaulting Member Event and allocate the loss pursuant to proposed Section 7 of Rule 4, which would then require the application of FICC's Corporate Contribution.

Contribution.<sup>9</sup> To ensure transparency, all GSD Members and MBSD Members would receive notice of any such reduction to the Corporate Contribution. There would be one FICC Corporate Contribution, the amount of which would be available to both Divisions and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs, i.e., FICC would not have two separate Corporate Contributions, one for each Division. In the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution would be applied to that Division up to the amount then available. If a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution would be applied to the respective Divisions in the same proportion that the aggregate Average RFDs (as defined below and in the proposed rule change) of all members in that Division bear to the aggregate Average RFDs of all members in both Divisions.<sup>10</sup>

As compared to the current approach of applying “up to” a percentage of retained earnings to defaulting member losses, the proposed Corporate Contribution would be a fixed percentage of FICC’s General Business Risk Capital Requirement, which would provide greater transparency and accessibility to members. The proposed Corporate Contribution would apply not only towards losses and liabilities arising out of or relating to Defaulting Member Events but also those arising out of or relating to Declared Non-Default Loss Events, which is consistent with the current industry guidance that “a CCP should identify the amount of its own resources to be applied towards losses arising from custody and investment risk, to bolster confidence that participants’ assets are prudently safeguarded.”<sup>11</sup>

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<sup>9</sup> FICC believes that two hundred and fifth (250) Business Days would be a reasonable estimate of the time frame that FICC would require to replenish the Corporate Contribution by equity in accordance with FICC’s Clearing Agency Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

<sup>10</sup> FICC believes that if a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, allocating the Corporate Contribution ratably between the two Divisions based on the aggregate Average RFDs of their respective members is appropriate because the aggregate Average RFDs of all members in a Division represent the amount of risks that those members bring to FICC over the look-back period of seventy (70) Business Days.

<sup>11</sup> See Resilience of central counterparties (CCPs): Further guidance on the PFMI, issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, at 42 (July 2017), available at [www.bis.org/cpmi/publ/d163.pdf](http://www.bis.org/cpmi/publ/d163.pdf).

Under current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4, FICC has the discretion to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by FICC as result of the failure of a Defaulting Member to fulfill its obligations to FICC. This option would be retained and expanded under the proposal so that it would be clear that FICC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of the Divisions, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

The proposed rule changes relating to the calculation and application of Corporate Contribution are set forth in proposed Sections 7 and 7a of GSD Rule 4 and Sections 7 and 7a of MBSD Rule 4, as further described below.

(2) Introducing an Event Period.

In order to clearly define the obligations of each Division and its respective Members regarding loss allocation and to balance the need to manage the risk of sequential loss events against members' need for certainty concerning their maximum loss allocation exposures, FICC is proposing to introduce the concept of an "Event Period" to the GSD Rules and the MBSD Rules to address the losses and liabilities that may arise from or relate to multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession in a Division. Specifically, the proposal would group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) Business Days ("Event Period") for purposes of allocating losses to Members of the respective Divisions in one or more rounds (as described below), subject to the limitations of loss allocation set forth in the proposed rule change and as explained below.<sup>12</sup> In the case of a loss or liability arising from or relating to a Defaulting Member Event, an Event Period would begin on the day one or both Divisions notify their respective members that FICC has ceased to act<sup>13</sup> for the GSD Defaulting Member and/or the MBSD Defaulting Member (or the next Business Day, if such day is not a Business Day). In the case of a loss or liability arising from or relating to a Declared Non-Default Loss Event, an Event Period would begin on the day that FICC notifies members of the respective Divisions of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Defaulting Member Events and Declared Non-Default Loss Events, and there would not be separate Event

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<sup>12</sup> FICC believes that having a ten (10) Business Day Event Period would provide a reasonable period of time to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate certainty for members concerning their maximum exposure to mutualized losses with respect to such events.

<sup>13</sup> Supra note 3.

Periods for Defaulting Member Events or Declared Non-Default Loss Events occurring during overlapping ten (10) Business Day periods.

The amount of losses that may be allocated by each Division, subject to the required Corporate Contribution, and to which a Loss Allocation Cap would apply for any member that elects to withdraw from membership in respect of a loss allocation round, would include any and all losses from any Defaulting Member Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.<sup>14</sup>

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

(3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Tier One Netting Members or Tier One Members, as applicable (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. FICC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice (as defined below and in the proposed rule change) in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4.

Each loss allocation would be communicated to Tier One Netting Members or Tier One Members, as applicable, by the issuance of a notice that advises the Tier One Netting Members or Tier One Members, as applicable, of the amount being allocated to them (“Loss Allocation Notice”). Each Tier One Netting Member’s or Tier One Member’s, as applicable, pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the member has been a member (each member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all members subject to loss allocation in such round.

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<sup>14</sup> As discussed below, each Tier One Netting Member or Tier One Member, as applicable, that is a Tier One Netting Member or Tier One Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Netting Member or Tier One Member, as applicable, in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to notify FICC of its election to withdraw from membership with GSD or MBSD, as applicable, pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, and thereby benefit from its Loss Allocation Cap.<sup>15</sup> The “Loss Allocation Cap” of a Tier One Netting Member or Tier One Member, as applicable, would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would be subject to further loss allocation with respect to that Event Period.

The amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Tier One Netting Members or Tier One Members, as applicable, in a second or subsequent round if Tier One Netting Members or Tier One Members, as applicable, elect to withdraw from membership with GSD or MBSD, as applicable, as provided in proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if FICC has a \$5 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Tier One Netting Members or Tier One Members, as applicable, subject to the loss allocation is \$4 billion, the first round would begin when FICC issues the first Loss Allocation Notice for that Event Period. FICC could issue one or more Loss Allocation Notices

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<sup>15</sup> Pursuant to current Section 7(g) of GSD Rule 4 and MBSD Rule 4, the time period for a member to give notice, pursuant to Section 13 of GSD Rule 3 and MBSD Rule 3, of its election to terminate its membership in GSD or MBSD, as applicable, in respect of an allocation arising from any Remaining Loss allocated by FICC pursuant to Section 7(d) of GSD Rule 4 or Section 7(e) of MBSD Rule 4, as applicable, and any Other Loss, is the Close of Business on the Business Day on which the loss allocation payment is due to FICC. Current Section 13 of GSD Rule 4 and MBSD Rule 4 requires a 10-day notice period. Supra note 1.

FICC believes that it is appropriate to shorten such time period from 10 days to five (5) Business Days because FICC needs timely notice of which Tier One Netting Members or Tier One Members, as applicable, would remain in its membership for purpose of calculating the loss allocation for any subsequent round. FICC believes that five (5) Business Days would provide Tier One Netting Members or Tier One Members, as applicable, with sufficient time to decide whether to cap their loss allocation obligations by withdrawing from their membership in GSD or MBSD, as applicable.

for the first round until the sum of losses allocated equals \$4 billion. Once the \$4 billion is allocated, the first round would end and FICC would need a second round in order to allocate the remaining \$1 billion of loss. FICC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Tier One Netting Members or Tier One Members, as applicable, the option to limit their loss allocation exposure at the beginning of each round. As proposed and as described further below, a Tier One Netting Member or Tier One Member, as applicable, could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to withdraw from membership within five (5) Business Days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

- (4) Implementing a revised “look-back” period to calculate a member’s loss allocation pro rata share and its Loss Allocation Cap.

Currently, the GSD Rules and the MBSD Rules calculate a Tier One Netting Member’s or a Tier One Member’s pro rata share for purposes of loss allocation based on the member’s average daily Required Fund Deposit over the prior twelve (12) months (or such shorter period as may be available in the case of a member which has not maintained a deposit over such time period). The Rules currently do not anticipate the possibility of more than one Defaulting Member Event or Declared Non-Default Loss Event in quick succession.

GSD and MBSD are proposing to calculate each Tier One Netting Member’s or Tier One Member’s, as applicable, pro rata share of losses and liabilities to be allocated in any round (as described above and in the proposed rule change) to be equal to (i) the member’s Average RFD divided by (ii) the sum of Average RFD amounts for all members that are subject to loss allocation in such round.

Additionally, as described above and in the proposed rule change, if a Tier One Netting Member or Tier One Member, as applicable, withdraws from membership pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, GSD and MBSD are proposing that the member’s Loss Allocation Cap be equal to the greater of (i) its Required Fund Deposit on the first day of the applicable Event Period or (ii) its Average RFD.

FICC believes that employing a revised look-back period of seventy (70) Business Days instead of twelve (12) months to calculate a Tier One Netting Member’s or a Tier One Member’s, as applicable, loss allocation pro rata share and Loss Allocation Cap is appropriate, because FICC recognizes that the current look-back period of twelve (12) months is a very long period during which a member’s business strategy and outlook could have shifted significantly, resulting in material changes to the size of its portfolios. A look-back period of seventy (70)

Business Days would minimize that issue yet still would be long enough to enable FICC to capture a full calendar quarter of such members' activities and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred.

The proposed rule changes relating to the implementation of the revised look-back period are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

(5) Capping withdrawing members' loss allocation exposure and related changes.

Currently, pursuant to Section 7(g) of GSD Rule 4 and MBSD Rule 4, a member can withdraw from membership in order to avail itself of a cap on loss allocation if the member notifies FICC via a written notice, in accordance with Section 13 of GSD Rule 3 or MBSD Rule 3, as applicable, of its election to terminate its membership. Such notice must be provided by the Close of Business on the Business Day on which the loss allocation payment is due to FICC and, if properly provided to FICC, would limit the member's liability for a loss allocation to its Required Fund Deposit for the Business Day on which the notification of allocation is provided to the member.<sup>16</sup> As discussed above, the proposed rule change would continue providing members the opportunity to limit their loss allocation exposure by offering withdrawal options; however, the cap on loss allocation would be calculated differently and the associated withdrawal process would also be modified as it relates to withdrawals associated with the loss allocation process. In particular, the proposed rule change would shorten the withdrawal notification period from 10 days to five (5) Business Days, as further described below.

As proposed, if a member timely provides notice of its withdrawal from membership in respect of a loss allocation round, the maximum amount of losses it would be responsible for would be its Loss Allocation Cap,<sup>17</sup> provided that the member complies with the requirements of the withdrawal process in proposed Section 7b of GSD Rule 4 and Section 7b of MBSD Rule 4.

Currently, pursuant to Section 7(g) of GSD Rule 4 and MBSD Rule 4, if notification is provided to a member that an allocation has been made against the member pursuant to GSD Rule 4 or MBSD Rule 4, as applicable, and that application of the member's Required Fund Deposit is not sufficient to satisfy such obligation to make payment to FICC, the member is required to deliver to FICC by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by FICC, that amount which is necessary to eliminate any such deficiency, unless the member elects to terminate its membership in FICC. To increase transparency of the timeframe under which FICC would require funds from members to satisfy their loss allocation obligations, FICC is

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<sup>16</sup> Current Section 13 of GSD Rule 3 and MBSD Rule 3 requires a member to provide FICC with 10 days written notice of the member's termination; however, FICC, in its discretion, may accept such termination within a shorter notice period. Supra note 1.

<sup>17</sup> If a member's Loss Allocation Cap exceeds the member's then-current Required Fund Deposit, it must still cover the excess amount.

proposing that members would receive two (2) Business Days' notice of a loss allocation, and members would be required to pay the requisite amount no later than the second Business Day following issuance of such notice.<sup>18</sup> Members would have five (5) Business Days<sup>19</sup> from the issuance of the first Loss Allocation Notice in any round of an Event Period to decide whether to withdraw from membership.

Each round would allow a Tier One Netting Member or Tier One Member, as applicable, the opportunity to notify FICC of its election to withdraw from membership after satisfaction of the losses allocated in such round. Multiple Loss Allocation Notices may be issued with respect to each round to allocate losses up to the round cap.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Tier One Netting Members or Tier One Members, as applicable, included in the round. If a Tier One Netting Member or Tier One Member, as applicable, provides notice of its election to withdraw from membership, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover FICC's losses, a second round will be noticed to those members that did not elect to withdraw from membership in the previous round; however, as noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Tier One Netting Members or Tier One Members, as applicable, in a second or subsequent round if Tier One Netting Members or Tier One Members, as applicable, elect to withdraw from membership with GSD or MBSD, as applicable, as provided in proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, following the first Loss Allocation Notice in any round.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, a Tier One Netting Member or Tier One Member, as applicable, would need to follow the requirements in proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, which would provide that the Tier One Netting Member or Tier One Member, as applicable, must: (i) specify in its Loss Allocation Withdrawal Notice an effective date of withdrawal, which date shall not be prior to the scheduled final settlement date of any remaining obligations owed by the member to FICC, unless otherwise approved by FICC, and (ii) as of the time of such member's submission of the Loss Allocation Withdrawal Notice, cease submitting transactions to FICC for processing, clearance or settlement, unless otherwise approved by FICC.

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<sup>18</sup> FICC believes that allowing members two (2) Business Days to satisfy their loss allocation obligations would provide Members sufficient notice to arrange funding, if necessary, while allowing FICC to address losses in a timely manner.

<sup>19</sup> Supra note 15.



As proposed, a Tier One Netting Member or a Tier One Member, as applicable, that withdraws in compliance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under GSD Rule 4 or MBSD Rule 4, as applicable; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

The proposed rule changes are designed to enable FICC to continue the loss allocation process in successive rounds until all of FICC's losses are allocated. To the extent that the Loss Allocation Cap of a Tier One Netting Member or Tier One Member, as applicable, exceeds such member's Required Fund Deposit on the first day of an Event Period, FICC may in its discretion retain any excess amounts on deposit from the member, up to the Loss Allocation Cap of a Tier One Netting Member or Tier One Member, as applicable.

The proposed rule changes relating to capping withdrawing members' loss allocation exposure and related changes to the withdrawal process are set forth in proposed Sections 7 and 7b of GSD Rule 4 and Sections 7 and 7b of MBSD Rule 4, as further described below.

#### B. Changes to Align Loss Allocation Rules

The proposed rule changes would align the loss allocation rules, to the extent practicable and appropriate, of the three DTCC Clearing Agencies so as to provide consistent treatment, especially for firms that are participants of two or more DTCC Clearing Agencies. As proposed, the loss allocation waterfall and certain related provisions, e.g., returning a former member's Clearing Fund, would be consistent across the DTCC Clearing Agencies to the extent practicable and appropriate. The proposed rule changes of FICC that would align loss allocation rules of the DTCC Clearing Agencies are set forth in proposed Sections 1, 5, 6, 10, and 11 of GSD Rule 4 and MBSD Rule 4, as further described below.

#### C. Clarifying Changes Relating to Loss Allocation

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to members. In particular, FICC is proposing the following changes relating to loss allocation to clarify members' obligations for Declared Non-Default Loss Events.

Aside from losses that FICC might face as a result of a Defaulting Member Event, FICC could incur non-default losses incident to each Division's clearance and settlement business.<sup>20</sup> The GSD Rules and the MBSD Rules currently permit FICC to apply Clearing Fund to non-default losses.<sup>21</sup> Section 5 of GSD Rule 4 and MBSD Rule 4 provides that the use of Clearing

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<sup>20</sup> Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

<sup>21</sup> Arguably there is an ambiguity created by the first paragraph of Section 7 in both GSD Rule 4 and MBSD Rule 4, which suggests that losses or liabilities may only be allocated in a member default scenario, while Section 5 in both GSD Rule 4 and MBSD Rule 4

Fund deposits is limited to satisfaction of losses or liabilities of FICC, which includes losses or liabilities that are otherwise incident to the operation of the clearance and settlement business of FICC, although the application of Clearing Fund to such losses or liabilities is more limited under MBSD Rule 4 when compared to GSD Rule 4.<sup>22</sup> Section 7(f) of GSD Rule 4 and MBSD Rule 4 provides that any loss or liability incurred by the Corporation incident to its clearance and settlement business arising other than from a Remaining Loss shall be allocated among Tier One Netting Members or Tier One Members, as applicable, ratably, in accordance with their Average Required Clearing Fund Deposits.<sup>23</sup>

If there is a failure of FICC following a non-default loss, such occurrence would affect members in much the same way as a failure of FICC following a Defaulting Member Event. Accordingly, FICC is proposing rule changes to enhance the provisions relating to non-default losses by clarifying members' obligations for such losses and aligning the non-default loss provisions in the GSD Rules and the MBSD Rules.

Specifically, for both the GSD Rules and the MBSD Rules, FICC is proposing enhancement of the governance around non-default losses that would trigger loss allocation to Tier One Netting Members or Tier One Members, as applicable, by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of FICC to provide clearance

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makes it clear that the applicable Division's Clearing Fund may be used to satisfy non-default losses.

<sup>22</sup> Section 5 of GSD Rule 4 provides that "The use of the Clearing Fund deposits shall be limited to satisfaction of losses or liabilities of the Corporation...otherwise incident to the clearance and settlement business of the Corporation..." Supra note 1.

Section 5 of MBSD Rule 4 provides that "The use of the Clearing Fund deposits and assets and property on which the Corporation has a lien on shall be limited to satisfaction of losses or liabilities of the Corporation...otherwise incident to the clearance and settlement business of the Corporation with respect to losses and liabilities to meet unexpected or unusual requirements for funds that represent a small percentage of the Clearing Fund..." Supra note 1.

<sup>23</sup> Section 7(f) of GSD Rule 4 provides that "Any loss or liability incurred by the Corporation incident to its clearance and settlement business...arising other than from a Remaining Loss (hereinafter, an "Other Loss") shall be allocated among Tier One Netting Members, ratably, in accordance with the respective amounts of their Average Required FICC Clearing Fund Deposits. Supra note 1.

Section 7(f) of MBSD Rule 4 provides that "Any loss or liability incurred by the Corporation incident to its clearance and settlement business...arising other than from a Remaining Loss (hereinafter, an "Other Loss"), shall be allocated among Tier One Members, ratably, in accordance with the respective amounts of their Average Required Clearing Fund Deposits. Supra note 1.

and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Tier One Netting Members or Tier One Members, as applicable, in order to ensure that FICC may continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that FICC would then be required to promptly notify members of this determination (a “Declared Non-Default Loss Event”). In addition, FICC is proposing to better align the interest of FICC with those of its members by stipulating a mandatory Corporate Contribution apply to a Declared Non-Default Loss Event prior to any allocation of the loss among members, as described above. Additionally, FICC is proposing language to clarify members’ obligations for Declared Non-Default Loss Events.

Under the proposal, FICC would clarify the Rules of both Divisions to make clear that Tier One Netting Members or Tier One Members, as applicable, are subject to loss allocation for non-default losses (i.e., Declared Non-Default Loss Events under the proposal) and Tier Two Members are not subject to loss allocation for non-default losses.

The proposed rule changes relating to Declared Non-Default Loss Events and members’ obligations for such events are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

#### D. Amending Language Regarding FICC’s Use of MBSD Clearing Fund

The proposed rule change would delete language currently in Section 5 of MBSD Rule 4 that limits certain uses by FICC of the MBSD Clearing Fund to “unexpected or unusual” requirements for funds that represent a “small percentage” of the MBSD Clearing Fund. FICC believes that these limiting phrases (which appear in connection with FICC’s use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event as well as to cover certain liquidity needs) are vague and imprecise, and should be replaced in their entirety. Specifically, FICC is proposing to delete the limiting language with respect to FICC’s use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event so as to not have such language be interpreted as impairing FICC’s ability to access the MBSD Clearing Fund in order to manage non-default losses. FICC is also proposing to delete the limiting language with respect to FICC’s use of MBSD Clearing Fund to cover certain liquidity needs because the effect of the limitation in this context is confusing and unclear.

The proposed rule changes relating to FICC’s use of MBSD Clearing Fund are set forth in proposed Section 5 of MBSD Rule 4, as further described below.

The foregoing changes as well as other changes (including a number of conforming and technical changes) that FICC is proposing in order to improve the transparency and accessibility of the Rules are described in detail below.

E. Loss Allocation Waterfall Comparison

The following example<sup>24</sup> illustrates the differences between the current and proposed loss allocation provisions:

Assumptions:

- (i) Firms A, B, and X are each a GSD Netting Member and an MBSD Clearing Member and are referred to as Member A, Member B, and Member X, respectively.
- (ii) Member A defaults on a Business Day (Day 1). On the same day, FICC ceases to act for Member A and notifies members of the cease to act. After liquidating Member A's portfolio and applying Member A's Clearing Fund deposit, FICC has a total loss of \$350 million, with \$200 million in GSD and \$150 million in MBSD.
- (iii) Member X voluntarily retires from membership five (5) Business Days after FICC ceases to act for Member A (Day 6).
- (iv) Member B defaults seven (7) Business Days after FICC ceases to act for Member A (Day 8). On the same day, FICC ceases to act for Member B and notifies members of the cease to act. After liquidating Member B's portfolio and applying Member B's Clearing Fund deposit, FICC has a total loss of \$350 million, with \$200 million in GSD and \$150 million in MBSD.
- (v) The current FICC loss provisions require FICC to contribute up to 25% of its retained earnings as a corporate contribution. For the purposes of this example, it is assumed that FICC will contribute 25% of its retained earnings. The amount of FICC's retained earnings is \$176 million.
- (vi) FICC's General Business Risk Capital Requirement is \$98 million.

Current Loss Allocation:

Under the current loss allocation provisions, with respect to the losses arising out of Member A's default, FICC will contribute a total of \$44 million ( $\$176 \text{ million} * 25\%$ ) from retained earnings,<sup>25</sup> with approximately \$25 million ( $\$44 \text{ million} * (\$200 \text{ million} / \$350 \text{ million})$ ) for GSD and approximately \$19 million ( $\$44 \text{ million} * (\$150 \text{ million} / \$350 \text{ million})$ ) for MBSD.

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<sup>24</sup> For purposes of this example, FICC has assumed that no losses have arisen that apply to Tier Two Netting Members, Tier Two Members, or CCIT Members.

<sup>25</sup> The retained earnings are applied to the respective Divisions in the same proportion that the losses of that Division bear to the total losses of both Divisions.

FICC will then allocate the remaining GSD loss of \$175 million (\$200 million - \$25 million) to GSD Tier One Netting Members and the remaining MBSD loss of \$131 million (\$150 million - \$19 million) to MBSD Tier One Members.

With respect to losses arising out of Member B's default, FICC will contribute a total of approximately \$33 million ( $(\$176 \text{ million} - \$44 \text{ million}) * 25\%$ ) from retained earnings, with approximately \$19 million ( $\$33 \text{ million} * (\$200 \text{ million}/\$350 \text{ million})$ ) for GSD and approximately \$14 million ( $\$33 \text{ million} * (\$150 \text{ million}/\$350 \text{ million})$ ) for MBSD. FICC will then allocate the remaining GSD loss of \$181 million (\$200 million - \$19 million) to GSD Tier One Netting Members and the remaining MBSD loss of \$136 million (\$150 million - \$14 million) to MBSD Tier One Members.

Altogether, with respect to losses arising out of defaults of Member A and Member B, FICC will contribute a total of approximately \$77 million of retained earnings, with approximately \$44 million for GSD and approximately \$33 million for MBSD. FICC will allocate losses of \$356 million to GSD Tier One Netting Members and \$267 million to MBSD Tier One Members.

#### Proposed Loss Allocation:

Under the proposed loss allocation provisions, a Defaulting Member Event with respect to Member A's default would have occurred on Day One, and a Defaulting Member Event with respect to Member B's default would have occurred on Day 8. Because the Defaulting Member Events occurred during a 10-business day period, they would be grouped together into an Event Period for purposes of allocating losses to members. The Event Period would begin on the 1<sup>st</sup> business day and end on the 10<sup>th</sup> business day.

With respect to losses arising out of Member A's default, FICC would apply a Corporate Contribution of \$49 million ( $\$98 \text{ million} * 50\%$ ),<sup>26</sup> with approximately \$32 million ( $\$49 \text{ million} * (\$10 \text{ billion}/\$15.2 \text{ billion})$ ) for GSD and approximately \$17 million ( $\$49 \text{ million} * (\$5.2 \text{ billion}/\$15.2 \text{ billion})$ ) for MBSD. FICC would then allocate the remaining GSD loss of \$168 million (\$200 million - \$32 million) to GSD Tier One Netting Members and the remaining MBSD loss of \$133 million (\$150 million - \$17 million) to MBSD Tier One Members. With respect to losses arising out of Member B's default, FICC would not apply a Corporate Contribution since it would have already contributed the maximum Corporate Contribution of 50% of its General Business Risk Capital Requirement. With respect to losses arising out of Member B's default, FICC would allocate the GSD loss of \$200 million to GSD Tier One Netting Members and the MBSD loss of \$150 million to MBSD Tier One Members. Because Member X was a member in both Divisions on the first day of the Event Period, Member X would be subject to loss allocation with respect to all events occurring during the Event Period,

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<sup>26</sup> The Corporate Contribution would be applied to the respective Divisions in the same proportion that the aggregate Average RFDs of all members in that Division bear to the aggregate Average RFDs of all members in both Divisions. For the purposes of this example, FICC has assumed that the aggregate Average RFDs of all GSD members is \$10 billion and the aggregate Average RFDs of all MBSD members is \$5.2 billion.

even if the event occurred after its retirement. Therefore, Member X would be subject to loss allocation with respect to Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, FICC would apply a Corporate Contribution of \$49 million, with approximately \$32 million for GSD and approximately \$17 million for MBSD. FICC would allocate losses of \$368 million to GSD Tier One Netting Members and \$283 million to MBSD Tier One Members.

The principal differences in the above example are due to (i) the proposed changes to the calculation and application of the Corporate Contribution and (ii) the proposed introduction of an Event Period.

(ii) Detailed Description of the Proposed Rule Changes Related to Loss Allocation

A. Proposed Changes to GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD Rule 4 (Clearing Fund and Loss Allocation)

Overview of GSD Rule 4 and MBSD Rule 4

GSD Rule 4 and MBSD Rule 4 currently address Clearing Fund requirements and loss allocation obligations, as well as permissible uses of the Clearing Fund. These Rules address the various Clearing Fund calculations for each Division's Clearing Fund and set forth rights, obligations and other aspects associated with each Division's Clearing Fund, as well as each Division's loss allocation process. GSD Rule 4 and MBSD Rule 4 are each currently organized into 12 sections. Sections of these Rules that FICC is proposing to change are described below.

Section 1 of GSD Rule 4 and MBSD Rule 4

Currently, Section 1 of GSD Rule 4 and MBSD Rule 4 set forth the requirement that each GSD Netting Member and each MBSD Clearing Member make and maintain a deposit to the Clearing Fund at the minimum level set forth in the respective Rule 4 and note that the timing of such payment is set forth in another section of the respective Rule 4. Current Section 1 of the respective rule also provides that the deposits to the Clearing Fund will be held by FICC or its designated agents. Current Section 1 of MBSD Rule 4 also defines the term "Transaction" for purposes of MBSD Rule 4 and references a Member's obligation to replenish the deficit in its Required Fund Deposit if it is charged by FICC under certain circumstances.

FICC is proposing to rename the subheading of Section 1 of Rule 4 in both the GSD Rules and MBSD Rules from "General" to "Required Fund Deposits" and to restructure the wording of the provisions for clarity and readability.

Under the proposed rule change, Section 1 of GSD Rule 4 and Section 1 of MBS Rule 4 would continue to have the same provisions as they relate to Netting Members or Clearing Members, as applicable, except for the following: (i) the language throughout the sections would be reorganized, streamlined and clarified, and (ii) language would be added regarding additional deposits maintained by the Netting Members or Clearing Members, as applicable, at FICC, and highlight for members that such additional deposits would be deemed to be part of the Clearing Fund and the member's Actual Deposit (as discussed below and as defined in the proposed rule change) but would not be deemed to be part of the member's Required Fund Deposit.

The proposed language regarding maintenance of a member's Actual Deposit would also make it clear that FICC will not be required to segregate such deposit, but shall maintain books and records concerning the assets that constitute each member's Actual Deposit.

In addition, FICC proposes a technical change to update a cross reference in Section 1 of GSD Rule 4 and MBS Rule 4.

Furthermore, in Section 1 of MBS Rule 4, FICC is proposing to move the definition of "Transactions" to proposed Section 2(a) of MBS Rule 4, where the first usage of "Transactions" in MBS Rule 4 appears. FICC is also proposing to delete the last sentence in Section 1 of MBS Rule 4, which references a Member's obligation to replenish the deficit in its Required Fund Deposit if it is charged by FICC under certain circumstances, because it would no longer be relevant under the proposed rule change to Section 7 of MBS Rule 4, as FICC would require members to pay their loss allocation amounts instead of charging their Required Fund Deposits for Clearing Fund losses.

#### Section 2 of GSD Rule 4 and MBS Rule 4

Current Section 2 of GSD Rule 4 and MBS Rule 4 set forth more detailed requirements pertaining to members' Required Fund Deposits. FICC is proposing to rename the subheadings in these sections from "Required Fund Deposit" to "Required Fund Deposit Requirements" in order to better reflect the purpose of this section.

In addition, FICC is proposing to expand the definition of "Legal Risk" in both the GSD and MBS provisions (current Section 2(e) of GSD Rule 4 and Section 2(f) of MBS Rule 4) by revising the parameters of Legal Risk so that it would not be limited to laws applicable to a member's insolvency or bankruptcy, as FICC believes that Legal Risk may arise outside the context of an insolvency or bankruptcy event regarding a member, and FICC should be permitted to adequately protect itself in those non- insolvency/bankruptcy circumstances as well.

For better organization of Rule 4, FICC is also proposing to relocate the provision on minimum Clearing Fund cash requirements (current Section 2(b) of GSD Rule 4 and Section 2(d) of MBS Rule 4) to the section in each of GSD Rule 4 and MBS Rule 4 dealing specifically with the form of Clearing Fund deposits (proposed Section 3 of GSD Rule 4 and MBS Rule 4). This would necessitate the re-lettering of the provisions in Section 2. In addition, as stated above, the provision regarding the definition of "Transactions" for purposes of MBS Rule 4 would be moved to proposed Section 2(a) from current Section 1.

FICC is proposing technical changes to correct typographical errors in current Section 2 of GSD Rule 4.

Sections 3, 3a and 3b of GSD Rule 4 and MBSD Rule 4

Currently, Sections 3, 3a and 3b of GSD Rule 4 and MBSD Rule 4 address the permissible form of Clearing Fund deposits and contain detailed requirements regarding each form. FICC is proposing changes to improve the readability of these sections.

In addition, for better organization of the subject matter, FICC is proposing to move certain paragraphs from one section to another, including (i) moving clauses (b) and (d) in current Section 2 of GSD Rule 4 and MBSD Rule 4, respectively, to proposed Section 3 of GSD Rule 4 and MBSD Rule 4 and (ii) moving the last paragraph of current Section 3 in GSD Rule 4 and MBSD Rule 4 to proposed Section 3b of GSD Rule 4 and MBSD Rule 4.

Under the proposed rule change, FICC is also proposing to update the cash investment provision in Section 3a of GSD Rule 4 and MBSD Rule 4 to reflect the Clearing Agency Investment Policy adopted by FICC<sup>27</sup> and to define Clearing Fund Cash as (i) cash deposited by a Netting Member or Clearing Member, as applicable, as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to FICC secured by the pledge by FICC of Eligible Clearing Fund Securities pledged to FICC or (y) any sales of Eligible Clearing Fund Securities pledged to FICC, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit. Lastly, FICC is proposing technical changes to correct typographical errors in current Section 3 of MBSD Rule 4 and current Section 3b of GSD Rule 4.

Section 4 of GSD Rule 4 and MBSD Rule 4

Currently, Section 4 of GSD Rule 4 and MBSD Rule 4 address the granting of a first priority perfected security interest by each Netting Member or Clearing Member, as applicable,

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<sup>27</sup> See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-FICC-2016-005). The Clearing Agency Investment Policy (the “Policy”) governs the management, custody, and investment of cash deposited to the GSD and MBSD Clearing Funds, the proprietary liquid net assets (cash and cash equivalents) of FICC and other funds held by FICC. The Policy sets forth guiding principles for the investment of those funds, which include adherence to a conservative investment philosophy that places the highest priority on maximizing liquidity and avoiding risk, as well as mandating the segregation and separation of funds. The Policy also addresses the process for evaluating credit ratings of counterparties and identifies permitted investments within specified parameters. In general, assets are required to be held by regulated and creditworthy financial institution counterparties and invested in financial instruments that, with respect to the GSD and MBSD Clearing Funds, may include deposits with banks, including the Federal Reserve Bank of New York, collateralized reverse-repurchase agreements, direct obligations of the U.S. government and money-market mutual funds.



in all assets and property placed by the member in the possession of FICC (or its agents acting on its behalf). FICC is not proposing any substantive changes to these sections except for streamlining the provisions for readability and clarity, and adding “Actual Deposit” as a defined term to refer to Eligible Clearing Fund Securities, funds and assets pledged to FICC to secure any and all obligations and liabilities of a Netting Member or a Clearing Member, as applicable, to FICC.

*Section 5 of GSD Rule 4 and MBSD Rule 4*

Currently, Section 5 of GSD Rule 4 and MBSD Rule 4 describe the use of each Division’s Clearing Fund. FICC is proposing to rename the subheading of this section from “Use of Deposits and Payments” to “Use of Clearing Fund” to better reflect the purpose of the section.

Under the proposed rule change, FICC is also proposing changes to streamline this section for clarity and readability and to align the GSD Rules and MBSD Rules. Specifically, FICC is proposing to delete the first paragraph of current Section 5 of GSD Rule 4 and MBSD Rule 4 and replace it with clearer language that sets forth the permitted uses of each Division’s Clearing Fund. Specifically, the proposed Section 5 of GSD Rule 4 and MBSD Rule 4 provides that each Division’s Clearing Fund would only be used by FICC (i) to secure each member’s performance of obligations to FICC, including, without limitation, each member’s obligations with respect to any loss allocations as set forth in proposed Section 7 of GSD Rule 4 and MBSD Rule 4 and any obligations arising from a Cross-Guaranty Agreement pursuant to GSD Rule 41 or MBSD Rule 32, as applicable, or a Cross-Margining Agreement pursuant to GSD Rule 43, (ii) to provide liquidity to FICC to meet its settlement obligations, including, without limitation, through the direct use of cash in the GSD Clearing Fund or MBSD Clearing Fund, as applicable, or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in proposed Section 3a of GSD Rule 4 and MBSD Rule 4.

The current first paragraph of Section 5 of GSD Rule 4 and MBSD Rule 4 provides that if FICC pledges, hypothecates, encumbers, borrows, or applies any part of the respective Division’s Clearing Fund deposits to satisfy any liability, obligation, or liquidity requirements for more than thirty (30) days, FICC, at the Close of Business on the 30<sup>th</sup> day (or on the first Business Day thereafter) will consider the amount used as an actual loss to the respective Division’s Clearing Fund and immediately allocate such loss in accordance with Section 7 of GSD Rule 4 or MBSD Rule 4, as applicable. As proposed, FICC would retain this provision conceptually but replace it with clearer and streamlined language that provides that each time FICC uses any part of the respective Division’s Clearing Fund for more than 30 calendar days to provide liquidity to FICC to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, FICC, at the Close of Business on the 30<sup>th</sup> calendar day (or on the first Business Day thereafter) from the day of such use, would consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with proposed Section 7 of GSD Rule 4 or MBSD Rule 4, as applicable.

The proposed rule change also includes deleting language currently in Section 5 of MBSB Rule 4 that limits certain uses by FICC of the MBSB Clearing Fund to “unexpected or unusual” requirements for funds that represent a “small percentage” of the MBSB Clearing Fund. FICC believes that these limiting phrases (which appear in connection with FICC’s use of MBSB Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSB Defaulting Member Event as well as to cover certain liquidity needs) are vague and imprecise, and should be replaced in their entirety. Specifically, FICC is proposing to delete the limiting language with respect to FICC’s use of MBSB Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside of an MBSB Defaulting Member Event so as to not have such language be interpreted as impairing FICC’s ability to access the MBSB Clearing Fund in order to manage non-default losses. FICC is also proposing to delete the limiting language with respect to FICC’s use of MBSB Clearing Fund to cover certain liquidity needs because the effect of the limitation in this context is confusing and unclear.

In addition, FICC is proposing to delete the last paragraph in current Section 5 of GSD Rule 4 and MBSB Rule 4 because these paragraphs address the application of a member’s deposits to the applicable Clearing Fund to cover the allocation of a loss or liability incurred by FICC. These paragraphs would no longer be relevant, because, under the proposed Section 7 of GSD Rule 4 and MBSB Rule 4 (discussed below), FICC would not apply the member’s deposit to the Clearing Fund unless the member does not satisfy payment of its allocated loss amount within the required timeframe. These paragraphs also currently include provisions regarding other agreements, such as a Cross-Guaranty Agreement, that pertain to a Defaulting Member, and such provisions would now be covered by proposed Section 6 of GSD Rule 4 and MBSB Rule 4.

#### Section 6 of GSD Rule 4 and MBSB Rule 4

Currently, Section 6 of GSD Rule 4 and MBSB Rule 4 are reserved for future use. FICC is proposing to use this section for provisions relating to the application of deposits to the respective Division’s Clearing Fund and other amounts held by FICC to a Defaulting Member’s obligations.

FICC is proposing to add a subheading of “Application of Clearing Fund Deposits and Other Amounts to Defaulting Members’ Obligations” to Section 6 of GSD Rule 4 and MBSB Rule 4. Under the proposed rule change, for better organization by subject matter, FICC is also proposing to relocate certain provisions to these sections from the respective current Section 7 of GSD Rule 4 and MBSB Rule 4, which addresses FICC’s application of Clearing Fund deposits and other assets held by FICC securing a Defaulting Member’s obligations to FICC.

For additional clarity and for consistency with the loss allocation rules of the other DTCC Clearing Agencies, FICC proposes to add a provision which makes it clear that, if FICC applies a Defaulting Member’s Clearing Fund deposits, FICC may take any and all actions with respect to the Defaulting Member’s Actual Deposits, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that FICC determines is appropriate.

Sections 7, 7a and 7b of GSD Rule 4 and MBSD Rule 4

Current Section 7 of GSD Rule 4 and MBSD Rule 4 contains FICC's current loss allocation waterfall for losses or liabilities incurred by FICC. With respect to any loss or liability incurred by FICC as the result of the failure of a Defaulting Member to fulfill its obligations to FICC, the loss allocation waterfall for each Division currently provides:

- (i) Application of any Clearing Fund deposits and other collateral held by FICC securing a Defaulting Member's obligations to FICC and additional resources as are applicable to the Defaulting Member.
- (ii) If a loss or liability remains after the application of the Defaulting Member's collateral and resources, FICC would apply up to 25% of FICC's existing retained earnings, or such higher amount as the Board of Directors determines.
- (iii) If a loss or liability still remains after the application of the retained earnings, FICC would apply the loss or liability to members as follows:
  - (a) If the remaining loss or liability is attributable to Tier One Netting Members or Tier One Members, as applicable, then FICC will allocate such loss or liability to Tier One Netting Members or Tier One Members, as applicable, by assessing the Required Fund Deposit maintained by each such member an amount up to \$50,000, in an equal basis per Tier One Netting Member or Tier One Member, as applicable.
  - (b) If the remaining loss or liability is attributable to Tier Two Members, then FICC will allocate such loss or liability to Tier Two Members based upon their trading activity with the Defaulting Member that resulted in a loss.
- (iv) If there is any loss or liability that still remains after the application of (ii) and (iii) above that is attributable to Tier One Netting Members or Tier One Members, as applicable, then FICC will allocate such loss or liability among Tier One Netting Members or Tier One Members, as applicable, ratably based on the amount of each Tier One Netting Member's or Tier One Member's Required Fund Deposit and based on the average daily level of such deposit over the prior twelve (12) months (or such shorter period as may be available if the member has not maintained a deposit over such time period).

Current Section 7(f) of GSD Rule 4 and MBSD Rule 4 also provides that Other Losses shall be allocated among Tier One Netting Members or Tier One Members, as applicable, ratably in accordance with the respective amounts of each Tier One Netting Member's or Tier One Member's Required Fund Deposit and based on the average daily level of such deposit over the prior twelve (12) months (or such shorter period as may be available if the member has not maintained a deposit over such time period).

Currently, pursuant to Section 7(e) of GSD Rule 4, an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Broker Account,

will not be subject to an aggregate allocation loss for any single loss-allocation event that exceeds \$5 million. FICC believes that it is appropriate for GSD to retain this cap under the proposed rule change because the Inter-Dealer Broker Netting Members are required to limit their business as provided in Section 8(e) of GSD Rule 3, which would in turn minimize the potential losses or liabilities that could be incurred by FICC from Inter-Dealer Broker Netting Members.<sup>28</sup> FICC believes that it is also appropriate for GSD to retain this cap under the proposed rule change for Non-IDB Repo Brokers because their activity in their respective Segregated Broker Accounts would be subject to similar limitations as the Inter-Dealer Broker Netting Members. However, the proposal would apply the cap to an Event Period instead of a single loss event in order to conform with the concept of the Event Period under the proposal. FICC believes applying the cap to an Event Period would continue to reasonably represent the risk profiles of the Inter-Dealer Broker Netting Members, and Non-IDB Repo Brokers with respect to their Segregated Broker Accounts, because they submit affirmed trades from their systems to GSD, with each trade already matched to the counterparty that will ultimately deliver or receive the securities. Therefore, Inter-Dealer Broker Netting Members, and Non-IDB Repo Brokers with respect to their Segregated Broker Accounts, do not generally maintain positions with FICC and present minimal risk to FICC. FICC is also proposing technical changes to replace (i) the term “Segregated Broker Account” with “Segregated Repo Account” and (ii) the term “Non-IDB Broker” with “Non-IDB Repo Broker,” both of which are the correct terms defined in GSD Rule 1.

Current Section 7(g) of GSD Rule 4 and MBSD Rule 4 further provides that if the Required Fund Deposit of the member being allocated the loss is not sufficient to satisfy its loss allocation obligation, the member is required to deliver to FICC an amount that is necessary to eliminate the deficiency by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by FICC. Under the current Rules, a member may elect to terminate its membership, which would limit its loss allocation to the amount of its Required Fund Deposit for the Business Day on which the notification of such loss allocation is provided to the member. If the member does not elect to terminate its membership and fails to satisfy its Required Fund Deposit within the timeframe specified in the Rules, FICC will cease to act generally with regard to such member pursuant to GSD Rules 21 and 22A or MBSD Rules 14 and 17, as applicable, and may take disciplinary action against such member pursuant to GSD Rule 48 or MBSD Rule 38, as applicable.

Current Section 7(h) of GSD Rule 4 and MBSD Rule 4 requires FICC to promptly notify members and the Commission of the amount involved and the causes if a Remaining Loss or Other Loss occurs. In addition, current Section 7(i) of GSD Rule 4 and MBSD Rule 4 also

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<sup>28</sup> Pursuant to Section 8(e) of GSD Rule 3, an Inter-Dealer Broker Netting Member is required to (A) limit its business to acting exclusively as a broker, (B) conduct all of its business in Repo Transactions with Netting Members, and (C) conduct at least 90 percent of its business in transactions that are not Repo Transactions with Netting Members. If an Inter-Dealer Broker Netting Member fails to comply with these requirements, then the Inter-Dealer Broker Netting Member shall be considered by FICC as a Dealer Netting Member. Supra note 1.

provides that any increase in Clearing Fund deposit as required by subsection (f) of current Section 2 of GSD Rule 4 or provisions of MBSD Rule 4 regarding special charges or other premiums will not be taken into account when calculating loss allocation based on a GSD Member's Average Required FICC Clearing Fund Deposit amount or an MBSD Member's Average Required Fund Deposit amount, as applicable, under current Section 7 of GSD Rule 4 and MBSD Rule 4.

Under the proposed rule change, FICC is proposing to rename the subheading of Section 7 of GSD Rule 4 and MBSD Rule 4 to "Loss Allocation Waterfall, Off-the-Market Transactions." In addition, FICC is proposing to restructure its loss allocation waterfall as described below.

For better organization of the subject matter, FICC is proposing to move certain paragraphs from one section to another, including (i) relocating the last sentence of current Section 7(h) of GSD Rule 4 and MBSD Rule 4 regarding recovery of allocated losses or liabilities by FICC to the fifth paragraph of proposed Section 7 of GSD Rule 4 and MBSD Rule 4, (ii) relocating from current Section 7(a) of GSD Rule 4 and MBSD Rule 4 provisions which address FICC's application of Clearing Fund deposits and other assets held by FICC securing a Defaulting Member's obligations to FICC to proposed Section 6 of GSD Rule 4 and MBSD Rule 4, (iii) relocating from current Section 7 of GSD Rule 4 to proposed Section 6 of GSD Rule 4 the provision regarding FICC's right to treat certain payments to an FCO under a Cross-Margining Guaranty as a loss to be allocated, (iv) relocating the provisions in current Section 7(i) of GSD Rule 4 and MBSD Rule 4 regarding certain increases in Clearing Fund deposits not being taken into account when calculating loss allocation so that such provisions would come right after the loss allocation calculation provision, with an updated reference to proposed renumbered Sections 2(d) and 2(e) in GSD Rule 4 and MBSD Rule 4, respectively, and (v) relocating the provision regarding withdrawing members reapplying to become members<sup>29</sup> in the second paragraph of

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<sup>29</sup> Current Section 7(g) of GSD Rule 4 provides that a Member that elects to terminate its membership pursuant to alternative (ii) in Section 7(g) of GSD Rule 4 in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Comparison-Only Member or a Netting Member unless, prior to submitting such application, it makes the payment to FICC provided for in alternative (i) in Section 7(g) of GSD Rule 4, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Remaining Loss or Other Loss was incurred by FICC until the date of such payment. Supra note 1.

Current Section 7(g) of MBSD Rule 4 provides that a Member that elects to terminate its membership pursuant to alternative (ii) in Section 7(g) of MBSD Rule 4 in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Clearing Member unless, prior to submitting such application, it makes the payment to FICC provided for in alternative (i) in Section 7(g) of MBSD Rule 4, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Remaining Loss or Other Loss was incurred by FICC until the date of such payment. Supra note 1.

current Section 7(g) of GSD Rule 4 and MBSD Rule 4 to come right after the paragraph regarding the election of a Tier One Netting Member or Tier One Member, as applicable, to withdraw from membership in proposed Section 7 of GSD Rule 4 and MBSD Rule 4. Furthermore, in order to enhance readability and clarity, FICC is proposing a number of changes to streamline the language in these provisions.

In Section 7 of GSD Rule 4 and MBSD Rule 4, as applicable, FICC is proposing to make it clear that no loss allocation under proposed GSD Rule 4 or proposed MBSD Rule 4, as applicable, would constitute a waiver of any claim FICC may have against a member for any losses or liabilities to which the member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under proposed GSD Rule 4 or proposed MBSD Rule 4, as applicable. FICC is proposing this change to preserve its legal rights and to make it clear to members that loss allocation under proposed GSD Rule 4 and proposed MBSD Rule 4 would not be deemed as FICC waiving any claims it may have against a member for any losses or liabilities to which the member is subject under the Rules.

Under the proposal, Section 7 of GSD Rule 4 and MBSD Rule 4 would make clear that the loss allocation waterfall applies to losses and liabilities (i) arising out of or relating to a default of a member or (ii) otherwise incident to the clearance and settlement business of FICC (i.e., non-default losses). The loss allocation waterfall would be triggered if FICC incurs a loss or liability arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event.

As proposed, Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that, for the purposes of GSD Rule 4 or MBSD Rule 4, as applicable, the term “Defaulting Member” would mean a GSD Member or MBSD Member, as applicable, for which FICC has ceased to act pursuant to GSD Rule 21 or GSD Rule 22,<sup>30</sup> or MBSD Rule 14 or MBSD Rule 16,<sup>31</sup> as

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The condition for re-application was historically in the rules of Government Securities Clearing Corporation (“GSCC”) (FICC’s predecessor) to solidify GSCC’s membership base and thereby discourage members from withdrawing from membership during a time of stress solely to avoid their loss allocation obligations. This condition was later incorporated into the GSD Rules and MBSD Rules. In the interest of continuing to encourage members to remain in FICC central clearing in order to preserve the robustness of the Treasury and mortgage-backed securities markets, FICC would like to retain this condition for re-application in the GSD and MBSD Rules as is. As the provision applies to a remote contingency and, without an immediate business need, NSCC and DTC would prefer not to add this provision at this time.

<sup>30</sup> FICC may cease to act for a GSD Member pursuant to any of the circumstances set forth under GSD Rule 21 (Restrictions on Access to Services) or GSD Rule 22 (Insolvency of a Member). Supra note 1.

<sup>31</sup> FICC may cease to act for an MBSD Member pursuant to any of the circumstances set forth under MBSD Rule 14 (Restrictions on Access to Services) or MBSD Rule 16 (Insolvency of a Member). Supra note 1.

applicable, the term “Defaulting Member Event” would mean the determination by FICC to cease to act for a GSD Member or MBSD Member, as applicable, pursuant to GSD Rule 21 or GSD Rule 22, or MBSD Rule 14 or MBSD Rule 16, as applicable, and the term “Declared Non-Default Loss Event” would mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of FICC may be a significant and substantial loss or liability that may materially impair the ability of FICC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among members in order to ensure that FICC may continue to offer clearance and settlement services in an orderly manner.

As proposed, each member would be obligated to FICC for the entire amount of any loss or liability incurred by FICC arising out of or relating to any Defaulting Member Event with respect to such member. Under the proposal, to the extent that such loss or liability is not satisfied pursuant to proposed Section 6 of GSD Rule 4 or MBSD Rule 4, as applicable, FICC would apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other members, as provided in proposed Section 7 of GSD Rule 4 and MBSD Rule 4.

Under proposed Section 7 of GSD Rule 4 and MBSD Rule 4, the loss allocation waterfall would begin with a corporate contribution from FICC (“Corporate Contribution”), as is the case under the current Rules, but in a different form than under the current Section 7 of GSD Rule 4 and MBSD Rule 4 described above. Today, Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4 provide that, if FICC incurs any loss or liability as the result of the failure of a Defaulting Member to fulfill its obligations to FICC, FICC will contribute up to 25% of its existing retained earnings (or such higher amount as the Board of Directors shall determine), to such loss or liability; however, no corporate contribution from FICC is currently required for losses resulting other than those from Member impairments. Under the proposal, FICC would add a proposed new Section 7a to GSD Rule 4 and MBSD Rule 4 with a subheading of “Corporate Contribution” and define FICC’s Corporate Contribution with respect to any loss allocation pursuant to proposed Section 7 of GSD Rule 4 or MBSD Rule 4, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, as an amount that is equal to fifty (50) percent of the amount calculated by FICC in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.<sup>32</sup> The proposed rule change would specify that FICC’s General Business Risk Capital Requirement, as defined in FICC’s Clearing Agency Policy on Capital Requirements,<sup>33</sup> is, at a minimum, equal to the regulatory capital that FICC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>34</sup>

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<sup>32</sup> Supra note 5.

<sup>33</sup> Supra note 6.

<sup>34</sup> Supra note 7.

As proposed, if FICC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Defaulting Member Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the two hundred fifty (250) Business Days thereafter,<sup>35</sup> the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period. Proposed Section 7a of both GSD Rule 4 and MBSD Rule 4 would require FICC to notify members of any such reduction to the Corporate Contribution.

Proposed Section 7a to GSD Rule 4 and MBSD Rule 4 would also make clear that there would be one FICC Corporate Contribution, the amount of which would be available to both Divisions and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs, i.e., FICC would not have two separate Corporate Contributions, one for each Division. As proposed, in the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution would be applied to that Division up to the amount then available. Under the proposal, if a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution would be applied to the respective Divisions in the same proportion that the aggregate Average RFDs of all members in that Division bears to the aggregate Average RFDs of all members in both Divisions.<sup>36</sup>

Currently, the Rules do not require FICC to contribute its retained earnings to losses and liabilities other than those from member defaults. Under the proposal, FICC would expand the application of its corporate contribution beyond losses and liabilities as the result of the failure of a Defaulting Member to fulfill its obligations to FICC. The proposed Corporate Contribution would apply to losses or liabilities relating to or arising out of Defaulting Member Events and Declared Non-Default Loss Events, and would be a mandatory loss contribution by FICC prior to any allocation of the loss among the applicable Division's members.

Current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4 provide FICC the option to contribute amounts higher than the specified percentage of retained earnings as determined by the Board of Directors, to any loss or liability incurred by FICC as the result of the failure of a Defaulting Member to fulfill its obligations to FICC. This option would be retained and expanded under the proposal to also cover non-default losses. Proposed Section 7a of GSD Rule 4 and MBSD Rule 4 would provide that nothing in the Rules would prevent FICC from voluntarily applying amounts greater than the Corporate Contribution against any FICC loss or liability, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

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<sup>35</sup> Supra note 9.

<sup>36</sup> Supra note 10.



Proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that FICC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or (ii) Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, FICC would allocate such losses and liabilities to members, as described below.

As proposed, Section 7 of GSD Rule 4 and MBSD Rule 4 would retain the differentiation in allocating losses to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members. Specifically, as is the case today, losses or liabilities that arise out of or relate to one or more Defaulting Member Events would be attributable to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members, while losses or liabilities that arise out of or relate to one or more Declared Non-Default Loss Events would only be attributable to Tier One Netting Members or Tier One Members, as applicable. Tier Two Members would not be subject to loss allocation with respect to Declared Non-Default Loss Events.

Under the proposal, FICC would delete the provision in current Section 7(h) of GSD Rule 4 and MBSD Rule 4 that requires FICC to promptly notify members and the Commission of the amounts involved and the causes if a Remaining Loss or Other Loss occurs because such notification would no longer be necessary under the proposed rule change. Under the proposed rule change, FICC would notify members subject to loss allocation of the amounts being allocated to them in one or more Loss Allocation Notices for both Defaulting Member Events and Declared Non-Default Loss Events. As such, in order to conform to the proposed rule change, FICC is proposing to eliminate the notification to members regarding the amounts involved and the causes if a Remaining Loss or Other Loss occurs that is required under current Section 7(h) of GSD Rule 4 and MBSD Rule 4. FICC is also proposing to delete the notification to the Commission regarding the amounts involved and the causes if a Remaining Loss or Other Loss occurs as required in the same section. While as a practical matter, FICC would notify the Commission of a decision to loss allocate, FICC does not believe such notification needs to be specified in the Rules.

In addition, FICC is proposing to clarify the provision related to Off-the-Market Transactions so that it is clear that loss or liability of FICC in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member would be allocated to the Member that was the counterparty to such transaction.

*Tier One Netting Members/Tier One Members:*

For Tier One Netting Members or Tier One Members, as applicable, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would establish the concept of an “Event Period” to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) Business Days, which would be grouped into an Event Period.<sup>37</sup> As stated above, both Defaulting Member Events or Declared Non-Default Loss Events could occur within the same Event Period.

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<sup>37</sup> Supra note 12.

Under the proposal, an Event Period with respect to a Defaulting Member Event would begin on the day FICC notifies members that it has ceased to act for the Defaulting Member (or the next Business Day, if such day is not a Business Day). In the case of a Declared Non-Default Loss Event, an Event Period would begin on the day that FICC notifies members of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would also retain the requirement of loss allocation among Tier One Netting Members or Tier One Members, as applicable, if a loss or liability remains after the application of the Corporate Contribution, as described above. In contrast to the current Section 7 where FICC would assess the Required Fund Deposits of Tier One Netting Members or Tier One Members, as applicable, to allocate losses, under the proposal, FICC would require Tier One Netting Members or Tier One Members, as applicable, to pay their loss allocation amounts (leaving their Required Fund Deposits intact).<sup>38</sup> Loss allocation obligations would continue to be calculated based upon a Tier One Netting Member's or Tier One Member's, as applicable, pro rata share of losses and liabilities (although the pro rata share would be calculated differently than it is today), and Tier One Netting Members or Tier One Members, as applicable, would still retain the ability to voluntarily withdraw from membership and cap their loss allocation obligation (although the loss allocation obligation would also be calculated differently than it is today).

The proposed rule change to Section 7 of GSD Rule 4 and MBSD Rule 4 would clarify that each Tier One Netting Member or Tier One Member, as applicable, that is a Tier One Netting Member or Tier One Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member

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<sup>38</sup> FICC believes that shifting from the two-step methodology of applying the respective Division's Clearing Fund and then requiring members to immediately replenish it to requiring direct payment would increase efficiency, while preserving the right to charge the member's Clearing Fund deposits in the event the member does not timely pay. Such a failure to pay would trigger recourse to the Clearing Fund deposits of the member under proposed Section 6 of GSD Rule 4 or MBSD Rule 4, as applicable. In addition, this change would provide greater stability for FICC in times of stress by allowing FICC to retain the respective Division's Clearing Fund, its critical prefunded resource, while charging loss allocations. FICC believes doing so would allow FICC to cover the respective Division's current credit exposures to its Members at all times. By retaining the GSD and MBSD Clearing Funds as proposed, FICC could use the Clearing Funds to secure the performance obligations of Members to their respective Division, including their payment obligation for any loss allocation, while maintaining access to prefunded resources. By being able to manage the respective Division's current credit exposures throughout the loss allocation process, FICC would be able to continue to provide its critical operations and services during what would be expected to be a stressful period.

Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. The proposal would make it clear that any Tier One Netting Member or Tier One Member, as applicable, for which FICC ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day, shall be deemed to be a Tier One Netting Member or Tier One Member, as applicable, on the first day of that Event Period.

Under the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the round cap. When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. FICC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4.

As proposed, each loss allocation would be communicated to the Tier One Netting Members or Tier One Members, as applicable, by the issuance of a Loss Allocation Notice. Under the proposal, each Tier One Netting Member’s or Tier One Member’s, as applicable, pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the member’s Average RFD divided by (ii) the sum of Average RFD amounts of all members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Netting Member or Tier One Member, as applicable, in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to notify FICC of its election to withdraw from membership with GSD or MBSD, as applicable, pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, and thereby benefit from its Loss Allocation Cap.<sup>39</sup> As proposed, the “Loss Allocation Cap” of a Tier One Netting Member or a Tier One Member, as applicable, would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

FICC is proposing to clarify that after a first round of loss allocation with respect to an Event Period, only Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would be subject to further loss allocation with respect to that Event Period.

As proposed, each such member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the member’s Average RFD, divided by (ii) the sum of the

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<sup>39</sup> Supra note 15.

Average RFD amounts of all members subject to loss allocation in such round. Each such member would have a maximum payment obligation with respect to any loss allocation round that would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period or (y) its Average RFD (such amount would be each member's "Loss Allocation Cap"). Therefore, the sum of the Loss Allocation Caps of the members subject to loss allocation would constitute the maximum amount that FICC would be permitted to allocate in each round. FICC would retain the loss allocation limit of \$5 million for Inter-Dealer Broker Netting Members, or Non-IDB Repo Brokers with respect to activities in their Segregated Broker Accounts, as discussed above.

As proposed, Section 7 of GSD Rule 4 and MBSD Rule 4, would also provide that, to the extent that a Tier One Netting Member's or Tier One Member's, as applicable, Loss Allocation Cap exceeds such member's Required Fund Deposit on the first day of the applicable Event Period, FICC may, in its discretion, retain any excess amounts on deposit from the member, up to the Loss Allocation Cap of the Tier One Netting Member or Tier One Member, as applicable.

As proposed, Tier One Netting Members or Tier One Members, as applicable, would have two (2) Business Days after FICC issues a first round Loss Allocation Notice to pay the amount specified in any such notice.<sup>40</sup> On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because FICC was only able to allocate up to the round cap), these members would also have two (2) Business Days after notice by FICC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless the members have notified (or will timely notify) FICC of their election to withdraw from membership with respect to a prior loss allocation round.

Under the proposal, if a Tier One Netting Member or Tier One Member, as applicable, fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, FICC would have the right to proceed against such member as a Defaulting Member that has failed to satisfy an obligation in accordance with proposed Section 6 of GSD Rule 4 or MBSD Rule 4 described above. Members who wish to withdraw from membership would be required to comply with the requirements in proposed Section 7b of GSD Rule 4 and MBSD Rule 4, described further below. Specifically, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that if, after notifying FICC of its election to withdraw from membership pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, the Tier One Netting Member or Tier One Member, as applicable, fails to comply with the provisions of proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, its notice of withdrawal would be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

FICC is proposing to delete the provisions in the current GSD Rule 4 and MBSD Rule 4 that require FICC to assess the Required Fund Deposit maintained by each Tier One Netting Member or Tier One Member, as applicable, an amount up to \$50,000, in an equal basis per such member, before allocating losses to Tier One Netting Members or Tier One Members, as applicable, ratably, in accordance with each such member's Required Fund Deposit and Average

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<sup>40</sup> Supra note 18.

Required FICC Clearing Fund Deposit or Average Required Clearing Fund Deposit, as applicable. FICC believes that in the event of a loss or liability, this assessment is unlikely to alleviate the need for loss mutualization and creates an unnecessary administrative burden for each Division. FICC believes that moving straight to the loss mutualization described herein would be more practical. This proposed change would also streamline each Division's loss allocation waterfall processes and align such processes with those of the other DTCC Clearing Agencies.

*Tier Two Members:*

FICC is not proposing any substantive change to the provisions regarding Tier Two Members in current Section 7 of GSD Rule 4 and MBS Rule 4, except to (i) add a subheading of "Tier Two Members" in the beginning of these provisions for ease of identification and (ii) add a paragraph that makes it clear that if a Tier Two Member fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, FICC would have the right to proceed against such member as a Defaulting Member that has failed to satisfy an obligation in accordance with proposed Section 6 of GSD Rule 4 or MBS Rule 4 described above, consistent with the proposed change regarding Tier One Netting Members or Tier One Members, as applicable.

*Withdrawal from Membership:*

Proposed Section 7b of GSD Rule 4 and MBS Rule 4 would include the provisions regarding withdrawal from membership currently covered by Section 7(g) of GSD Rule 4 and MBS Rule 4. FICC believes that relocating the provisions on withdrawal from membership as it pertains to loss allocation, so that it comes right after the section on the loss allocation waterfall, would provide for the better organization of GSD Rule 4 and MBS Rule 4. As proposed, the subheading for Section 7b of GSD Rule 4 and MBS Rule 4 would read "Withdrawal Following Loss Allocation."

Currently, Section 7(g) of GSD Rule 4 and MBS Rule 4 provides that a member may, pursuant to current Section 13 of GSD Rule 3 or MBS Rule 3, notify FICC by the Close of Business on the Business Day on which a payment in an amount necessary to cover losses allocated to such member after the application of its Required Fund Deposit is due, of its election to terminate its membership and thereby avail itself of a cap on loss allocation, which is currently its Required Fund Deposit as fixed on the Business Day the pro rata charge loss allocation notification is provided to such member.

As stated above, under the proposed rule change, Section 7 of GSD Rule 4 and MBS Rule 4 would provide that a Tier One Netting Member or a Tier One Member, as applicable, who wishes to withdraw from membership in respect of a loss allocation round must provide notice of its election to withdraw ("Loss Allocation Withdrawal Notice") within five (5) Business Days from the issuance of the first Loss Allocation Notice in any round.<sup>41</sup> In order to avail itself of its Loss Allocation Cap, such member would need to follow the requirements in

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<sup>41</sup> Supra note 15.

proposed Section 7b of GSD Rule 4 and MBSD Rule 4, as applicable, which would provide that such member must: (i) specify in its Loss Allocation Withdrawal Notice an effective date for withdrawal from membership, which date shall not be prior to the scheduled final settlement date of any remaining obligations owed by the member to FICC, unless otherwise approved by FICC, and (ii) as of the time of such member's submission of the Loss Allocation Withdrawal Notice, cease submitting transactions to FICC for processing, clearance or settlement, unless otherwise approved by FICC.

Proposed Section 7b of GSD Rule 4 and MBSD Rule 4 would provide that a Tier One Netting Member or a Tier One Member, as applicable, that withdraws in compliance with the requirements of proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under proposed GSD Rule 4 or MBSD Rule 4, as applicable; however, the Tier One Netting Member's or Tier One Member's, as applicable, aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

FICC is proposing to include a sentence in proposed Section 7b of GSD Rule 4 and MBSD Rule 4 to make it clear that if the Tier One Netting Member or Tier One Member, as applicable, fails to comply with the requirements set forth in that section, its Loss Allocation Withdrawal Notice will be deemed void, and such member will remain subject to further loss allocations pursuant to proposed Section 7 of GSD Rule 4 and MBSD Rule 4 as if it had not given such notice.

For better organization of the subject matter, FICC is also proposing to move the provision that covers members' obligations to eliminate any deficiency in their Required Fund Deposits from the last sentence in the first paragraph of current Section 7(g) of GSD Rule 4 and MBSD Rule 4 to proposed Section 9 of GSD Rule 4 and MBSD Rule 4.

### Section 8

As proposed, Section 8 of GSD Rule 4 and MBSD Rule 4 would cover the provisions on the return of a member's Clearing Fund deposit that are currently covered by Section 10 of GSD Rule 4 and MBSD Rule 4. Proposed Section 8's subheading would be "Return of Members' Clearing Fund Deposits."

FICC is proposing changes to streamline and enhance the clarity and readability of this section, including adding language to clarify that a member's obligations to FICC would include both matured as well as contingent obligations, but is otherwise retaining the substantive provisions of this section.

### Section 9

FICC is proposing to renumber Section 8 of GSD Rule 4 and MBSD Rule 4, which addresses the timing of members' payment of the respective Division's Clearing Fund. Under the proposal, this section would be renumbered as Section 9 of GSD Rule 4 and MBSD Rule 4

and retitled to “Initial Required Fund Deposit and Changes in Members’ Required Fund Deposits” to better reflect the subject matter of this section.

Currently, Section 8 of GSD Rule 4 and MBSD Rule 4 requires members to satisfy any increase in their Required Fund Deposit requirement within such time as FICC requires. FICC is proposing to clarify that at the time the increase becomes effective, the member’s obligations to FICC will be determined in accordance with the increased Required Fund Deposit whether or not the member has satisfied such increased amount. FICC is also proposing to add language to clarify that (i) if FICC applies a GSD Netting Member’s or an MBSD Clearing Member’s Clearing Fund deposits as permitted pursuant to GSD Rule 4 or MBSD Rule 4, as applicable, FICC may take any and all actions with respect to the GSD Netting Member’s or MBSD Clearing Member’s Actual Deposit, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that FICC determines is appropriate, and (ii) if such application results in any deficiency in the GSD Netting Member’s or MBSD Clearing Member’s, as applicable, Required Fund Deposit, such member shall immediately replenish it. These clarifications are consistent with the Divisions’ rights as set forth in current Sections 4 and 11 of GSD Rule 4 and current Sections 4 and 11 of MBSD Rule 4. In addition, the provisions in clause (ii) of the previous sentence is consistent with the requirements in current Section 1 of GSD Rule 4 and MBSD Rule 4 that a member must maintain its Required Fund Deposit.

As discussed above, for better organization of the subject matter, FICC is proposing to move the provision that covers members’ obligations to eliminate any deficiency in their Required Fund Deposits from the last sentence in the first paragraph of current Section 7(g) of GSD Rule 4 and MBSD Rule 4 to proposed Section 9 of GSD Rule 4 and MBSD Rule 4.

#### Section 10

Currently, Section 9 of GSD Rule 4 and MBSD Rule 4 addresses situations where a member has excess on deposit in the Clearing Fund (i.e., amounts above its Required Fund Deposit). The current provision provides that FICC will notify a member of any Excess Clearing Fund Deposit as FICC determines from time to time. Upon the request of a member, FICC will return an excess amount requested by a member that follows the formats and timeframe established by FICC for such request. The current provision makes clear that FICC may, in its discretion, withhold any or all of a member’s Excess Clearing Fund Deposit (i) if the member has an outstanding payment obligation to FICC, (ii) if FICC determines that the member’s anticipated activity over the next 90 calendar days may reasonably be expected to be materially different than the prior 90 calendar days, or (iii) if the member has been placed on the Watch List. Section 9 also makes clear that the return of an Excess Clearing Fund Deposit to any member is subject to (i) such return of Excess Clearing Fund Deposit not being done in a manner that would cause the member to violate any other section of the Rules, (ii) such return not reducing the amount of the member’s Cross-Guaranty Repayment Deposit to the Clearing Fund below the amount required to be maintained by the member pursuant to GSD Rule 41 or MBSD Rule 32, as applicable, and (iii) with respect to GSD Members only, such return not reducing the amount of a GSD Member’s Cross-Margining Repayment Deposit to the Clearing Fund below the amount required to be maintained by the GSD Member pursuant to GSD Rule 43.

FICC is proposing to renumber Section 9 as Section 10 for both GSD Rule 4 and MBS Rule 4 and to retitle its subheading to “Excess Clearing Fund Deposits” to better reflect the subject matter of the provisions. FICC is not proposing any changes to this section except to streamline and clarify the provisions as well as to align GSD Rule 4 and MBS Rule 4, including adding a sentence to clarify that nothing in this section limits FICC’s rights under Section 7 of GSD Rule 3 or Section 6 of MBS Rule 3, as applicable.

### Section 11

Current Section 11 of GSD Rule 4 and MBS Rule 4 provides that FICC has certain rights with respect to the Clearing Fund. FICC is proposing to add a sentence which would make it clear that GSD Rule 4 or MBS Rule 4, as applicable, would govern in the event of any conflict or inconsistency between such rule and any agreement between FICC and any member. FICC believes that this proposed change would facilitate members’ understanding of the Rules and their obligations thereunder. It would also align the Rules with the Rules and Procedures of NSCC so as to provide consistent treatment for firms that are members of both FICC and NSCC.<sup>42</sup> Furthermore, in order to enhance the readability and clarity, FICC is proposing a number of changes to streamline the language in this section.

#### (ii) Other Proposed Rule Changes

FICC is proposing changes to GSD Rule 1 (Definitions), GSD Rule 3 (Ongoing Membership Requirements), GSD Rule 3A (Sponsoring Members and Sponsored Members), GSD Rule 3B (Centrally Cleared Institutional Triparty Service), GSD Rule 13 (Funds-Only Settlement), GSD Rule 18 (Special Provisions for Repo Transactions), GSD Rule 21A (Wind-Down of a Netting Member), GSD Rule 22B (Corporation Default), GSD Rule 41 (Cross Guaranty Agreements), GSD Rule 43 (Cross-Margining Arrangements), GSD Board Interpretations and Statements of Policy, and GSD Interpretive Guidance with Respect to Watch List Consequences. FICC is also proposing changes to MBS Rule 1 (Definitions), MBS Rule 3 (Ongoing Membership Requirements), MBS Rule 5 (Trade Comparison), MBS Rule 11 (Cash Settlement), MBS Rule 17A (Corporation Default), MBS Rule 32 (Cross Guaranty Agreements), and MBS Interpretive Guidance with Respect to Watch List Consequences. FICC is proposing changes to these Rules in order to conform them with the proposed changes to GSD Rule 4 and MBS Rule 4, as applicable, as well as to make certain technical changes to these Rules, as further described below.

#### *Adding Defined Terms*

Specifically, FICC is proposing to add the following defined terms to GSD Rule 1, in alphabetical order: Actual Deposit, Average RFD, CCIT Member Termination Date, CCIT Member Voluntary Termination Notice, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member Event, Event Period, Excess Clearing Fund Deposit, Former Sponsored Members, Lender, Loss Allocation Cap, Loss Allocation Notice,

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<sup>42</sup> See Section 12 of Rule 4 in NSCC’s Rules and Procedures, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).



Loss Allocation Withdrawal Notice, Sponsored Member Termination Date, Sponsored Member Voluntary Termination Notice, Sponsoring Member Termination Date, Sponsoring Member Voluntary Termination Notice, Termination Date, and Voluntary Termination Notice.

FICC is also proposing to add the following defined terms to MBSD Rule 1, in alphabetical order: Actual Deposit, Average RFD, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member Event, Event Period, Excess Clearing Fund Deposit, Lender, Loss Allocation Cap, Loss Allocation Notice, Loss Allocation Withdrawal Notice, Termination Date, and Voluntary Termination Notice.

### *Technical Changes*

In addition, FICC is proposing technical changes (i) to delete the defined term “The Corporation” in GSD Rule 1 and replace it with “Corporation” in GSD Rule 1, (ii) to correct cross-references in Section 8 of MBSD Rule 5 and the definition of “Legal Risk” in GSD Rule 1, (iii) to update references to sections that would be changed under this proposal in Section 12 of GSD Rule 3, Sections 10 and 12(a) of GSD Rule 3A, Section 3(f) of GSD Rule 18, GSD Rule 21A, Sections 3(a), 3(b) and 4 of GSD Rule 41, Section 6 of GSD Rule 43, GSD Interpretive Guidance with Respect to Watch List Consequences, Sections 11, 14, and 15 of MBSD Rule 3, Section 3(b) of MBSD Rule 32, and MBSD Interpretive Guidance with Respect to Watch List Consequences, (iv) to update the reference to a subheading that would be changed under this proposal in Section 7 of GSD Rule 3B, and (v) to delete a reference to the Cross-Margining Agreement between FICC and NYPC that is no longer in effect. FICC believes that these proposed technical changes would ensure the Rules remain clear and accurate, which would in turn allow Members to readily understand their obligations under the Rules.

### *Voluntary Termination*

FICC is also proposing changes to the voluntary termination provisions in GSD Rule 3, GSD Rule 3A, GSD Rule 3B, and MBSD Rule 3 in order to ensure that termination provisions in the GSD Rules and MBSD Rules, whether voluntary or in response to a loss allocation, are consistent with one another to the extent appropriate.

Currently, the voluntary termination provisions in GSD Rule 3, GSD Rule 3A, GSD Rule 3B, and MBSD Rule 3 generally provide that a member may elect to terminate its membership by providing FICC with 10 days written notice of such termination. Such termination will not be effective until accepted by FICC, which shall be no later than 10 Business Days after the receipt of the notice. FICC’s acceptance shall be evidenced by a notice to FICC’s members announcing the member’s termination and the effective date of the termination (“Termination Date”), and that the terminating member will no longer be eligible to submit transactions to FICC as of the Termination Date.<sup>43</sup> This provision also provides that a member’s voluntary termination of membership shall not affect its obligations to FICC.

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<sup>43</sup> Account(s) of a terminating member would generally be deactivated before the open of business on the Termination Date.

Where appropriate, FICC is proposing changes to align the voluntary termination provisions in Section 13 of GSD Rule 3, Sections 2(i) and 3(e) of GSD Rule 3A, Section 6 of GSD Rule 3B, and Section 14 of MBSD Rule 3 with the proposed new Section 7b of GSD Rule 4 and MBSD Rule 4, given that they all address termination of membership. Specifically, in Section 13 of GSD Rule 3, FICC is proposing that when a GSD Member elects to voluntarily terminate its membership by providing FICC a written notice of such termination (“Voluntary Termination Notice”), the GSD Member must specify in its Voluntary Termination Notice a desired date for its withdrawal from membership; provided, however, if the GSD Member is terminating its membership in GSD (i.e., not terminating its membership just in the Netting System), such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the GSD Member to FICC as of the time such Voluntary Termination Notice is submitted to FICC, unless otherwise approved by FICC. FICC is proposing to delete the provision that requires a member to provide FICC with 10 days written notice of the member’s termination; however, FICC is retaining the provision that states termination will not be effective until accepted by FICC,<sup>44</sup> which shall be no later than 10 Business Days after the receipt of the notice. FICC is also retaining the provision that states FICC’s acceptance shall be evidenced by a notice to FICC’s members announcing the member’s termination and the Termination Date, and that the terminating member will no longer be eligible to submit transactions to FICC as of the Termination Date.

As an example, Member A submits a Voluntary Termination Notice to GSD on April 1<sup>st</sup> indicating its desired termination date is June 15<sup>th</sup>. GSD would accept such termination request by issuing a notice to GSD Members within 10 Business Days from April 1<sup>st</sup>; such notice would provide that the effective date of Member A’s GSD membership termination is June 15<sup>th</sup>. In contrast, if Member A submits a Voluntary Termination Notice on April 1<sup>st</sup> and indicates its desired termination date is April 5<sup>th</sup>, GSD would either (i) accept such termination notice by issuing a notice to GSD Members on or before April 5<sup>th</sup>, and such notice would provide that the effective date of Member A’s GSD membership termination is April 5<sup>th</sup> or (ii) if GSD requires additional time to process the termination, GSD would accept such termination notice by issuing notice to GSD Members after April 5<sup>th</sup> but still within 10 Business Days from April 1<sup>st</sup>; and such notice would provide that the effective date of Member A’s GSD membership termination as a date after April 5<sup>th</sup>.

The proposed change to Section 13 of GSD Rule 3 would also provide that if any trade is submitted to FICC either by the withdrawing GSD Member or its authorized submitter that is scheduled to settle on or after the Termination Date, the GSD Member’s Voluntary Termination Notice would be deemed void and the GSD Member would remain subject to the GSD Rules as

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<sup>44</sup> Unlike the Voluntary Termination Notice, the Loss Allocation Withdrawal Notice as proposed in Section 7b of GSD Rule 4 and MBSD Rule 4 does not require explicit acceptance by FICC to be effective. FICC believes that requiring explicit acceptance of the Loss Allocation Withdrawal Notice could complicate the loss allocation process and potentially result in membership withdrawal being delayed as well as detract from the objective to have FICC know on a timely basis which members would remain subject to the subsequent rounds of loss allocation.

if it had not given such notice. Furthermore, FICC is proposing to add a sentence to Section 13 of GSD Rule 3 to refer GSD Members to Section 8 of GSD Rule 4 regarding provisions on the return of a GSD Member's Clearing Fund deposit and to specify that if an Event Period were to occur after a Tier One Netting Member has submitted its Voluntary Termination Notice but prior to the Termination Date, in order for such Tier One Netting Member to benefit from its Loss Allocation Cap pursuant to Section 7 of GSD Rule 4, the Tier One Netting Member would need to comply with the provisions of Section 7b of GSD Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, would supersede and void any pending Voluntary Termination Notice previously submitted by the Tier One Netting Member.<sup>45</sup> As an example, if an Event Period occurs after submission of the Voluntary Termination Notice by a Tier One Netting Member or Tier One Member, as applicable, but prior to the Termination Date, and the Tier One Netting Member or Tier One Member, as applicable, does not subsequently submit a Loss Allocation Withdrawal Notice as proposed in Section 7b of GSD Rule 4 or MBS Rule 4, as applicable, then the Tier One Netting Member or Tier One Member, as applicable, would not benefit from its Loss Allocation Cap, i.e., the Tier One Netting Member or Tier One Member, as applicable, would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period that commenced prior to the Termination Date.

Parallel changes are also being proposed to Section 2(i) of GSD Rule 3A and Section 14 of MBS Rule 3 with additional language in Section 2(i) of GSD Rule 3A and Section 14 of MBS Rule 3 making it clear that the acceptance by FICC of a member's Voluntary Termination Notice shall be no later than ten (10) Business Days after the receipt of such notice from the member, in order to provide certainty to members as well as to align these sections with the current Section 13 of GSD Rule 3.

With respect to Section 3(e) of GSD Rule 3A and Section 6 of GSD Rule 3B, changes similar to the ones described above in the previous paragraph are also being proposed for Sponsored Members and CCIT Members, except there would be no references to the return of a member's Clearing Fund deposits and to Loss Allocation Caps because they would not apply to these member types. In addition, FICC is proposing a technical change in Section 6 of GSD Rule 3B to reflect a defined term that would be changed under this proposal.

#### *Other MBS Proposed Rule Changes*

FICC is proposing to delete Section 15 of MBS Rule 3 because FICC believes that this section is akin to a loss allocation provision and therefore would no longer be necessary under the proposed rule change, as the scenarios envisioned by Section 15 of MBS Rule 3 would be governed by the proposed loss allocation provisions in MBS Rule 4.

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<sup>45</sup> Loss Allocation Caps would not apply to Tier Two Netting Members and Tier Two Members because the loss allocation obligations of Tier Two Netting Members and Tier Two Members are already capped to the liquidation losses that resulted from their trading activity with the Defaulting Member. Tier Two Netting Members and Tier Two Members are required to pay their loss allocation obligations in full.

### *Other GSD Proposed Rule Changes*

Under the proposal, Section 12(c) of GSD Rule 3A would also be revised to incorporate the concept of the Loss Allocation Cap and to reference the applicable proposed sections in GSD Rule 4 that would apply when a Sponsoring Member elects to terminate its status as a Sponsoring Member.

FICC is also proposing to delete an Interpretation of the Board of Directors of the Government Securities Clearing Corporation (the predecessor to GSD), which currently clarifies certain provisions of GSD Rule 4 and the extent to which the GSD Clearing Fund and other required deposits of GSD Netting Members may be applied to a loss or liability incurred by FICC. FICC is proposing this deletion because this interpretation would no longer be necessary following the proposed rule change. This is because the proposed rule change to GSD Rule 4 would cover the extent to which the GSD Clearing Fund and other collateral or assets of GSD Netting Members would be applied to a loss or liability incurred by FICC.

### *Other GSD Proposed Rule Changes and MBSD Proposed Rule Changes*

FICC is proposing changes to Section 11 of GSD Rule 4 and MBSD Rule 4. Specifically, FICC is proposing to replace “letters of credit” with “Eligible Letters of Credit,” which is already a defined term in the Rules. In addition, FICC is proposing to specify that a reference to 30 days means 30 calendar days.

FICC is proposing to delete “Remaining Loss” and “Other Loss” in Sections 12(a) and 12(b) of GSD Rule 3A, Section 5 of GSD Rule 13, Section 4 of GSD Rule 41, Section 6 of GSD Rule 43, Section 9(o) of MBSD Rule 11, and Section 4 of MBSD Rule 32 because these terms would no longer be used under the proposed GSD Rule 4 and MBSD Rule 4, and to add clarifying language that conforms to the proposed changes to GSD Rule 4 and MBSD Rule 4.

In addition, FICC is proposing changes to GSD Rule 22B (Corporation Default) and MBSD Rule 17A (Corporation Default). FICC is proposing to relocate the interpretational parenthetical in each rule to come right after the reference to GSD Rule 22A and MBSD Rule 17. FICC is proposing this change because, in the event of a Corporation Default, the portfolio of each GSD Member or MBSD Member, as applicable, would be closed out in the same way as the portfolio of a GSD Defaulting Member or MBSD Defaulting Member, i.e., by applying the close out procedures of GSD Rule 22A (Procedures for When the Corporation Ceases to Act) or MBSD Rule 17 (Procedures for When the Corporation Ceases to Act), as applicable. In addition, in the proposed GSD Rule 22B and MBSD Rule 17A, FICC is proposing to add a reference to the loss allocation provisions of GSD Rule 4 and MBSD Rule 4 and delete references to specific sections of GSD Rule 4 and MBSD Rule 4, because those sections are being modified under the proposed rule change.

### Member Outreach

Beginning in August 2017, FICC conducted outreach to Members in order to provide them with advance notice of the proposed changes. As of the date of this filing, no written

comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

#### Implementation Timeframe

Pending Commission approval, FICC expects to implement this proposal within two (2) Business Days after approval. Members would be advised of the implementation date of this proposal through issuance of a FICC Important Notice.

#### Expected Effect on Risks to the Clearing Agency, its Participants and the Market

FICC believes that the proposed rule changes to enhance the resiliency of each Division's loss allocation process and to delete certain limiting language regarding FICC's use of MBSD Clearing Fund would reduce the risk of uncertainty to FICC, each Division's members and the market overall. Specifically, by modifying the calculation of FICC's corporate contribution, FICC would apply a mandatory fixed percentage of its General Business Risk Capital Requirement (as compared to the current Rules which provide for "up to" a percentage of retained earnings), which would provide greater transparency and accessibility to members as to how much FICC would contribute in the event of a loss or liability. By modifying the application of FICC's corporate contribution to apply to Declared Non-Default Loss Events, in addition to Defaulting Member Events, on a mandatory basis, FICC would expand the application of its corporate contribution beyond losses and liabilities from member defaults, which would better align the interests of FICC with those of its respective Division's members by stipulating a mandatory application of the Corporate Contribution to a Declared Non-Default Loss Event prior to any allocation of the loss among Tier One Netting Members or Tier One Members, as applicable. Taken together, these proposed rule changes would enhance the overall resiliency of each Division's loss allocation process by enhancing the calculation and application of FICC's Corporate Contribution, which is one of the key elements of each Division's loss allocation process. Moreover, by providing greater transparency and accessibility to members, as stated above, the proposed rule changes regarding the Corporate Contribution, including the proposed replenishment period and proposed allocation of FICC Corporate Contribution between Divisions, would allow members to better assess the adequacy of each Division's loss allocation process.

By introducing the concept of an Event Period, FICC would be able to group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) Business Days for purposes of allocating losses to members. FICC believes that the Event Period would provide a defined structure for the loss allocation process to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or market dislocation episode. Having this structure would enhance the overall resiliency of FICC's loss allocation process because FICC would be better equipped to address losses that may arise from multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would provide certainty for members concerning their maximum exposure to mutualized losses with respect to such events.

By introducing the concept of “rounds” (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the member withdrawal process in connection with the loss allocation process, FICC would (i) set forth a defined amount that it would allocate to members during each round (i.e., the round cap), (ii) advise members of loss allocation obligation information as well as round information through the issuance of Loss Allocation Notices, and (iii) provide members with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of FICC’s loss allocation process because they would enable FICC to continue the loss allocation process in successive rounds until all of FICC’s losses are allocated and enable FICC to identify continuing members for purposes of calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for members a clear manner and process in which they could cap their loss allocation exposure to FICC.

By implementing a revised “look-back” period to calculate a member’s loss allocation obligations and its Loss Allocation Cap, FICC would be able to capture a full calendar quarter of the member’s activities and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred. By determining a member’s loss allocation obligations based on the average of its Required Fund Deposit over a look-back period and its Loss Allocation Cap based on the greater of its Required Fund Deposit or the average thereof over a look-back period, FICC would be able to calculate a member’s pro rata share of losses and liabilities based on the amount of risk that the member brings to FICC. These proposed rule changes would enhance the overall resiliency of each Division’s loss allocation process because they would align a member’s loss allocation obligation and its Loss Allocation Cap with the amount of risk that the member brings to FICC.

By deleting certain vague and imprecise limiting language that could be interpreted as impairing FICC’s ability to access the MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event, as well as to cover certain liquidity needs, the proposed rule change to amend FICC’s permitted use of MBSD Clearing Fund would enhance FICC’s ability to ensure that it can continue its operations and clearance and settlement services in an orderly manner in the event that it would be necessary or appropriate for FICC to access MBSD Clearing Fund deposits to address losses, liabilities or liquidity needs to meet its settlement obligations.

#### *Management of Identified Risks*

FICC is proposing the rule changes as described in detail above in order to enhance the resiliency of each Division’s loss allocation process and provide transparency and accessibility to its respective members regarding each Division’s loss allocation process.

#### *Consistency with the Clearing Supervision Act*

The proposed rule change would be consistent with Section 805(b) 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”).<sup>46</sup> The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.<sup>47</sup>

The proposed rule change would enhance the resiliency of each Division’s loss allocation process by (1) modifying the calculation and application of FICC’s corporate contribution, (2) introducing an Event Period, (3) introducing the concept of “rounds” (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the member withdrawal process in connection with the loss allocation process, and (4) implementing a revised “look-back” period to calculate a member’s loss allocation obligation and its Loss Allocation Cap. Together, these proposed rule changes would (i) create greater certainty for members regarding each Division’s obligation towards a loss, (ii) more clearly specify each Division’s and its respective members’ obligations toward a loss and balance the need to manage the risk of sequential defaults and other potential loss events against members’ need for certainty concerning their maximum exposures, and (iii) provide members the opportunity to limit their exposure to FICC by capping their exposure to loss allocation. Reducing the risk of uncertainty to FICC, each Division’s members and the market overall would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, FICC believes that the proposed rule change to enhance the resiliency of each Division’s loss allocation process is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

By deleting certain vague and imprecise limiting language that could be interpreted as impairing FICC’s ability to access the MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event, as well as to cover certain liquidity needs, the proposed rule change to amend FICC’s permitted use of MBSD Clearing Fund would enhance FICC’s ability to ensure that it can continue its operations and clearance and settlement services in an orderly manner in the event that it would be necessary or appropriate for FICC to access MBSD Clearing Fund deposits to address losses, liabilities or liquidity needs to meet its settlement obligations. Enabling FICC to continue its operations and clearance and settlement services in an orderly manner under such circumstances would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, FICC believes that this proposed rule change is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change is also consistent with Rules 17Ad-22(e)(13) and 17Ad-22(e)(23)(i), promulgated under the Act.<sup>48</sup> Rule 17Ad-22(e)(13) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably

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<sup>46</sup> 12 U.S.C. 5464(b).

<sup>47</sup> Id.

<sup>48</sup> 17 CFR 240.17Ad-22(e)(13) and (e)(23)(i).

designed to ensure each Division has the authority and operational capacity to take timely action to contain losses and continue to meet its obligations.<sup>49</sup> As described above, the proposed rule changes to (1) modify the calculation and application of FICC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the member withdrawal process in connection with the loss allocation process, and (4) implement a revised "look-back" period to calculate a member's loss allocation obligation and its Loss Allocation Cap, taken together, are designed to enhance the resiliency of each Division's loss allocation process. Having a resilient loss allocation process would help ensure that each Division can effectively and timely address losses relating to or arising out of either the default of one or more members or one or more non-default loss events, which in turn would help each Division contain losses and continue to meet its clearance and settlement obligations. Therefore, FICC believes that the proposed rule changes to enhance the resiliency of each Division's loss allocation process are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of each Division's default rules and procedures.<sup>50</sup> The proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) improve the overall transparency and accessibility of the provisions in the Rules governing loss allocation and (iii) make conforming and technical changes, would not only ensure that each Division's loss allocation rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of other DTCC Clearing Agencies, but also would help to ensure that each Division's loss allocation rules are transparent and clear to members. Aligning the loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable members to better understand the key aspects of each Division's default rules and procedures and provide members with increased predictability and certainty regarding their exposures and obligations. As such, FICC believes that the proposed rule changes to align the loss allocation rules of the DTCC Clearing Agencies as well as to improve the overall transparency and accessibility of each Division's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

## **11. Exhibits**

Exhibit 1 – Not applicable.

Exhibit 1A – Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 – Not applicable.

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<sup>49</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>50</sup> 17 CFR 240.17Ad-22(e)(23)(i).



Exhibit 3 – Not applicable.

Exhibit 4 – Changes to the Rules proposed by this Amendment.

Exhibit 5 – Proposed changes to the Rules.

**SR-FICC-2017-806 Amendment No. 1**

**EXHIBIT 1A**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-[\_\_\_\_\_]; File No. SR-FICC-2017-806)

[DATE]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Amendment No. 1 to Advance Notice to Amend the Loss Allocation Rules and Make Other Changes

On December 18, 2017, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) an advance notice SR-FICC-2017-806 (“Advance Notice”) 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”)<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”).<sup>2</sup> The Advance Notice was published in the Federal Register on January 30, 2018.<sup>3</sup> Notice is hereby given that on June \_\_, 2018, FICC filed with the Commission Amendment No. 1 to the Advance Notice, as described in Items I, II and III below, which Items have been prepared by the clearing agency.<sup>4</sup> Amendment No. 1 supersedes and replaces the Advance Notice in its

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> See Securities Exchange Act Release No. 82583 (January 24, 2018), 83 FR 4358 (January 30, 2018) (SR-FICC-2017-806).

<sup>4</sup> On December 18, 2017, FICC filed the Advance Notice as a proposed rule change (SR-FICC-2017-022) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder, 17 CFR 240.19b-4. The proposed rule change was published in the Federal Register on January 8, 2018. See Securities Exchange Act Release No. 82427 (January 2, 2018), 83 FR 854 (January 8, 2018) (SR-FICC-2017-022). On June \_\_, 2018, FICC filed with the

entirety. The Commission is publishing this notice to solicit comments on Amendment No. 1 to the Advance Notice from interested persons.

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

This Advance Notice consists of proposed modifications to FICC's Government Securities Division ("GSD") Rulebook ("GSD Rules") and Mortgage-Backed Securities Division ("MBSD" and, together with GSD, the "Divisions" and, each, a "Division") Clearing Rules ("MBSD Rules," and collectively with the GSD Rules, the "Rules") in order to amend provisions in the Rules regarding loss allocation as well as make other changes, as described in greater detail below.<sup>5</sup>

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.

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Commission Amendment No. 1 to the proposed rule change, which supersedes and replaces the proposed rule change in its entirety. A copy of Amendment No. 1 to the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

<sup>5</sup> Capitalized terms not defined herein are defined in the GSD Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_gov\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf), and the MBSD Rules, available at [www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_mbsd\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf).

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

Written comments relating to this proposal have not been solicited or received.

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 Amendment No. 1

This filing constitutes Amendment No. 1 (“Amendment”) to Advance Notice previously filed by FICC on December 18, 2017.<sup>6</sup> This Amendment amends and replaces the Advance Notice in its entirety. FICC submits this Amendment in order to further clarify the operation of the proposed rule changes on loss allocation by providing additional information and examples. In particular, this Amendment would:

- (i) Clarify which Tier One Netting Members and Tier One Members would be subject to loss allocation with respect to Defaulting Member Events (as defined below and in the proposed rule change) and Declared Non-Default Loss Events (as defined below and in the proposed rule change) occurring during an Event Period (as defined below and in the proposed rule change). Specifically, pursuant to the Amendment, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that each Tier One Netting Member or Tier One Member, as applicable, that is a Tier One Netting Member or Tier One Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or

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<sup>6</sup> See Securities Exchange Act Release No. 82583 (January 24, 2018), 83 FR 4358 (January 30, 2018) (SR-FICC-2017-806).

relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member (as defined below and in the proposed rule change)) and each Declared Non-Default Loss Event occurring during the Event Period. Proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would also make it clear that any Tier One Netting Member or Tier One Member, as applicable, for which FICC ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day, would be deemed to be a Tier One Netting Member or Tier One Member, as applicable, on the first day of that Event Period.

- (ii) Clarify the obligations and Loss Allocation Cap (as defined below and in the proposed rule change) of a Tier One Netting Member or a Tier One Member, as applicable, that withdraws from membership in respect of a loss allocation round. Specifically, pursuant to the Amendment, proposed Section 7b of GSD Rule 4 and MBSD Rule 4 would provide that the Tier One Netting Member or Tier One Member, as applicable, would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under GSD Rule 4 or MBSD Rule 4, as applicable; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap as fixed in the round for which it withdrew.

- (iii) Clarify that a member would be obligated to FICC for all losses and liabilities incurred by FICC arising out of or relating to any Defaulting Member Event with respect to the member. Specifically, pursuant to the Amendment, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that each member would be obligated to FICC for the entire amount of any loss or liability incurred by FICC arising out of or relating to any Defaulting Member Event with respect to such member.
  
- (iv) Clarify that, although a Defaulting Member would not be allocated a ratable share of losses and liabilities arising out of or relating to its own Defaulting Member Event, it would remain obligated to FICC for all such losses and liabilities. Specifically, pursuant to the Amendment, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that no loss allocation under GSD Rule 4 or MBSD Rule 4, as applicable, would constitute a waiver of any claim FICC may have against a GSD Member or MBSD Member, as applicable, for any loss or liability to which the GSD Member or MBSD Member is subject under the GSD Rules or MBSD Rules, as applicable, including, without limitation, any loss or liability to which it may be subject under GSD Rule 4 or MBSD Rule 4, as applicable.

In addition, pursuant to the Amendment, FICC is making other clarifying and technical changes to the proposed rule change, as proposed herein.

*Nature of the Proposed Change*

The primary purpose of this proposed rule change is to amend GSD's and MBSD's loss allocation rules in order to enhance the resiliency of the Divisions' loss allocation processes so that each Division can take timely action to address multiple loss events that occur in succession during a short period of time (defined and explained in detail below). In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of The Depository Trust & Clearing Corporation ("DTCC"), namely The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC"), and FICC (collectively, the "DTCC Clearing Agencies"), so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the loss allocation rules by enhancing their readability and clarity, (iii) amend language regarding FICC's use of MBSD Clearing Fund, and (iv) make conforming and technical changes.

(i) Background

Central counterparties ("CCPs") play a key role in financial markets by mitigating counterparty credit risk on transactions between market participants. CCPs achieve this by providing guaranties to participants and, as a consequence, are typically exposed to credit risks that could lead to default losses. In addition, in performing its critical functions, a CCP could be exposed to non-default losses that are otherwise incident to the CCP's clearance and settlement business.

A CCP's rulebook should provide a complete description of how losses would be allocated to participants if the size of the losses exceeded the CCP's pre-funded resources. Doing so provides for an orderly allocation of losses, and potentially allows the CCP to continue providing critical services to the market and thereby results in significant financial stability benefits. In addition, a clear description of the loss allocation process offers transparency and accessibility to the CCP's participants.

*Current FICC Loss Allocation Process*

As CCPs, FICC's Divisions' loss allocation processes are key components of their respective risk management processes. Risk management is the foundation of FICC's ability to guarantee settlement in each Division, as well as the means by which FICC protects itself and its members from the risks inherent in the clearance and settlement process. FICC's risk management processes must account for the fact that, in certain extreme circumstances, the collateral and other financial resources that secure FICC's risk exposures may not be sufficient to fully cover losses resulting from the liquidation of the portfolio of a member for whom a Division has ceased to act.<sup>7</sup>

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<sup>7</sup> GSD is permitted to cease to act for (i) a GSD Member pursuant to GSD Rule 21 (Restrictions on Access to Services) and GSD Rule 22 (Insolvency of a Member), (ii) a Sponsoring Member pursuant to Section 14 and Section 16 of GSD Rule 3A (Sponsoring Members and Sponsored Members), and (iii) a Sponsored Member pursuant to Section 13 and Section 15 of GSD Rule 3A (Sponsoring Members and Sponsored Members). MBSB is permitted to cease to act for an MBSB Member pursuant to MBSB Rule 14 (Restrictions on Access to Services) and MBSB Rule 16 (Insolvency of a Member). GSD Rule 22A (Procedures for When the Corporation Ceases to Act) and MBSB Rule 17 (Procedures for When the Corporation Ceases to Act) set out the types of actions FICC may take when it ceases to act for a member. Supra note 5.



The GSD Rules and the MBSD Rules each currently provide for a loss allocation process through which both FICC (by applying up to 25% of its retained earnings in accordance with Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4) and its members would share in the allocation of a loss resulting from the default of a member for whom a Division has ceased to act pursuant to the Rules. The GSD Rules and the MBSD Rules also recognize that FICC may incur losses outside the context of a defaulting member that are otherwise incident to each Division's clearance and settlement business.

The current GSD and MBSD loss allocation rules provide that, in the event the Division ceases to act for a member, the amounts on deposit to the Clearing Fund from the defaulting member, along with any other resources of, or attributable to, the defaulting member that FICC may access under the GSD Rules or the MBSD Rules (e.g., payments from Cross-Guaranty Agreements), are the first source of funds the Division would use to cover any losses that may result from the closeout of the defaulting member's guaranteed positions. If these amounts are not sufficient to cover all losses incurred, then each Division will apply the following available resources, in the following loss allocation waterfall order:

First, as provided in the current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4, FICC's corporate contribution of up to 25 percent of FICC's retained earnings existing at the time of the failure of a defaulting member to fulfill its obligations to FICC, or such greater amount as the Board of Directors may determine; and

Second, if a loss still remains, use of the Clearing Fund of the Division and assessing the Division's Members in the manner provided in GSD Rule 4 and MBSD Rule 4, as the case may be. Specifically, FICC will divide the loss ratably between Tier One Netting Members and Tier Two Members with respect to GSD, or between Tier One Members and Tier Two Members with respect to MBSD, based on original counterparty activity with the defaulting member. Then the loss allocation process applicable to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members will proceed in the manner provided in GSD Rule 4 and MBSD Rule 4, as the case may be.

Specifically, the applicable Division will first assess each Tier One Netting Member or Tier One Member, as applicable, an amount up to \$50,000, in an equal basis per such member. If a loss remains, the Division will allocate the remaining loss ratably among Tier One Netting Members or Tier One Members, as applicable, in accordance with the amount of each Tier One Netting Member's or Tier One Member's, as applicable, respective average daily Required Fund Deposit over the prior twelve (12) months. If a Tier One Netting Member or Tier One Member, as applicable, did not maintain a Required Fund Deposit for twelve (12) months, its loss allocation amount will be based on its average daily Required Fund Deposit over the time period during which such member did maintain a Required Fund Deposit.

Pursuant to current Section 7(g) of GSD Rule 4 and MBSD Rule 4, if, as a result of the Division's application of the Required Fund Deposit of a member, a member's actual Clearing Fund deposit is less than its Required Fund Deposit, it will be required to eliminate such deficiency in order to satisfy its Required Fund Deposit amount. In

addition to losses that may result from the closeout of the defaulting member's guaranteed positions, Tier One Netting Members or Tier One Members, as applicable, can also be assessed for non-default losses incident to each Division's clearance and settlement business, pursuant to current Section 7(f) of GSD Rule 4 and MBSD Rule 4.

The Rules of both Divisions currently provide that Tier Two Members are only subject to loss allocation to the extent they traded with the defaulting member and their trades resulted in a liquidation loss. FICC will assess Tier Two Members ratably based on their loss as a percentage of the entire remaining loss attributable to Tier Two Members.<sup>8</sup> Tier Two Members are required to pay their loss allocation obligations in full and replenish their Required Fund Deposits as needed and as applicable. The current Rule provisions which provide for loss allocation of non-default losses incident to each Division's clearance and settlement business (i.e., Section 7(f) of GSD Rule 4 and MBSD Rule 4) do not apply to Tier Two Members.

*Overview of the Proposed Rule Changes*

A. Changes to Enhance Resiliency of GSD's and MBSD's Loss Allocation Processes

In order to enhance the resiliency of GSD's and MBSD's loss allocation processes, FICC proposes to change the manner in which each of the aspects of the loss allocation waterfall described above would be employed. GSD and MBSD would retain

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<sup>8</sup> GSD Rule 3B, Section 7 (Loss Allocation Obligations of CCIT Members) provides that CCIT Members will be allocated losses as Tier Two Members and will be responsible for the total amount of loss allocated to them. With respect to CCIT Members with a Joint Account Submitter, loss allocation will be calculated at the Joint Account level and then applied pro rata to each CCIT Member within the Joint Account based on the trade settlement allocation instructions. Supra note 5.

the current core loss allocation process following the application of the defaulting member's resources, i.e., first, by applying FICC's corporate contribution, and second, by pro rata allocations to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members. However, GSD and MBSD would clarify or adjust certain elements and introduce certain new loss allocation concepts, as further discussed below. The proposal would also retain the types of losses that can be allocated to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members as stated above. In addition, the proposed rule change would address the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time, also as described below.

Accordingly, FICC is proposing five (5) key changes to enhance each Division's loss allocation process:

- (1) Changing the calculation and application of FICC's corporate contribution.

As stated above, Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4 currently provide that FICC will contribute up to 25% of its retained earnings (or such higher amount as the Board of Directors shall determine) to a loss or liability that is not satisfied by the defaulting member's Clearing Fund deposit. Under the proposal, FICC would amend the calculation of its corporate contribution from a percentage of its retained earnings to a mandatory amount equal to 50% of the FICC General Business Risk Capital Requirement.<sup>9</sup> FICC's General Business Risk Capital Requirement, as

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<sup>9</sup> FICC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of FICC's critical operations, and (iii) an amount

defined in FICC's Clearing Agency Policy on Capital Requirements,<sup>10</sup> is, at a minimum, equal to the regulatory capital that FICC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>11</sup> The proposed Corporate Contribution (as defined below and in the proposed rule change) would be held in addition to FICC's General Business Risk Capital Requirement.

Currently, the Rules do not require FICC to contribute its retained earnings to losses and liabilities other than those from member defaults. Under the proposal, FICC would apply its corporate contribution to non-default losses as well. The proposed Corporate Contribution would apply to losses arising from Defaulting Member Events and Declared Non-Default Loss Events (as such terms are defined below and in the proposed rule change), and would be a mandatory contribution by FICC prior to any allocation of the loss among the applicable Division's members.<sup>12</sup> As proposed, if the Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period by one or both Divisions, the Corporate Contribution would be reduced to

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determined based on an analysis of FICC's estimated operating expenses for a six (6) month period.

<sup>10</sup> See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-FICC-2017-007).

<sup>11</sup> 17 CFR 240.17Ad-22(e)(15).

<sup>12</sup> The proposed rule change would not require a Corporate Contribution with respect to the use of each Division's Clearing Fund as a liquidity resource; however, if FICC uses a Division's Clearing Fund as a liquidity resource for more than 30 calendar days, as set forth in proposed Section 5 of GSD Rule 4 and MBSD Rule 4, then FICC would have to consider the amount used as a loss to the respective Division's Clearing Fund incurred as a result of a Defaulting Member Event and allocate the loss pursuant to proposed Section 7 of Rule 4, which would then require the application of FICC's Corporate Contribution.

the remaining unused amount, if any, during the following two hundred fifty (250) Business Days in order to permit FICC to replenish the Corporate Contribution.<sup>13</sup> To ensure transparency, all GSD Members and MBSD Members would receive notice of any such reduction to the Corporate Contribution. There would be one FICC Corporate Contribution, the amount of which would be available to both Divisions and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs, i.e., FICC would not have two separate Corporate Contributions, one for each Division. In the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution would be applied to that Division up to the amount then available. If a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution would be applied to the respective Divisions in the same proportion that the aggregate Average RFDs (as defined below and in the proposed rule change) of all members in that Division bear to the aggregate Average RFDs of all members in both Divisions.<sup>14</sup>

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<sup>13</sup> FICC believes that two hundred and fifth (250) Business Days would be a reasonable estimate of the time frame that FICC would require to replenish the Corporate Contribution by equity in accordance with FICC's Clearing Agency Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

<sup>14</sup> FICC believes that if a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, allocating the Corporate Contribution ratably between the two Divisions based on the aggregate Average RFDs of their respective members is appropriate because the aggregate Average

As compared to the current approach of applying “up to” a percentage of retained earnings to defaulting member losses, the proposed Corporate Contribution would be a fixed percentage of FICC’s General Business Risk Capital Requirement, which would provide greater transparency and accessibility to members. The proposed Corporate Contribution would apply not only towards losses and liabilities arising out of or relating to Defaulting Member Events but also those arising out of or relating to Declared Non-Default Loss Events, which is consistent with the current industry guidance that “a CCP should identify the amount of its own resources to be applied towards losses arising from custody and investment risk, to bolster confidence that participants’ assets are prudently safeguarded.”<sup>15</sup>

Under current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4, FICC has the discretion to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by FICC as result of the failure of a Defaulting Member to fulfill its obligations to FICC. This option would be retained and expanded under the proposal so that it would be clear that FICC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of the Divisions, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

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RFDs of all members in a Division represent the amount of risks that those members bring to FICC over the look-back period of seventy (70) Business Days.

<sup>15</sup> See Resilience of central counterparties (CCPs): Further guidance on the PFMI, issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, at 42 (July 2017), available at [www.bis.org/cpmi/publ/d163.pdf](http://www.bis.org/cpmi/publ/d163.pdf).

The proposed rule changes relating to the calculation and application of Corporate Contribution are set forth in proposed Sections 7 and 7a of GSD Rule 4 and Sections 7 and 7a of MBSD Rule 4, as further described below.

(2) Introducing an Event Period.

In order to clearly define the obligations of each Division and its respective Members regarding loss allocation and to balance the need to manage the risk of sequential loss events against members' need for certainty concerning their maximum loss allocation exposures, FICC is proposing to introduce the concept of an "Event Period" to the GSD Rules and the MBSD Rules to address the losses and liabilities that may arise from or relate to multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession in a Division. Specifically, the proposal would group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) Business Days ("Event Period") for purposes of allocating losses to Members of the respective Divisions in one or more rounds (as described below), subject to the limitations of loss allocation set forth in the proposed rule change and as explained below.<sup>16</sup> In the case of a loss or liability arising from or relating to a Defaulting Member Event, an Event Period would begin on the day one or both Divisions notify their respective members that FICC has ceased to act<sup>17</sup> for the GSD

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<sup>16</sup> FICC believes that having a ten (10) Business Day Event Period would provide a reasonable period of time to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate certainty for members concerning their maximum exposure to mutualized losses with respect to such events.

<sup>17</sup> Supra note 7.



Defaulting Member and/or the MBSD Defaulting Member (or the next Business Day, if such day is not a Business Day). In the case of a loss or liability arising from or relating to a Declared Non-Default Loss Event, an Event Period would begin on the day that FICC notifies members of the respective Divisions of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Defaulting Member Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for Defaulting Member Events or Declared Non-Default Loss Events occurring during overlapping ten (10) Business Day periods.

The amount of losses that may be allocated by each Division, subject to the required Corporate Contribution, and to which a Loss Allocation Cap would apply for any member that elects to withdraw from membership in respect of a loss allocation round, would include any and all losses from any Defaulting Member Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.<sup>18</sup>

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<sup>18</sup> As discussed below, each Tier One Netting Member or Tier One Member, as applicable, that is a Tier One Netting Member or Tier One Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period.

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

(3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Tier One Netting Members or Tier One Members, as applicable (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. FICC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice (as defined below and in the proposed rule change) in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4.

Each loss allocation would be communicated to Tier One Netting Members or Tier One Members, as applicable, by the issuance of a notice that advises the Tier One Netting Members or Tier One Members, as applicable, of the amount being allocated to them (“Loss Allocation Notice”). Each Tier One Netting Member’s or Tier One Member’s, as applicable, pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the member has been a member (each member’s “Average RFD”),

divided by (ii) the sum of Average RFD amounts of all members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Netting Member or Tier One Member, as applicable, in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to notify FICC of its election to withdraw from membership with GSD or MBSD, as applicable, pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, and thereby benefit from its Loss Allocation Cap.<sup>19</sup> The “Loss Allocation Cap” of a Tier One Netting Member or Tier One Member, as applicable, would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

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<sup>19</sup> Pursuant to current Section 7(g) of GSD Rule 4 and MBSD Rule 4, the time period for a member to give notice, pursuant to Section 13 of GSD Rule 3 and MBSD Rule 3, of its election to terminate its membership in GSD or MBSD, as applicable, in respect of an allocation arising from any Remaining Loss allocated by FICC pursuant to Section 7(d) of GSD Rule 4 or Section 7(e) of MBSD Rule 4, as applicable, and any Other Loss, is the Close of Business on the Business Day on which the loss allocation payment is due to FICC. Current Section 13 of GSD Rule 4 and MBSD Rule 4 requires a 10-day notice period. Supra note 5.

FICC believes that it is appropriate to shorten such time period from 10 days to five (5) Business Days because FICC needs timely notice of which Tier One Netting Members or Tier One Members, as applicable, would remain in its membership for purpose of calculating the loss allocation for any subsequent round. FICC believes that five (5) Business Days would provide Tier One Netting Members or Tier One Members, as applicable, with sufficient time to decide whether to cap their loss allocation obligations by withdrawing from their membership in GSD or MBSD, as applicable.

After a first round of loss allocations with respect to an Event Period, only Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would be subject to further loss allocation with respect to that Event Period.

The amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Tier One Netting Members or Tier One Members, as applicable, in a second or subsequent round if Tier One Netting Members or Tier One Members, as applicable, elect to withdraw from membership with GSD or MBSD, as applicable, as provided in proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if FICC has a \$5 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Tier One Netting Members or Tier One Members, as applicable, subject to the loss allocation is \$4 billion, the first round would begin when FICC issues the first Loss Allocation Notice for that Event Period. FICC could issue one or more Loss Allocation Notices for the first round until the sum of losses allocated equals \$4 billion. Once the \$4 billion is allocated, the first round would end and FICC would need a second round in order to allocate the remaining \$1 billion of loss. FICC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Tier One Netting Members or Tier One Members, as applicable, the option to limit their loss allocation exposure at the beginning of each round. As proposed and as described further below, a Tier One Netting Member or Tier One Member, as applicable, could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to withdraw from membership within five (5) Business Days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

- (4) Implementing a revised “look-back” period to calculate a member’s loss allocation pro rata share and its Loss Allocation Cap.

Currently, the GSD Rules and the MBSD Rules calculate a Tier One Netting Member’s or a Tier One Member’s pro rata share for purposes of loss allocation based on the member’s average daily Required Fund Deposit over the prior twelve (12) months (or such shorter period as may be available in the case of a member which has not maintained a deposit over such time period). The Rules currently do not anticipate the possibility of more than one Defaulting Member Event or Declared Non-Default Loss Event in quick succession.

GSD and MBSD are proposing to calculate each Tier One Netting Member’s or Tier One Member’s, as applicable, pro rata share of losses and liabilities to be allocated in any round (as described above and in the proposed rule change) to be equal to (i) the

member's Average RFD divided by (ii) the sum of Average RFD amounts for all members that are subject to loss allocation in such round.

Additionally, as described above and in the proposed rule change, if a Tier One Netting Member or Tier One Member, as applicable, withdraws from membership pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, GSD and MBSD are proposing that the member's Loss Allocation Cap be equal to the greater of (i) its Required Fund Deposit on the first day of the applicable Event Period or (ii) its Average RFD.

FICC believes that employing a revised look-back period of seventy (70) Business Days instead of twelve (12) months to calculate a Tier One Netting Member's or a Tier One Member's, as applicable, loss allocation pro rata share and Loss Allocation Cap is appropriate, because FICC recognizes that the current look-back period of twelve (12) months is a very long period during which a member's business strategy and outlook could have shifted significantly, resulting in material changes to the size of its portfolios. A look-back period of seventy (70) Business Days would minimize that issue yet still would be long enough to enable FICC to capture a full calendar quarter of such members' activities and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred.

The proposed rule changes relating to the implementation of the revised look-back period are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

(5) Capping withdrawing members' loss allocation exposure and related changes.

Currently, pursuant to Section 7(g) of GSD Rule 4 and MBSD Rule 4, a member can withdraw from membership in order to avail itself of a cap on loss allocation if the member notifies FICC via a written notice, in accordance with Section 13 of GSD Rule 3 or MBSD Rule 3, as applicable, of its election to terminate its membership. Such notice must be provided by the Close of Business on the Business Day on which the loss allocation payment is due to FICC and, if properly provided to FICC, would limit the member's liability for a loss allocation to its Required Fund Deposit for the Business Day on which the notification of allocation is provided to the member.<sup>20</sup> As discussed above, the proposed rule change would continue providing members the opportunity to limit their loss allocation exposure by offering withdrawal options; however, the cap on loss allocation would be calculated differently and the associated withdrawal process would also be modified as it relates to withdrawals associated with the loss allocation process. In particular, the proposed rule change would shorten the withdrawal notification period from 10 days to five (5) Business Days, as further described below.

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<sup>20</sup> Current Section 13 of GSD Rule 3 and MBSD Rule 3 requires a member to provide FICC with 10 days written notice of the member's termination; however, FICC, in its discretion, may accept such termination within a shorter notice period. Supra note 5.

As proposed, if a member timely provides notice of its withdrawal from membership in respect of a loss allocation round, the maximum amount of losses it would be responsible for would be its Loss Allocation Cap,<sup>21</sup> provided that the member complies with the requirements of the withdrawal process in proposed Section 7b of GSD Rule 4 and Section 7b of MBSD Rule 4.

Currently, pursuant to Section 7(g) of GSD Rule 4 and MBSD Rule 4, if notification is provided to a member that an allocation has been made against the member pursuant to GSD Rule 4 or MBSD Rule 4, as applicable, and that application of the member's Required Fund Deposit is not sufficient to satisfy such obligation to make payment to FICC, the member is required to deliver to FICC by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by FICC, that amount which is necessary to eliminate any such deficiency, unless the member elects to terminate its membership in FICC. To increase transparency of the timeframe under which FICC would require funds from members to satisfy their loss allocation obligations, FICC is proposing that members would receive two (2) Business Days' notice of a loss allocation, and members would be required to pay the requisite amount no later than the second Business Day following issuance of such notice.<sup>22</sup> Members would have five (5) Business Days<sup>23</sup> from the

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<sup>21</sup> If a member's Loss Allocation Cap exceeds the member's then-current Required Fund Deposit, it must still cover the excess amount.

<sup>22</sup> FICC believes that allowing members two (2) Business Days to satisfy their loss allocation obligations would provide Members sufficient notice to arrange funding, if necessary, while allowing FICC to address losses in a timely manner.

<sup>23</sup> Supra note 19.



issuance of the first Loss Allocation Notice in any round of an Event Period to decide whether to withdraw from membership.

Each round would allow a Tier One Netting Member or Tier One Member, as applicable, the opportunity to notify FICC of its election to withdraw from membership after satisfaction of the losses allocated in such round. Multiple Loss Allocation Notices may be issued with respect to each round to allocate losses up to the round cap.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Tier One Netting Members or Tier One Members, as applicable, included in the round. If a Tier One Netting Member or Tier One Member, as applicable, provides notice of its election to withdraw from membership, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover FICC's losses, a second round will be noticed to those members that did not elect to withdraw from membership in the previous round; however, as noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Tier One Netting Members or Tier One Members, as applicable, in a second or subsequent round if Tier One Netting Members or Tier One Members, as applicable, elect to withdraw from membership with GSD or MBSD, as applicable, as provided in proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, following the first Loss Allocation Notice in any round.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, a Tier One Netting Member or Tier One Member, as applicable, would need to follow the requirements in proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as

applicable, which would provide that the Tier One Netting Member or Tier One Member, as applicable, must: (i) specify in its Loss Allocation Withdrawal Notice an effective date of withdrawal, which date shall not be prior to the scheduled final settlement date of any remaining obligations owed by the member to FICC, unless otherwise approved by FICC, and (ii) as of the time of such member's submission of the Loss Allocation Withdrawal Notice, cease submitting transactions to FICC for processing, clearance or settlement, unless otherwise approved by FICC.

As proposed, a Tier One Netting Member or a Tier One Member, as applicable, that withdraws in compliance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under GSD Rule 4 or MBSD Rule 4, as applicable; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

The proposed rule changes are designed to enable FICC to continue the loss allocation process in successive rounds until all of FICC's losses are allocated. To the extent that the Loss Allocation Cap of a Tier One Netting Member or Tier One Member, as applicable, exceeds such member's Required Fund Deposit on the first day of an Event Period, FICC may in its discretion retain any excess amounts on deposit from the member, up to the Loss Allocation Cap of a Tier One Netting Member or Tier One Member, as applicable.

The proposed rule changes relating to capping withdrawing members' loss allocation exposure and related changes to the withdrawal process are set forth in

proposed Sections 7 and 7b of GSD Rule 4 and Sections 7 and 7b of MBSD Rule 4, as further described below.

B. Changes to Align Loss Allocation Rules

The proposed rule changes would align the loss allocation rules, to the extent practicable and appropriate, of the three DTCC Clearing Agencies so as to provide consistent treatment, especially for firms that are participants of two or more DTCC Clearing Agencies. As proposed, the loss allocation waterfall and certain related provisions, e.g., returning a former member's Clearing Fund, would be consistent across the DTCC Clearing Agencies to the extent practicable and appropriate. The proposed rule changes of FICC that would align loss allocation rules of the DTCC Clearing Agencies are set forth in proposed Sections 1, 5, 6, 10, and 11 of GSD Rule 4 and MBSD Rule 4, as further described below.

C. Clarifying Changes Relating to Loss Allocation

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to members. In particular, FICC is proposing the following changes relating to loss allocation to clarify members' obligations for Declared Non-Default Loss Events.

Aside from losses that FICC might face as a result of a Defaulting Member Event, FICC could incur non-default losses incident to each Division's clearance and settlement business.<sup>24</sup> The GSD Rules and the MBSD Rules currently permit FICC to apply

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<sup>24</sup> Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

Clearing Fund to non-default losses.<sup>25</sup> Section 5 of GSD Rule 4 and MBSD Rule 4 provides that the use of Clearing Fund deposits is limited to satisfaction of losses or liabilities of FICC, which includes losses or liabilities that are otherwise incident to the operation of the clearance and settlement business of FICC, although the application of Clearing Fund to such losses or liabilities is more limited under MBSD Rule 4 when compared to GSD Rule 4.<sup>26</sup> Section 7(f) of GSD Rule 4 and MBSD Rule 4 provides that any loss or liability incurred by the Corporation incident to its clearance and settlement business arising other than from a Remaining Loss shall be allocated among Tier One Netting Members or Tier One Members, as applicable, ratably, in accordance with their Average Required Clearing Fund Deposits.<sup>27</sup>

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<sup>25</sup> Arguably there is an ambiguity created by the first paragraph of Section 7 in both GSD Rule 4 and MBSD Rule 4, which suggests that losses or liabilities may only be allocated in a member default scenario, while Section 5 in both GSD Rule 4 and MBSD Rule 4 makes it clear that the applicable Division's Clearing Fund may be used to satisfy non-default losses.

<sup>26</sup> Section 5 of GSD Rule 4 provides that "The use of the Clearing Fund deposits shall be limited to satisfaction of losses or liabilities of the Corporation...otherwise incident to the clearance and settlement business of the Corporation..." Supra note 5.

Section 5 of MBSD Rule 4 provides that "The use of the Clearing Fund deposits and assets and property on which the Corporation has a lien on shall be limited to satisfaction of losses or liabilities of the Corporation...otherwise incident to the clearance and settlement business of the Corporation with respect to losses and liabilities to meet unexpected or unusual requirements for funds that represent a small percentage of the Clearing Fund..." Supra note 5.

<sup>27</sup> Section 7(f) of GSD Rule 4 provides that "Any loss or liability incurred by the Corporation incident to its clearance and settlement business...arising other than from a Remaining Loss (hereinafter, an "Other Loss") shall be allocated among Tier One Netting Members, ratably, in accordance with the respective amounts of their Average Required FICC Clearing Fund Deposits. Supra note 5.

If there is a failure of FICC following a non-default loss, such occurrence would affect members in much the same way as a failure of FICC following a Defaulting Member Event. Accordingly, FICC is proposing rule changes to enhance the provisions relating to non-default losses by clarifying members' obligations for such losses and aligning the non-default loss provisions in the GSD Rules and the MBSD Rules.

Specifically, for both the GSD Rules and the MBSD Rules, FICC is proposing enhancement of the governance around non-default losses that would trigger loss allocation to Tier One Netting Members or Tier One Members, as applicable, by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of FICC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Tier One Netting Members or Tier One Members, as applicable, in order to ensure that FICC may continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that FICC would then be required to promptly notify members of this determination (a "Declared Non-Default Loss Event"). In addition, FICC is proposing to better align the interest of FICC with those of its members by stipulating a mandatory Corporate Contribution apply to a Declared Non-Default Loss Event prior to any allocation of the loss among members, as described above. Additionally, FICC is

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Section 7(f) of MBSD Rule 4 provides that "Any loss or liability incurred by the Corporation incident to its clearance and settlement business...arising other than from a Remaining Loss (hereinafter, an "Other Loss"), shall be allocated among Tier One Members, ratably, in accordance with the respective amounts of their Average Required Clearing Fund Deposits. Supra note 5.

proposing language to clarify members' obligations for Declared Non-Default Loss Events.

Under the proposal, FICC would clarify the Rules of both Divisions to make clear that Tier One Netting Members or Tier One Members, as applicable, are subject to loss allocation for non-default losses (i.e., Declared Non-Default Loss Events under the proposal) and Tier Two Members are not subject to loss allocation for non-default losses.

The proposed rule changes relating to Declared Non-Default Loss Events and members' obligations for such events are set forth in proposed Section 7 of GSD Rule 4 and Section 7 of MBSD Rule 4, as further described below.

D. Amending Language Regarding FICC's Use of MBSD Clearing Fund

The proposed rule change would delete language currently in Section 5 of MBSD Rule 4 that limits certain uses by FICC of the MBSD Clearing Fund to "unexpected or unusual" requirements for funds that represent a "small percentage" of the MBSD Clearing Fund. FICC believes that these limiting phrases (which appear in connection with FICC's use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event as well as to cover certain liquidity needs) are vague and imprecise, and should be replaced in their entirety. Specifically, FICC is proposing to delete the limiting language with respect to FICC's use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event so as to not have such language be interpreted as impairing FICC's ability to access the MBSD Clearing Fund in order to manage non-default losses. FICC is also proposing to delete the limiting language with respect to FICC's use of

MBSD Clearing Fund to cover certain liquidity needs because the effect of the limitation in this context is confusing and unclear.

The proposed rule changes relating to FICC's use of MBSD Clearing Fund are set forth in proposed Section 5 of MBSD Rule 4, as further described below.

The foregoing changes as well as other changes (including a number of conforming and technical changes) that FICC is proposing in order to improve the transparency and accessibility of the Rules are described in detail below.

#### E. Loss Allocation Waterfall Comparison

The following example<sup>28</sup> illustrates the differences between the current and proposed loss allocation provisions:

##### Assumptions:

- (i) Firms A, B, and X are each a GSD Netting Member and an MBSD Clearing Member and are referred to as Member A, Member B, and Member X, respectively.
- (ii) Member A defaults on a Business Day (Day 1). On the same day, FICC ceases to act for Member A and notifies members of the cease to act. After liquidating Member A's portfolio and applying Member A's Clearing Fund deposit, FICC has a total loss of \$350 million, with \$200 million in GSD and \$150 million in MBSD.

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<sup>28</sup> For purposes of this example, FICC has assumed that no losses have arisen that apply to Tier Two Netting Members, Tier Two Members, or CCIT Members.

- (iii) Member X voluntarily retires from membership five (5) Business Days after FICC ceases to act for Member A (Day 6).
- (iv) Member B defaults seven (7) Business Days after FICC ceases to act for Member A (Day 8). On the same day, FICC ceases to act for Member B and notifies members of the cease to act. After liquidating Member B's portfolio and applying Member B's Clearing Fund deposit, FICC has a total loss of \$350 million, with \$200 million in GSD and \$150 million in MBSD.
- (v) The current FICC loss provisions require FICC to contribute up to 25% of its retained earnings as a corporate contribution. For the purposes of this example, it is assumed that FICC will contribute 25% of its retained earnings. The amount of FICC's retained earnings is \$176 million.
- (vi) FICC's General Business Risk Capital Requirement is \$98 million.

Current Loss Allocation:

Under the current loss allocation provisions, with respect to the losses arising out of Member A's default, FICC will contribute a total of \$44 million ( $\$176 \text{ million} * 25\%$ ) from retained earnings,<sup>29</sup> with approximately \$25 million ( $\$44 \text{ million} * (\$200 \text{ million} / \$350 \text{ million})$ ) for GSD and approximately \$19 million ( $\$44 \text{ million} * (\$150$

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<sup>29</sup> The retained earnings are applied to the respective Divisions in the same proportion that the losses of that Division bear to the total losses of both Divisions.



million/\$350 million)) for MBSD. FICC will then allocate the remaining GSD loss of \$175 million (\$200 million - \$25 million) to GSD Tier One Netting Members and the remaining MBSD loss of \$131 million (\$150 million - \$19 million) to MBSD Tier One Members.

With respect to losses arising out of Member B's default, FICC will contribute a total of approximately \$33 million ( $(\$176 \text{ million} - \$44 \text{ million}) * 25\%$ ) from retained earnings, with approximately \$19 million ( $\$33 \text{ million} * (\$200 \text{ million}/\$350 \text{ million})$ ) for GSD and approximately \$14 million ( $\$33 \text{ million} * (\$150 \text{ million}/\$350 \text{ million})$ ) for MBSD. FICC will then allocate the remaining GSD loss of \$181 million (\$200 million - \$19 million) to GSD Tier One Netting Members and the remaining MBSD loss of \$136 million (\$150 million - \$14 million) to MBSD Tier One Members.

Altogether, with respect to losses arising out of defaults of Member A and Member B, FICC will contribute a total of approximately \$77 million of retained earnings, with approximately \$44 million for GSD and approximately \$33 million for MBSD. FICC will allocate losses of \$356 million to GSD Tier One Netting Members and \$267 million to MBSD Tier One Members.

Proposed Loss Allocation:

Under the proposed loss allocation provisions, a Defaulting Member Event with respect to Member A's default would have occurred on Day One, and a Defaulting Member Event with respect to Member B's default would have occurred on Day 8. Because the Defaulting Member Events occurred during a 10-business day period, they would be grouped together into an Event Period for purposes of allocating losses to

members. The Event Period would begin on the 1<sup>st</sup> business day and end on the 10<sup>th</sup> business day.

With respect to losses arising out of Member A's default, FICC would apply a Corporate Contribution of \$49 million ( $\$98 \text{ million} * 50\%$ ),<sup>30</sup> with approximately \$32 million ( $\$49 \text{ million} * (\$10 \text{ billion}/\$15.2 \text{ billion})$ ) for GSD and approximately \$17 million ( $\$49 \text{ million} * (\$5.2 \text{ billion}/\$15.2 \text{ billion})$ ) for MBSD. FICC would then allocate the remaining GSD loss of \$168 million ( $\$200 \text{ million} - \$32 \text{ million}$ ) to GSD Tier One Netting Members and the remaining MBSD loss of \$133 million ( $\$150 \text{ million} - \$17 \text{ million}$ ) to MBSD Tier One Members. With respect to losses arising out of Member B's default, FICC would not apply a Corporate Contribution since it would have already contributed the maximum Corporate Contribution of 50% of its General Business Risk Capital Requirement. With respect to losses arising out of Member B's default, FICC would allocate the GSD loss of \$200 million to GSD Tier One Netting Members and the MBSD loss of \$150 million to MBSD Tier One Members. Because Member X was a member in both Divisions on the first day of the Event Period, Member X would be subject to loss allocation with respect to all events occurring during the Event Period, even if the event occurred after its retirement. Therefore, Member X would be subject to loss allocation with respect to Member B's default.

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<sup>30</sup> The Corporate Contribution would be applied to the respective Divisions in the same proportion that the aggregate Average RFDs of all members in that Division bear to the aggregate Average RFDs of all members in both Divisions. For the purposes of this example, FICC has assumed that the aggregate Average RFDs of all GSD members is \$10 billion and the aggregate Average RFDs of all MBSD members is \$5.2 billion.

Altogether, with respect to losses arising out of defaults of Member A and Member B, FICC would apply a Corporate Contribution of \$49 million, with approximately \$32 million for GSD and approximately \$17 million for MBSD. FICC would allocate losses of \$368 million to GSD Tier One Netting Members and \$283 million to MBSD Tier One Members.

The principal differences in the above example are due to (i) the proposed changes to the calculation and application of the Corporate Contribution and (ii) the proposed introduction of an Event Period.

(ii) Detailed Description of the Proposed Rule Changes Related to Loss Allocation

A. Proposed Changes to GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD Rule 4 (Clearing Fund and Loss Allocation)

*Overview of GSD Rule 4 and MBSD Rule 4*

GSD Rule 4 and MBSD Rule 4 currently address Clearing Fund requirements and loss allocation obligations, as well as permissible uses of the Clearing Fund. These Rules address the various Clearing Fund calculations for each Division's Clearing Fund and set forth rights, obligations and other aspects associated with each Division's Clearing Fund, as well as each Division's loss allocation process. GSD Rule 4 and MBSD Rule 4 are each currently organized into 12 sections. Sections of these Rules that FICC is proposing to change are described below.

*Section 1 of GSD Rule 4 and MBSD Rule 4*

Currently, Section 1 of GSD Rule 4 and MBSD Rule 4 set forth the requirement that each GSD Netting Member and each MBSD Clearing Member make and maintain a deposit to the Clearing Fund at the minimum level set forth in the respective Rule 4 and

note that the timing of such payment is set forth in another section of the respective Rule 4. Current Section 1 of the respective rule also provides that the deposits to the Clearing Fund will be held by FICC or its designated agents. Current Section 1 of MBSD Rule 4 also defines the term “Transaction” for purposes of MBSD Rule 4 and references a Member’s obligation to replenish the deficit in its Required Fund Deposit if it is charged by FICC under certain circumstances.

FICC is proposing to rename the subheading of Section 1 of Rule 4 in both the GSD Rules and MBSD Rules from “General” to “Required Fund Deposits” and to restructure the wording of the provisions for clarity and readability.

Under the proposed rule change, Section 1 of GSD Rule 4 and Section 1 of MBSD Rule 4 would continue to have the same provisions as they relate to Netting Members or Clearing Members, as applicable, except for the following: (i) the language throughout the sections would be reorganized, streamlined and clarified, and (ii) language would be added regarding additional deposits maintained by the Netting Members or Clearing Members, as applicable, at FICC, and highlight for members that such additional deposits would be deemed to be part of the Clearing Fund and the member’s Actual Deposit (as discussed below and as defined in the proposed rule change) but would not be deemed to be part of the member’s Required Fund Deposit.

The proposed language regarding maintenance of a member’s Actual Deposit would also make it clear that FICC will not be required to segregate such deposit, but shall maintain books and records concerning the assets that constitute each member’s Actual Deposit.

In addition, FICC proposes a technical change to update a cross reference in Section 1 of GSD Rule 4 and MBSD Rule 4.

Furthermore, in Section 1 of MBSD Rule 4, FICC is proposing to move the definition of “Transactions” to proposed Section 2(a) of MBSD Rule 4, where the first usage of “Transactions” in MBSD Rule 4 appears. FICC is also proposing to delete the last sentence in Section 1 of MBSD Rule 4, which references a Member’s obligation to replenish the deficit in its Required Fund Deposit if it is charged by FICC under certain circumstances, because it would no longer be relevant under the proposed rule change to Section 7 of MBSD Rule 4, as FICC would require members to pay their loss allocation amounts instead of charging their Required Fund Deposits for Clearing Fund losses.

*Section 2 of GSD Rule 4 and MBSD Rule 4*

Current Section 2 of GSD Rule 4 and MBSD Rule 4 set forth more detailed requirements pertaining to members’ Required Fund Deposits. FICC is proposing to rename the subheadings in these sections from “Required Fund Deposit” to “Required Fund Deposit Requirements” in order to better reflect the purpose of this section.

In addition, FICC is proposing to expand the definition of “Legal Risk” in both the GSD and MBSD provisions (current Section 2(e) of GSD Rule 4 and Section 2(f) of MBSD Rule 4) by revising the parameters of Legal Risk so that it would not be limited to laws applicable to a member’s insolvency or bankruptcy, as FICC believes that Legal Risk may arise outside the context of an insolvency or bankruptcy event regarding a member, and FICC should be permitted to adequately protect itself in those non-insolvency/bankruptcy circumstances as well.

For better organization of Rule 4, FICC is also proposing to relocate the provision on minimum Clearing Fund cash requirements (current Section 2(b) of GSD Rule 4 and Section 2(d) of MBSD Rule 4) to the section in each of GSD Rule 4 and MBSD Rule 4 dealing specifically with the form of Clearing Fund deposits (proposed Section 3 of GSD Rule 4 and MBSD Rule 4). This would necessitate the re-lettering of the provisions in Section 2. In addition, as stated above, the provision regarding the definition of “Transactions” for purposes of MBSD Rule 4 would be moved to proposed Section 2(a) from current Section 1.

FICC is proposing technical changes to correct typographical errors in current Section 2 of GSD Rule 4.

*Sections 3, 3a and 3b of GSD Rule 4 and MBSD Rule 4*

Currently, Sections 3, 3a and 3b of GSD Rule 4 and MBSD Rule 4 address the permissible form of Clearing Fund deposits and contain detailed requirements regarding each form. FICC is proposing changes to improve the readability of these sections.

In addition, for better organization of the subject matter, FICC is proposing to move certain paragraphs from one section to another, including (i) moving clauses (b) and (d) in current Section 2 of GSD Rule 4 and MBSD Rule 4, respectively, to proposed Section 3 of GSD Rule 4 and MBSD Rule 4 and (ii) moving the last paragraph of current Section 3 in GSD Rule 4 and MBSD Rule 4 to proposed Section 3b of GSD Rule 4 and MBSD Rule 4.

Under the proposed rule change, FICC is also proposing to update the cash investment provision in Section 3a of GSD Rule 4 and MBSD Rule 4 to reflect the

Clearing Agency Investment Policy adopted by FICC<sup>31</sup> and to define Clearing Fund Cash as (i) cash deposited by a Netting Member or Clearing Member, as applicable, as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to FICC secured by the pledge by FICC of Eligible Clearing Fund Securities pledged to FICC or (y) any sales of Eligible Clearing Fund Securities pledged to FICC, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit. Lastly, FICC is proposing technical changes to correct typographical errors in current Section 3 of MBSD Rule 4 and current Section 3b of GSD Rule 4.

*Section 4 of GSD Rule 4 and MBSD Rule 4*

Currently, Section 4 of GSD Rule 4 and MBSD Rule 4 address the granting of a first priority perfected security interest by each Netting Member or Clearing Member, as applicable, in all assets and property placed by the member in the possession of FICC (or its agents acting on its behalf). FICC is not proposing any substantive changes to these

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<sup>31</sup> See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-FICC-2016-005). The Clearing Agency Investment Policy (the “Policy”) governs the management, custody, and investment of cash deposited to the GSD and MBSD Clearing Funds, the proprietary liquid net assets (cash and cash equivalents) of FICC and other funds held by FICC. The Policy sets forth guiding principles for the investment of those funds, which include adherence to a conservative investment philosophy that places the highest priority on maximizing liquidity and avoiding risk, as well as mandating the segregation and separation of funds. The Policy also addresses the process for evaluating credit ratings of counterparties and identifies permitted investments within specified parameters. In general, assets are required to be held by regulated and creditworthy financial institution counterparties and invested in financial instruments that, with respect to the GSD and MBSD Clearing Funds, may include deposits with banks, including the Federal Reserve Bank of New York, collateralized reverse-repurchase agreements, direct obligations of the U.S. government and money-market mutual funds.

sections except for streamlining the provisions for readability and clarity, and adding “Actual Deposit” as a defined term to refer to Eligible Clearing Fund Securities, funds and assets pledged to FICC to secure any and all obligations and liabilities of a Netting Member or a Clearing Member, as applicable, to FICC.

*Section 5 of GSD Rule 4 and MBSD Rule 4*

Currently, Section 5 of GSD Rule 4 and MBSD Rule 4 describe the use of each Division’s Clearing Fund. FICC is proposing to rename the subheading of this section from “Use of Deposits and Payments” to “Use of Clearing Fund” to better reflect the purpose of the section.

Under the proposed rule change, FICC is also proposing changes to streamline this section for clarity and readability and to align the GSD Rules and MBSD Rules. Specifically, FICC is proposing to delete the first paragraph of current Section 5 of GSD Rule 4 and MBSD Rule 4 and replace it with clearer language that sets forth the permitted uses of each Division’s Clearing Fund. Specifically, the proposed Section 5 of GSD Rule 4 and MBSD Rule 4 provides that each Division’s Clearing Fund would only be used by FICC (i) to secure each member’s performance of obligations to FICC, including, without limitation, each member’s obligations with respect to any loss allocations as set forth in proposed Section 7 of GSD Rule 4 and MBSD Rule 4 and any obligations arising from a Cross-Guaranty Agreement pursuant to GSD Rule 41 or MBSD Rule 32, as applicable, or a Cross-Margining Agreement pursuant to GSD Rule 43, (ii) to provide liquidity to FICC to meet its settlement obligations, including, without limitation, through the direct use of cash in the GSD Clearing Fund or MBSD Clearing Fund, as applicable, or through the pledge or rehypothecation of pledged Eligible



Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in proposed Section 3a of GSD Rule 4 and MBSD Rule 4.

The current first paragraph of Section 5 of GSD Rule 4 and MBSD Rule 4 provides that if FICC pledges, hypothecates, encumbers, borrows, or applies any part of the respective Division's Clearing Fund deposits to satisfy any liability, obligation, or liquidity requirements for more than thirty (30) days, FICC, at the Close of Business on the 30<sup>th</sup> day (or on the first Business Day thereafter) will consider the amount used as an actual loss to the respective Division's Clearing Fund and immediately allocate such loss in accordance with Section 7 of GSD Rule 4 or MBSD Rule 4, as applicable. As proposed, FICC would retain this provision conceptually but replace it with clearer and streamlined language that provides that each time FICC uses any part of the respective Division's Clearing Fund for more than 30 calendar days to provide liquidity to FICC to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, FICC, at the Close of Business on the 30<sup>th</sup> calendar day (or on the first Business Day thereafter) from the day of such use, would consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with proposed Section 7 of GSD Rule 4 or MBSD Rule 4, as applicable.

The proposed rule change also includes deleting language currently in Section 5 of MBSD Rule 4 that limits certain uses by FICC of the MBSD Clearing Fund to "unexpected or unusual" requirements for funds that represent a "small percentage" of the MBSD Clearing Fund. FICC believes that these limiting phrases (which appear in

connection with FICC's use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event as well as to cover certain liquidity needs) are vague and imprecise, and should be replaced in their entirety. Specifically, FICC is proposing to delete the limiting language with respect to FICC's use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside of an MBSD Defaulting Member Event so as to not have such language be interpreted as impairing FICC's ability to access the MBSD Clearing Fund in order to manage non-default losses. FICC is also proposing to delete the limiting language with respect to FICC's use of MBSD Clearing Fund to cover certain liquidity needs because the effect of the limitation in this context is confusing and unclear.

In addition, FICC is proposing to delete the last paragraph in current Section 5 of GSD Rule 4 and MBSD Rule 4 because these paragraphs address the application of a member's deposits to the applicable Clearing Fund to cover the allocation of a loss or liability incurred by FICC. These paragraphs would no longer be relevant, because, under the proposed Section 7 of GSD Rule 4 and MBSD Rule 4 (discussed below), FICC would not apply the member's deposit to the Clearing Fund unless the member does not satisfy payment of its allocated loss amount within the required timeframe. These paragraphs also currently include provisions regarding other agreements, such as a Cross-Guaranty Agreement, that pertain to a Defaulting Member, and such provisions would now be covered by proposed Section 6 of GSD Rule 4 and MBSD Rule 4.

Section 6 of GSD Rule 4 and MBSD Rule 4

Currently, Section 6 of GSD Rule 4 and MBSD Rule 4 are reserved for future use. FICC is proposing to use this section for provisions relating to the application of deposits to the respective Division's Clearing Fund and other amounts held by FICC to a Defaulting Member's obligations.

FICC is proposing to add a subheading of "Application of Clearing Fund Deposits and Other Amounts to Defaulting Members' Obligations" to Section 6 of GSD Rule 4 and MBSD Rule 4. Under the proposed rule change, for better organization by subject matter, FICC is also proposing to relocate certain provisions to these sections from the respective current Section 7 of GSD Rule 4 and MBSD Rule 4, which addresses FICC's application of Clearing Fund deposits and other assets held by FICC securing a Defaulting Member's obligations to FICC.

For additional clarity and for consistency with the loss allocation rules of the other DTCC Clearing Agencies, FICC proposes to add a provision which makes it clear that, if FICC applies a Defaulting Member's Clearing Fund deposits, FICC may take any and all actions with respect to the Defaulting Member's Actual Deposits, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that FICC determines is appropriate.

Sections 7, 7a and 7b of GSD Rule 4 and MBSD Rule 4

Current Section 7 of GSD Rule 4 and MBSD Rule 4 contains FICC's current loss allocation waterfall for losses or liabilities incurred by FICC. With respect to any loss or liability incurred by FICC as the result of the failure of a Defaulting Member to fulfill its obligations to FICC, the loss allocation waterfall for each Division currently provides:

- (i) Application of any Clearing Fund deposits and other collateral held by FICC securing a Defaulting Member's obligations to FICC and additional resources as are applicable to the Defaulting Member.
- (ii) If a loss or liability remains after the application of the Defaulting Member's collateral and resources, FICC would apply up to 25% of FICC's existing retained earnings, or such higher amount as the Board of Directors determines.
- (iii) If a loss or liability still remains after the application of the retained earnings, FICC would apply the loss or liability to members as follows:
  - (a) If the remaining loss or liability is attributable to Tier One Netting Members or Tier One Members, as applicable, then FICC will allocate such loss or liability to Tier One Netting Members or Tier One Members, as applicable, by assessing the Required Fund Deposit maintained by each such member an amount up to \$50,000, in an equal basis per Tier One Netting Member or Tier One Member, as applicable.
  - (b) If the remaining loss or liability is attributable to Tier Two Members, then FICC will allocate such loss or liability to Tier Two Members based upon their trading activity with the Defaulting Member that resulted in a loss.
- (iv) If there is any loss or liability that still remains after the application of (ii) and (iii) above that is attributable to Tier One Netting Members or Tier One Members, as applicable, then FICC will allocate such loss or liability

among Tier One Netting Members or Tier One Members, as applicable, ratably based on the amount of each Tier One Netting Member's or Tier One Member's Required Fund Deposit and based on the average daily level of such deposit over the prior twelve (12) months (or such shorter period as may be available if the member has not maintained a deposit over such time period).

Current Section 7(f) of GSD Rule 4 and MBSD Rule 4 also provides that Other Losses shall be allocated among Tier One Netting Members or Tier One Members, as applicable, ratably in accordance with the respective amounts of each Tier One Netting Member's or Tier One Member's Required Fund Deposit and based on the average daily level of such deposit over the prior twelve (12) months (or such shorter period as may be available if the member has not maintained a deposit over such time period).

Currently, pursuant to Section 7(e) of GSD Rule 4, an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Broker Account, will not be subject to an aggregate allocation loss for any single loss-allocation event that exceeds \$5 million. FICC believes that it is appropriate for GSD to retain this cap under the proposed rule change because the Inter-Dealer Broker Netting Members are required to limit their business as provided in Section 8(e) of GSD Rule 3, which would in turn minimize the potential losses or liabilities that could be incurred by FICC from Inter-Dealer Broker Netting Members.<sup>32</sup> FICC believes that it is also appropriate for

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<sup>32</sup> Pursuant to Section 8(e) of GSD Rule 3, an Inter-Dealer Broker Netting Member is required to (A) limit its business to acting exclusively as a broker, (B) conduct all of its business in Repo Transactions with Netting Members, and (C) conduct at least 90 percent of its business in transactions that are not Repo Transactions with Netting Members. If an Inter-Dealer Broker Netting Member fails to comply with

GSD to retain this cap under the proposed rule change for Non-IDB Repo Brokers because their activity in their respective Segregated Broker Accounts would be subject to similar limitations as the Inter-Dealer Broker Netting Members. However, the proposal would apply the cap to an Event Period instead of a single loss event in order to conform with the concept of the Event Period under the proposal. FICC believes applying the cap to an Event Period would continue to reasonably represent the risk profiles of the Inter-Dealer Broker Netting Members, and Non-IDB Repo Brokers with respect to their Segregated Broker Accounts, because they submit affirmed trades from their systems to GSD, with each trade already matched to the counterparty that will ultimately deliver or receive the securities. Therefore, Inter-Dealer Broker Netting Members, and Non-IDB Repo Brokers with respect to their Segregated Broker Accounts, do not generally maintain positions with FICC and present minimal risk to FICC. FICC is also proposing technical changes to replace (i) the term “Segregated Broker Account” with “Segregated Repo Account” and (ii) the term “Non-IDB Broker” with “Non-IDB Repo Broker,” both of which are the correct terms defined in GSD Rule 1.

Current Section 7(g) of GSD Rule 4 and MBSD Rule 4 further provides that if the Required Fund Deposit of the member being allocated the loss is not sufficient to satisfy its loss allocation obligation, the member is required to deliver to FICC an amount that is necessary to eliminate the deficiency by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by FICC. Under the current Rules, a member may elect to terminate its

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these requirements, then the Inter-Dealer Broker Netting Member shall be considered by FICC as a Dealer Netting Member. Supra note 5.

membership, which would limit its loss allocation to the amount of its Required Fund Deposit for the Business Day on which the notification of such loss allocation is provided to the member. If the member does not elect to terminate its membership and fails to satisfy its Required Fund Deposit within the timeframe specified in the Rules, FICC will cease to act generally with regard to such member pursuant to GSD Rules 21 and 22A or MBSD Rules 14 and 17, as applicable, and may take disciplinary action against such member pursuant to GSD Rule 48 or MBSD Rule 38, as applicable.

Current Section 7(h) of GSD Rule 4 and MBSD Rule 4 requires FICC to promptly notify members and the Commission of the amount involved and the causes if a Remaining Loss or Other Loss occurs. In addition, current Section 7(i) of GSD Rule 4 and MBSD Rule 4 also provides that any increase in Clearing Fund deposit as required by subsection (f) of current Section 2 of GSD Rule 4 or provisions of MBSD Rule 4 regarding special charges or other premiums will not be taken into account when calculating loss allocation based on a GSD Member's Average Required FICC Clearing Fund Deposit amount or an MBSD Member's Average Required Fund Deposit amount, as applicable, under current Section 7 of GSD Rule 4 and MBSD Rule 4.

Under the proposed rule change, FICC is proposing to rename the subheading of Section 7 of GSD Rule 4 and MBSD Rule 4 to "Loss Allocation Waterfall, Off-the-Market Transactions." In addition, FICC is proposing to restructure its loss allocation waterfall as described below.

For better organization of the subject matter, FICC is proposing to move certain paragraphs from one section to another, including (i) relocating the last sentence of current Section 7(h) of GSD Rule 4 and MBSD Rule 4 regarding recovery of allocated

losses or liabilities by FICC to the fifth paragraph of proposed Section 7 of GSD Rule 4 and MBSD Rule 4, (ii) relocating from current Section 7(a) of GSD Rule 4 and MBSD Rule 4 provisions which address FICC's application of Clearing Fund deposits and other assets held by FICC securing a Defaulting Member's obligations to FICC to proposed Section 6 of GSD Rule 4 and MBSD Rule 4, (iii) relocating from current Section 7 of GSD Rule 4 to proposed Section 6 of GSD Rule 4 the provision regarding FICC's right to treat certain payments to an FCO under a Cross-Margining Guaranty as a loss to be allocated, (iv) relocating the provisions in current Section 7(i) of GSD Rule 4 and MBSD Rule 4 regarding certain increases in Clearing Fund deposits not being taken into account when calculating loss allocation so that such provisions would come right after the loss allocation calculation provision, with an updated reference to proposed renumbered Sections 2(d) and 2(e) in GSD Rule 4 and MBSD Rule 4, respectively, and (v) relocating the provision regarding withdrawing members reapplying to become members<sup>33</sup> in the

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<sup>33</sup> Current Section 7(g) of GSD Rule 4 provides that a Member that elects to terminate its membership pursuant to alternative (ii) in Section 7(g) of GSD Rule 4 in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Comparison-Only Member or a Netting Member unless, prior to submitting such application, it makes the payment to FICC provided for in alternative (i) in Section 7(g) of GSD Rule 4, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Remaining Loss or Other Loss was incurred by FICC until the date of such payment. Supra note 5.

Current Section 7(g) of MBSD Rule 4 provides that a Member that elects to terminate its membership pursuant to alternative (ii) in Section 7(g) of MBSD Rule 4 in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Clearing Member unless, prior to submitting such application, it makes the payment to FICC provided for in alternative (i) in Section 7(g) of MBSD Rule 4, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Remaining Loss or Other Loss was incurred by FICC until the date of such payment. Supra note 5.



second paragraph of current Section 7(g) of GSD Rule 4 and MBS Rule 4 to come right after the paragraph regarding the election of a Tier One Netting Member or Tier One Member, as applicable, to withdraw from membership in proposed Section 7 of GSD Rule 4 and MBS Rule 4. Furthermore, in order to enhance readability and clarity, FICC is proposing a number of changes to streamline the language in these provisions.

In Section 7 of GSD Rule 4 and MBS Rule 4, as applicable, FICC is proposing to make it clear that no loss allocation under proposed GSD Rule 4 or proposed MBS Rule 4, as applicable, would constitute a waiver of any claim FICC may have against a member for any losses or liabilities to which the member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under proposed GSD Rule 4 or proposed MBS Rule 4, as applicable. FICC is proposing this change to preserve its legal rights and to make it clear to members that loss allocation under proposed GSD Rule 4 and proposed MBS Rule 4 would not be deemed as FICC waiving any claims it may have against a member for any losses or liabilities to which the member is subject under the Rules.

Under the proposal, Section 7 of GSD Rule 4 and MBS Rule 4 would make clear that the loss allocation waterfall applies to losses and liabilities (i) arising out of or

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The condition for re-application was historically in the rules of Government Securities Clearing Corporation (“GSCC”) (FICC’s predecessor) to solidify GSCC’s membership base and thereby discourage members from withdrawing from membership during a time of stress solely to avoid their loss allocation obligations. This condition was later incorporated into the GSD Rules and MBS Rules. In the interest of continuing to encourage members to remain in FICC central clearing in order to preserve the robustness of the Treasury and mortgage-backed securities markets, FICC would like to retain this condition for re-application in the GSD and MBS Rules as is. As the provision applies to a remote contingency and, without an immediate business need, NSCC and DTC would prefer not to add this provision at this time.

relating to a default of a member or (ii) otherwise incident to the clearance and settlement business of FICC (i.e., non-default losses). The loss allocation waterfall would be triggered if FICC incurs a loss or liability arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event.

As proposed, Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that, for the purposes of GSD Rule 4 or MBSD Rule 4, as applicable, the term “Defaulting Member” would mean a GSD Member or MBSD Member, as applicable, for which FICC has ceased to act pursuant to GSD Rule 21 or GSD Rule 22,<sup>34</sup> or MBSD Rule 14 or MBSD Rule 16,<sup>35</sup> as applicable, the term “Defaulting Member Event” would mean the determination by FICC to cease to act for a GSD Member or MBSD Member, as applicable, pursuant to GSD Rule 21 or GSD Rule 22, or MBSD Rule 14 or MBSD Rule 16, as applicable, and the term “Declared Non-Default Loss Event” would mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of FICC may be a significant and substantial loss or liability that may materially impair the ability of FICC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among members in order to ensure that FICC may continue to offer clearance and settlement services in an orderly manner.

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<sup>34</sup> FICC may cease to act for a GSD Member pursuant to any of the circumstances set forth under GSD Rule 21 (Restrictions on Access to Services) or GSD Rule 22 (Insolvency of a Member). Supra note 5.

<sup>35</sup> FICC may cease to act for an MBSD Member pursuant to any of the circumstances set forth under MBSD Rule 14 (Restrictions on Access to Services) or MBSD Rule 16 (Insolvency of a Member). Supra note 5.

As proposed, each member would be obligated to FICC for the entire amount of any loss or liability incurred by FICC arising out of or relating to any Defaulting Member Event with respect to such member. Under the proposal, to the extent that such loss or liability is not satisfied pursuant to proposed Section 6 of GSD Rule 4 or MBSD Rule 4, as applicable, FICC would apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other members, as provided in proposed Section 7 of GSD Rule 4 and MBSD Rule 4.

Under proposed Section 7 of GSD Rule 4 and MBSD Rule 4, the loss allocation waterfall would begin with a corporate contribution from FICC (“Corporate Contribution”), as is the case under the current Rules, but in a different form than under the current Section 7 of GSD Rule 4 and MBSD Rule 4 described above. Today, Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4 provide that, if FICC incurs any loss or liability as the result of the failure of a Defaulting Member to fulfill its obligations to FICC, FICC will contribute up to 25% of its existing retained earnings (or such higher amount as the Board of Directors shall determine), to such loss or liability; however, no corporate contribution from FICC is currently required for losses resulting other than those from Member impairments. Under the proposal, FICC would add a proposed new Section 7a to GSD Rule 4 and MBSD Rule 4 with a subheading of “Corporate Contribution” and define FICC’s Corporate Contribution with respect to any loss allocation pursuant to proposed Section 7 of GSD Rule 4 or MBSD Rule 4, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, as an amount that is equal to fifty (50) percent of the amount calculated by FICC in respect of its General Business Risk Capital Requirement as of the end of the calendar

quarter immediately preceding the Event Period.<sup>36</sup> The proposed rule change would specify that FICC's General Business Risk Capital Requirement, as defined in FICC's Clearing Agency Policy on Capital Requirements,<sup>37</sup> is, at a minimum, equal to the regulatory capital that FICC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>38</sup>

As proposed, if FICC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Defaulting Member Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the two hundred fifty (250) Business Days thereafter,<sup>39</sup> the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period. Proposed Section 7a of both GSD Rule 4 and MBSD Rule 4 would require FICC to notify members of any such reduction to the Corporate Contribution.

Proposed Section 7a to GSD Rule 4 and MBSD Rule 4 would also make clear that there would be one FICC Corporate Contribution, the amount of which would be available to both Divisions and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs, i.e., FICC would not have two separate Corporate Contributions, one for each Division. As proposed, in the event of a loss or liability relating to an Event Period, whether arising out of or relating to a

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<sup>36</sup> Supra note 9.

<sup>37</sup> Supra note 10.

<sup>38</sup> Supra note 11.

<sup>39</sup> Supra note 13.

Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution would be applied to that Division up to the amount then available. Under the proposal, if a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution would be applied to the respective Divisions in the same proportion that the aggregate Average RFDs of all members in that Division bears to the aggregate Average RFDs of all members in both Divisions.<sup>40</sup>

Currently, the Rules do not require FICC to contribute its retained earnings to losses and liabilities other than those from member defaults. Under the proposal, FICC would expand the application of its corporate contribution beyond losses and liabilities as the result of the failure of a Defaulting Member to fulfill its obligations to FICC. The proposed Corporate Contribution would apply to losses or liabilities relating to or arising out of Defaulting Member Events and Declared Non-Default Loss Events, and would be a mandatory loss contribution by FICC prior to any allocation of the loss among the applicable Division's members.

Current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4 provide FICC the option to contribute amounts higher than the specified percentage of retained earnings as determined by the Board of Directors, to any loss or liability incurred by FICC as the result of the failure of a Defaulting Member to fulfill its obligations to FICC. This option would be retained and expanded under the proposal to also cover non-default losses. Proposed Section 7a of GSD Rule 4 and MBSD Rule 4 would provide that

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<sup>40</sup> Supra note 14.

nothing in the Rules would prevent FICC from voluntarily applying amounts greater than the Corporate Contribution against any FICC loss or liability, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that FICC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or (ii) Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, FICC would allocate such losses and liabilities to members, as described below.

As proposed, Section 7 of GSD Rule 4 and MBSD Rule 4 would retain the differentiation in allocating losses to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members. Specifically, as is the case today, losses or liabilities that arise out of or relate to one or more Defaulting Member Events would be attributable to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members, while losses or liabilities that arise out of or relate to one or more Declared Non-Default Loss Events would only be attributable to Tier One Netting Members or Tier One Members, as applicable. Tier Two Members would not be subject to loss allocation with respect to Declared Non-Default Loss Events.

Under the proposal, FICC would delete the provision in current Section 7(h) of GSD Rule 4 and MBSD Rule 4 that requires FICC to promptly notify members and the

Commission of the amounts involved and the causes if a Remaining Loss or Other Loss occurs because such notification would no longer be necessary under the proposed rule change. Under the proposed rule change, FICC would notify members subject to loss allocation of the amounts being allocated to them in one or more Loss Allocation Notices for both Defaulting Member Events and Declared Non-Default Loss Events. As such, in order to conform to the proposed rule change, FICC is proposing to eliminate the notification to members regarding the amounts involved and the causes if a Remaining Loss or Other Loss occurs that is required under current Section 7(h) of GSD Rule 4 and MBSD Rule 4. FICC is also proposing to delete the notification to the Commission regarding the amounts involved and the causes if a Remaining Loss or Other Loss occurs as required in the same section. While as a practical matter, FICC would notify the Commission of a decision to loss allocate, FICC does not believe such notification needs to be specified in the Rules.

In addition, FICC is proposing to clarify the provision related to Off-the-Market Transactions so that it is clear that loss or liability of FICC in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member would be allocated to the Member that was the counterparty to such transaction.

*Tier One Netting Members/Tier One Members:*

For Tier One Netting Members or Tier One Members, as applicable, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would establish the concept of an “Event Period” to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) Business Days, which would be grouped into an Event

Period.<sup>41</sup> As stated above, both Defaulting Member Events or Declared Non-Default Loss Events could occur within the same Event Period.

Under the proposal, an Event Period with respect to a Defaulting Member Event would begin on the day FICC notifies members that it has ceased to act for the Defaulting Member (or the next Business Day, if such day is not a Business Day). In the case of a Declared Non-Default Loss Event, an Event Period would begin on the day that FICC notifies members of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would also retain the requirement of loss allocation among Tier One Netting Members or Tier One Members, as applicable, if a loss or liability remains after the application of the Corporate Contribution, as described above. In contrast to the current Section 7 where FICC would assess the Required Fund Deposits of Tier One Netting Members or Tier One Members, as applicable, to allocate losses, under the proposal, FICC would require Tier One Netting Members or Tier One Members, as applicable, to pay their loss allocation amounts (leaving their Required Fund Deposits intact).<sup>42</sup> Loss allocation obligations

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<sup>41</sup> Supra note 16.

<sup>42</sup> FICC believes that shifting from the two-step methodology of applying the respective Division's Clearing Fund and then requiring members to immediately replenish it to requiring direct payment would increase efficiency, while



would continue to be calculated based upon a Tier One Netting Member's or Tier One Member's, as applicable, pro rata share of losses and liabilities (although the pro rata share would be calculated differently than it is today), and Tier One Netting Members or Tier One Members, as applicable, would still retain the ability to voluntarily withdraw from membership and cap their loss allocation obligation (although the loss allocation obligation would also be calculated differently than it is today).

The proposed rule change to Section 7 of GSD Rule 4 and MBSD Rule 4 would clarify that each Tier One Netting Member or Tier One Member, as applicable, that is a Tier One Netting Member or Tier One Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. The proposal would make it clear that any Tier One Netting Member or Tier One Member, as applicable, for which FICC ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day,

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preserving the right to charge the member's Clearing Fund deposits in the event the member does not timely pay. Such a failure to pay would trigger recourse to the Clearing Fund deposits of the member under proposed Section 6 of GSD Rule 4 or MBSD Rule 4, as applicable. In addition, this change would provide greater stability for FICC in times of stress by allowing FICC to retain the respective Division's Clearing Fund, its critical prefunded resource, while charging loss allocations. FICC believes doing so would allow FICC to cover the respective Division's current credit exposures to its Members at all times. By retaining the GSD and MBSD Clearing Funds as proposed, FICC could use the Clearing Funds to secure the performance obligations of Members to their respective Division, including their payment obligation for any loss allocation, while maintaining access to prefunded resources. By being able to manage the respective Division's current credit exposures throughout the loss allocation process, FICC would be able to continue to provide its critical operations and services during what would be expected to be a stressful period.

shall be deemed to be a Tier One Netting Member or Tier One Member, as applicable, on the first day of that Event Period.

Under the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the round cap. When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. FICC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4.

As proposed, each loss allocation would be communicated to the Tier One Netting Members or Tier One Members, as applicable, by the issuance of a Loss Allocation Notice. Under the proposal, each Tier One Netting Member’s or Tier One Member’s, as applicable, pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the member’s Average RFD divided by (ii) the sum of Average RFD amounts of all members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Netting Member or Tier One Member, as applicable, in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to

notify FICC of its election to withdraw from membership with GSD or MBSD, as applicable, pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, and thereby benefit from its Loss Allocation Cap.<sup>43</sup> As proposed, the “Loss Allocation Cap” of a Tier One Netting Member or a Tier One Member, as applicable, would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

FICC is proposing to clarify that after a first round of loss allocation with respect to an Event Period, only Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would be subject to further loss allocation with respect to that Event Period.

As proposed, each such member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the member’s Average RFD, divided by (ii) the sum of the Average RFD amounts of all members subject to loss allocation in such round. Each such member would have a maximum payment obligation with respect to any loss allocation round that would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period or (y) its Average RFD (such amount would be each member’s “Loss Allocation Cap”). Therefore, the sum of the Loss Allocation Caps of the members subject to loss allocation would constitute the maximum amount that FICC would be permitted to allocate in each round. FICC would retain the loss allocation limit of \$5 million for Inter-Dealer Broker Netting Members, or Non-IDB

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<sup>43</sup> Supra note 19.

Repo Brokers with respect to activities in their Segregated Broker Accounts, as discussed above.

As proposed, Section 7 of GSD Rule 4 and MBSD Rule 4, would also provide that, to the extent that a Tier One Netting Member's or Tier One Member's, as applicable, Loss Allocation Cap exceeds such member's Required Fund Deposit on the first day of the applicable Event Period, FICC may, in its discretion, retain any excess amounts on deposit from the member, up to the Loss Allocation Cap of the Tier One Netting Member or Tier One Member, as applicable.

As proposed, Tier One Netting Members or Tier One Members, as applicable, would have two (2) Business Days after FICC issues a first round Loss Allocation Notice to pay the amount specified in any such notice.<sup>44</sup> On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because FICC was only able to allocate up to the round cap), these members would also have two (2) Business Days after notice by FICC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless the members have notified (or will timely notify) FICC of their election to withdraw from membership with respect to a prior loss allocation round.

Under the proposal, if a Tier One Netting Member or Tier One Member, as applicable, fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, FICC would have the right to proceed against such member as a Defaulting Member that has failed to satisfy an obligation in accordance with proposed Section 6 of GSD Rule 4 or MBSD Rule 4 described above. Members who wish to withdraw from membership would be required to comply with the requirements

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<sup>44</sup> Supra note 22.

in proposed Section 7b of GSD Rule 4 and MBSD Rule 4, described further below. Specifically, proposed Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that if, after notifying FICC of its election to withdraw from membership pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, the Tier One Netting Member or Tier One Member, as applicable, fails to comply with the provisions of proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, its notice of withdrawal would be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

FICC is proposing to delete the provisions in the current GSD Rule 4 and MBSD Rule 4 that require FICC to assess the Required Fund Deposit maintained by each Tier One Netting Member or Tier One Member, as applicable, an amount up to \$50,000, in an equal basis per such member, before allocating losses to Tier One Netting Members or Tier One Members, as applicable, ratably, in accordance with each such member's Required Fund Deposit and Average Required FICC Clearing Fund Deposit or Average Required Clearing Fund Deposit, as applicable. FICC believes that in the event of a loss or liability, this assessment is unlikely to alleviate the need for loss mutualization and creates an unnecessary administrative burden for each Division. FICC believes that moving straight to the loss mutualization described herein would be more practical. This proposed change would also streamline each Division's loss allocation waterfall processes and align such processes with those of the other DTCC Clearing Agencies.

*Tier Two Members:*

FICC is not proposing any substantive change to the provisions regarding Tier Two Members in current Section 7 of GSD Rule 4 and MBSD Rule 4, except to (i) add a

subheading of “Tier Two Members” in the beginning of these provisions for ease of identification and (ii) add a paragraph that makes it clear that if a Tier Two Member fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, FICC would have the right to proceed against such member as a Defaulting Member that has failed to satisfy an obligation in accordance with proposed Section 6 of GSD Rule 4 or MBSD Rule 4 described above, consistent with the proposed change regarding Tier One Netting Members or Tier One Members, as applicable.

*Withdrawal from Membership:*

Proposed Section 7b of GSD Rule 4 and MBSD Rule 4 would include the provisions regarding withdrawal from membership currently covered by Section 7(g) of GSD Rule 4 and MBSD Rule 4. FICC believes that relocating the provisions on withdrawal from membership as it pertains to loss allocation, so that it comes right after the section on the loss allocation waterfall, would provide for the better organization of GSD Rule 4 and MBSD Rule 4. As proposed, the subheading for Section 7b of GSD Rule 4 and MBSD Rule 4 would read “Withdrawal Following Loss Allocation.”

Currently, Section 7(g) of GSD Rule 4 and MBSD Rule 4 provides that a member may, pursuant to current Section 13 of GSD Rule 3 or MBSD Rule 3, notify FICC by the Close of Business on the Business Day on which a payment in an amount necessary to cover losses allocated to such member after the application of its Required Fund Deposit is due, of its election to terminate its membership and thereby avail itself of a cap on loss allocation, which is currently its Required Fund Deposit as fixed on the Business Day the pro rata charge loss allocation notification is provided to such member.

As stated above, under the proposed rule change, Section 7 of GSD Rule 4 and MBSD Rule 4 would provide that a Tier One Netting Member or a Tier One Member, as applicable, who wishes to withdraw from membership in respect of a loss allocation round must provide notice of its election to withdraw (“Loss Allocation Withdrawal Notice”) within five (5) Business Days from the issuance of the first Loss Allocation Notice in any round.<sup>45</sup> In order to avail itself of its Loss Allocation Cap, such member would need to follow the requirements in proposed Section 7b of GSD Rule 4 and MBSD Rule 4, as applicable, which would provide that such member must: (i) specify in its Loss Allocation Withdrawal Notice an effective date for withdrawal from membership, which date shall not be prior to the scheduled final settlement date of any remaining obligations owed by the member to FICC, unless otherwise approved by FICC, and (ii) as of the time of such member’s submission of the Loss Allocation Withdrawal Notice, cease submitting transactions to FICC for processing, clearance or settlement, unless otherwise approved by FICC.

Proposed Section 7b of GSD Rule 4 and MBSD Rule 4 would provide that a Tier One Netting Member or a Tier One Member, as applicable, that withdraws in compliance with the requirements of proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under proposed GSD Rule 4 or MBSD Rule 4, as applicable; however, the Tier One Netting Member’s or Tier One Member’s, as applicable, aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

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<sup>45</sup> Supra note 19.

FICC is proposing to include a sentence in proposed Section 7b of GSD Rule 4 and MBSD Rule 4 to make it clear that if the Tier One Netting Member or Tier One Member, as applicable, fails to comply with the requirements set forth in that section, its Loss Allocation Withdrawal Notice will be deemed void, and such member will remain subject to further loss allocations pursuant to proposed Section 7 of GSD Rule 4 and MBSD Rule 4 as if it had not given such notice.

For better organization of the subject matter, FICC is also proposing to move the provision that covers members' obligations to eliminate any deficiency in their Required Fund Deposits from the last sentence in the first paragraph of current Section 7(g) of GSD Rule 4 and MBSD Rule 4 to proposed Section 9 of GSD Rule 4 and MBSD Rule 4.

#### Section 8

As proposed, Section 8 of GSD Rule 4 and MBSD Rule 4 would cover the provisions on the return of a member's Clearing Fund deposit that are currently covered by Section 10 of GSD Rule 4 and MBSD Rule 4. Proposed Section 8's subheading would be "Return of Members' Clearing Fund Deposits."

FICC is proposing changes to streamline and enhance the clarity and readability of this section, including adding language to clarify that a member's obligations to FICC would include both matured as well as contingent obligations, but is otherwise retaining the substantive provisions of this section.

#### Section 9

FICC is proposing to renumber Section 8 of GSD Rule 4 and MBSD Rule 4, which addresses the timing of members' payment of the respective Division's Clearing Fund. Under the proposal, this section would be renumbered as Section 9 of GSD Rule 4



and MBSD Rule 4 and retitled to “Initial Required Fund Deposit and Changes in Members’ Required Fund Deposits” to better reflect the subject matter of this section.

Currently, Section 8 of GSD Rule 4 and MBSD Rule 4 requires members to satisfy any increase in their Required Fund Deposit requirement within such time as FICC requires. FICC is proposing to clarify that at the time the increase becomes effective, the member’s obligations to FICC will be determined in accordance with the increased Required Fund Deposit whether or not the member has satisfied such increased amount. FICC is also proposing to add language to clarify that (i) if FICC applies a GSD Netting Member’s or an MBSD Clearing Member’s Clearing Fund deposits as permitted pursuant to GSD Rule 4 or MBSD Rule 4, as applicable, FICC may take any and all actions with respect to the GSD Netting Member’s or MBSD Clearing Member’s Actual Deposit, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that FICC determines is appropriate, and (ii) if such application results in any deficiency in the GSD Netting Member’s or MBSD Clearing Member’s, as applicable, Required Fund Deposit, such member shall immediately replenish it. These clarifications are consistent with the Divisions’ rights as set forth in current Sections 4 and 11 of GSD Rule 4 and current Sections 4 and 11 of MBSD Rule 4. In addition, the provisions in clause (ii) of the previous sentence is consistent with the requirements in current Section 1 of GSD Rule 4 and MBSD Rule 4 that a member must maintain its Required Fund Deposit.

As discussed above, for better organization of the subject matter, FICC is proposing to move the provision that covers members’ obligations to eliminate any deficiency in their Required Fund Deposits from the last sentence in the first paragraph of

current Section 7(g) of GSD Rule 4 and MBSD Rule 4 to proposed Section 9 of GSD Rule 4 and MBSD Rule 4.

Section 10

Currently, Section 9 of GSD Rule 4 and MBSD Rule 4 addresses situations where a member has excess on deposit in the Clearing Fund (i.e., amounts above its Required Fund Deposit). The current provision provides that FICC will notify a member of any Excess Clearing Fund Deposit as FICC determines from time to time. Upon the request of a member, FICC will return an excess amount requested by a member that follows the formats and timeframe established by FICC for such request. The current provision makes clear that FICC may, in its discretion, withhold any or all of a member's Excess Clearing Fund Deposit (i) if the member has an outstanding payment obligation to FICC, (ii) if FICC determines that the member's anticipated activity over the next 90 calendar days may reasonably be expected to be materially different than the prior 90 calendar days, or (iii) if the member has been placed on the Watch List. Section 9 also makes clear that the return of an Excess Clearing Fund Deposit to any member is subject to (i) such return of Excess Clearing Fund Deposit not being done in a manner that would cause the member to violate any other section of the Rules, (ii) such return not reducing the amount of the member's Cross-Guaranty Repayment Deposit to the Clearing Fund below the amount required to be maintained by the member pursuant to GSD Rule 41 or MBSD Rule 32, as applicable, and (iii) with respect to GSD Members only, such return not reducing the amount of a GSD Member's Cross-Margining Repayment Deposit to the Clearing Fund below the amount required to be maintained by the GSD Member pursuant to GSD Rule 43.

FICC is proposing to renumber Section 9 as Section 10 for both GSD Rule 4 and MBSD Rule 4 and to retitle its subheading to “Excess Clearing Fund Deposits” to better reflect the subject matter of the provisions. FICC is not proposing any changes to this section except to streamline and clarify the provisions as well as to align GSD Rule 4 and MBSD Rule 4, including adding a sentence to clarify that nothing in this section limits FICC’s rights under Section 7 of GSD Rule 3 or Section 6 of MBSD Rule 3, as applicable.

Section 11

Current Section 11 of GSD Rule 4 and MBSD Rule 4 provides that FICC has certain rights with respect to the Clearing Fund. FICC is proposing to add a sentence which would make it clear that GSD Rule 4 or MBSD Rule 4, as applicable, would govern in the event of any conflict or inconsistency between such rule and any agreement between FICC and any member. FICC believes that this proposed change would facilitate members’ understanding of the Rules and their obligations thereunder. It would also align the Rules with the Rules and Procedures of NSCC so as to provide consistent treatment for firms that are members of both FICC and NSCC.<sup>46</sup> Furthermore, in order to enhance the readability and clarity, FICC is proposing a number of changes to streamline the language in this section.

(ii) Other Proposed Rule Changes

FICC is proposing changes to GSD Rule 1 (Definitions), GSD Rule 3 (Ongoing Membership Requirements), GSD Rule 3A (Sponsoring Members and Sponsored

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<sup>46</sup> See Section 12 of Rule 4 in NSCC’s Rules and Procedures, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

Members), GSD Rule 3B (Centrally Cleared Institutional Triparty Service), GSD Rule 13 (Funds-Only Settlement), GSD Rule 18 (Special Provisions for Repo Transactions), GSD Rule 21A (Wind-Down of a Netting Member), GSD Rule 22B (Corporation Default), GSD Rule 41 (Cross Guaranty Agreements), GSD Rule 43 (Cross-Margining Arrangements), GSD Board Interpretations and Statements of Policy, and GSD Interpretive Guidance with Respect to Watch List Consequences. FICC is also proposing changes to MBS Rule 1 (Definitions), MBS Rule 3 (Ongoing Membership Requirements), MBS Rule 5 (Trade Comparison), MBS Rule 11 (Cash Settlement), MBS Rule 17A (Corporation Default), MBS Rule 32 (Cross Guaranty Agreements), and MBS Interpretive Guidance with Respect to Watch List Consequences. FICC is proposing changes to these Rules in order to conform them with the proposed changes to GSD Rule 4 and MBS Rule 4, as applicable, as well as to make certain technical changes to these Rules, as further described below.

*Adding Defined Terms*

Specifically, FICC is proposing to add the following defined terms to GSD Rule 1, in alphabetical order: Actual Deposit, Average RFD, CCIT Member Termination Date, CCIT Member Voluntary Termination Notice, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member Event, Event Period, Excess Clearing Fund Deposit, Former Sponsored Members, Lender, Loss Allocation Cap, Loss Allocation Notice, Loss Allocation Withdrawal Notice, Sponsored Member Termination Date, Sponsored Member Voluntary Termination Notice, Sponsoring Member Termination Date, Sponsoring Member Voluntary Termination Notice, Termination Date, and Voluntary Termination Notice.

FICC is also proposing to add the following defined terms to MBSD Rule 1, in alphabetical order: Actual Deposit, Average RFD, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member Event, Event Period, Excess Clearing Fund Deposit, Lender, Loss Allocation Cap, Loss Allocation Notice, Loss Allocation Withdrawal Notice, Termination Date, and Voluntary Termination Notice.

*Technical Changes*

In addition, FICC is proposing technical changes (i) to delete the defined term “The Corporation” in GSD Rule 1 and replace it with “Corporation” in GSD Rule 1, (ii) to correct cross-references in Section 8 of MBSD Rule 5 and the definition of “Legal Risk” in GSD Rule 1, (iii) to update references to sections that would be changed under this proposal in Section 12 of GSD Rule 3, Sections 10 and 12(a) of GSD Rule 3A, Section 3(f) of GSD Rule 18, GSD Rule 21A, Sections 3(a), 3(b) and 4 of GSD Rule 41, Section 6 of GSD Rule 43, GSD Interpretive Guidance with Respect to Watch List Consequences, Sections 11, 14, and 15 of MBSD Rule 3, Section 3(b) of MBSD Rule 32, and MBSD Interpretive Guidance with Respect to Watch List Consequences, (iv) to update the reference to a subheading that would be changed under this proposal in Section 7 of GSD Rule 3B, and (v) to delete a reference to the Cross-Margining Agreement between FICC and NYPC that is no longer in effect. FICC believes that these proposed technical changes would ensure the Rules remain clear and accurate, which would in turn allow Members to readily understand their obligations under the Rules.

*Voluntary Termination*

FICC is also proposing changes to the voluntary termination provisions in GSD Rule 3, GSD Rule 3A, GSD Rule 3B, and MBSD Rule 3 in order to ensure that termination provisions in the GSD Rules and MBSD Rules, whether voluntary or in response to a loss allocation, are consistent with one another to the extent appropriate.

Currently, the voluntary termination provisions in GSD Rule 3, GSD Rule 3A, GSD Rule 3B, and MBSD Rule 3 generally provide that a member may elect to terminate its membership by providing FICC with 10 days written notice of such termination. Such termination will not be effective until accepted by FICC, which shall be no later than 10 Business Days after the receipt of the notice. FICC's acceptance shall be evidenced by a notice to FICC's members announcing the member's termination and the effective date of the termination ("Termination Date"), and that the terminating member will no longer be eligible to submit transactions to FICC as of the Termination Date.<sup>47</sup> This provision also provides that a member's voluntary termination of membership shall not affect its obligations to FICC.

Where appropriate, FICC is proposing changes to align the voluntary termination provisions in Section 13 of GSD Rule 3, Sections 2(i) and 3(e) of GSD Rule 3A, Section 6 of GSD Rule 3B, and Section 14 of MBSD Rule 3 with the proposed new Section 7b of GSD Rule 4 and MBSD Rule 4, given that they all address termination of membership. Specifically, in Section 13 of GSD Rule 3, FICC is proposing that when a GSD Member elects to voluntarily terminate its membership by providing FICC a written notice of such

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<sup>47</sup> Account(s) of a terminating member would generally be deactivated before the open of business on the Termination Date.

termination (“Voluntary Termination Notice”), the GSD Member must specify in its Voluntary Termination Notice a desired date for its withdrawal from membership; provided, however, if the GSD Member is terminating its membership in GSD (i.e., not terminating its membership just in the Netting System), such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the GSD Member to FICC as of the time such Voluntary Termination Notice is submitted to FICC, unless otherwise approved by FICC. FICC is proposing to delete the provision that requires a member to provide FICC with 10 days written notice of the member’s termination; however, FICC is retaining the provision that states termination will not be effective until accepted by FICC,<sup>48</sup> which shall be no later than 10 Business Days after the receipt of the notice. FICC is also retaining the provision that states FICC’s acceptance shall be evidenced by a notice to FICC’s members announcing the member’s termination and the Termination Date, and that the terminating member will no longer be eligible to submit transactions to FICC as of the Termination Date.

As an example, Member A submits a Voluntary Termination Notice to GSD on April 1<sup>st</sup> indicating its desired termination date is June 15<sup>th</sup>. GSD would accept such termination request by issuing a notice to GSD Members within 10 Business Days from April 1<sup>st</sup>; such notice would provide that the effective date of Member A’s GSD membership termination is June 15<sup>th</sup>. In contrast, if Member A submits a Voluntary

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<sup>48</sup> Unlike the Voluntary Termination Notice, the Loss Allocation Withdrawal Notice as proposed in Section 7b of GSD Rule 4 and MBSD Rule 4 does not require explicit acceptance by FICC to be effective. FICC believes that requiring explicit acceptance of the Loss Allocation Withdrawal Notice could complicate the loss allocation process and potentially result in membership withdrawal being delayed as well as detract from the objective to have FICC know on a timely basis which members would remain subject to the subsequent rounds of loss allocation.

Termination Notice on April 1<sup>st</sup> and indicates its desired termination date is April 5<sup>th</sup>, GSD would either (i) accept such termination notice by issuing a notice to GSD Members on or before April 5<sup>th</sup>, and such notice would provide that the effective date of Member A's GSD membership termination is April 5<sup>th</sup> or (ii) if GSD requires additional time to process the termination, GSD would accept such termination notice by issuing notice to GSD Members after April 5<sup>th</sup> but still within 10 Business Days from April 1<sup>st</sup>; and such notice would provide that the effective date of Member A's GSD membership termination as a date after April 5<sup>th</sup>.

The proposed change to Section 13 of GSD Rule 3 would also provide that if any trade is submitted to FICC either by the withdrawing GSD Member or its authorized submitter that is scheduled to settle on or after the Termination Date, the GSD Member's Voluntary Termination Notice would be deemed void and the GSD Member would remain subject to the GSD Rules as if it had not given such notice. Furthermore, FICC is proposing to add a sentence to Section 13 of GSD Rule 3 to refer GSD Members to Section 8 of GSD Rule 4 regarding provisions on the return of a GSD Member's Clearing Fund deposit and to specify that if an Event Period were to occur after a Tier One Netting Member has submitted its Voluntary Termination Notice but prior to the Termination Date, in order for such Tier One Netting Member to benefit from its Loss Allocation Cap pursuant to Section 7 of GSD Rule 4, the Tier One Netting Member would need to comply with the provisions of Section 7b of GSD Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, would supersede and void any pending Voluntary Termination Notice previously submitted by the Tier One Netting



Member.<sup>49</sup> As an example, if an Event Period occurs after submission of the Voluntary Termination Notice by a Tier One Netting Member or Tier One Member, as applicable, but prior to the Termination Date, and the Tier One Netting Member or Tier One Member, as applicable, does not subsequently submit a Loss Allocation Withdrawal Notice as proposed in Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, then the Tier One Netting Member or Tier One Member, as applicable, would not benefit from its Loss Allocation Cap, i.e., the Tier One Netting Member or Tier One Member, as applicable, would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period that commenced prior to the Termination Date.

Parallel changes are also being proposed to Section 2(i) of GSD Rule 3A and Section 14 of MBSD Rule 3 with additional language in Section 2(i) of GSD Rule 3A and Section 14 of MBSD Rule 3 making it clear that the acceptance by FICC of a member's Voluntary Termination Notice shall be no later than ten (10) Business Days after the receipt of such notice from the member, in order to provide certainty to members as well as to align these sections with the current Section 13 of GSD Rule 3.

With respect to Section 3(e) of GSD Rule 3A and Section 6 of GSD Rule 3B, changes similar to the ones described above in the previous paragraph are also being proposed for Sponsored Members and CCIT Members, except there would be no references to the return of a member's Clearing Fund deposits and to Loss Allocation

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<sup>49</sup> Loss Allocation Caps would not apply to Tier Two Netting Members and Tier Two Members because the loss allocation obligations of Tier Two Netting Members and Tier Two Members are already capped to the liquidation losses that resulted from their trading activity with the Defaulting Member. Tier Two Netting Members and Tier Two Members are required to pay their loss allocation obligations in full.

Caps because they would not apply to these member types. In addition, FICC is proposing a technical change in Section 6 of GSD Rule 3B to reflect a defined term that would be changed under this proposal.

*Other MBSD Proposed Rule Changes*

FICC is proposing to delete Section 15 of MBSD Rule 3 because FICC believes that this section is akin to a loss allocation provision and therefore would no longer be necessary under the proposed rule change, as the scenarios envisioned by Section 15 of MBSD Rule 3 would be governed by the proposed loss allocation provisions in MBSD Rule 4.

*Other GSD Proposed Rule Changes*

Under the proposal, Section 12(c) of GSD Rule 3A would also be revised to incorporate the concept of the Loss Allocation Cap and to reference the applicable proposed sections in GSD Rule 4 that would apply when a Sponsoring Member elects to terminate its status as a Sponsoring Member.

FICC is also proposing to delete an Interpretation of the Board of Directors of the Government Securities Clearing Corporation (the predecessor to GSD), which currently clarifies certain provisions of GSD Rule 4 and the extent to which the GSD Clearing Fund and other required deposits of GSD Netting Members may be applied to a loss or liability incurred by FICC. FICC is proposing this deletion because this interpretation would no longer be necessary following the proposed rule change. This is because the proposed rule change to GSD Rule 4 would cover the extent to which the GSD Clearing Fund and other collateral or assets of GSD Netting Members would be applied to a loss or liability incurred by FICC.

*Other GSD Proposed Rule Changes and MBSD Proposed Rule Changes*

FICC is proposing changes to Section 11 of GSD Rule 4 and MBSD Rule 4. Specifically, FICC is proposing to replace “letters of credit” with “Eligible Letters of Credit,” which is already a defined term in the Rules. In addition, FICC is proposing to specify that a reference to 30 days means 30 calendar days.

FICC is proposing to delete “Remaining Loss” and “Other Loss” in Sections 12(a) and 12(b) of GSD Rule 3A, Section 5 of GSD Rule 13, Section 4 of GSD Rule 41, Section 6 of GSD Rule 43, Section 9(o) of MBSD Rule 11, and Section 4 of MBSD Rule 32 because these terms would no longer be used under the proposed GSD Rule 4 and MBSD Rule 4, and to add clarifying language that conforms to the proposed changes to GSD Rule 4 and MBSD Rule 4.

In addition, FICC is proposing changes to GSD Rule 22B (Corporation Default) and MBSD Rule 17A (Corporation Default). FICC is proposing to relocate the interpretational parenthetical in each rule to come right after the reference to GSD Rule 22A and MBSD Rule 17. FICC is proposing this change because, in the event of a Corporation Default, the portfolio of each GSD Member or MBSD Member, as applicable, would be closed out in the same way as the portfolio of a GSD Defaulting Member or MBSD Defaulting Member, i.e., by applying the close out procedures of GSD Rule 22A (Procedures for When the Corporation Ceases to Act) or MBSD Rule 17 (Procedures for When the Corporation Ceases to Act), as applicable. In addition, in the proposed GSD Rule 22B and MBSD Rule 17A, FICC is proposing to add a reference to the loss allocation provisions of GSD Rule 4 and MBSD Rule 4 and delete references to

specific sections of GSD Rule 4 and MBSD Rule 4, because those sections are being modified under the proposed rule change.

#### Member Outreach

Beginning in August 2017, FICC conducted outreach to Members in order to provide them with advance notice of the proposed changes. As of the date of this filing, no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

#### Implementation Timeframe

Pending Commission approval, FICC expects to implement this proposal within two (2) Business Days after approval. Members would be advised of the implementation date of this proposal through issuance of a FICC Important Notice.

#### *Expected Effect on Risks to the Clearing Agency, its Participants and the Market*

FICC believes that the proposed rule changes to enhance the resiliency of each Division's loss allocation process and to delete certain limiting language regarding FICC's use of MBSD Clearing Fund would reduce the risk of uncertainty to FICC, each Division's members and the market overall. Specifically, by modifying the calculation of FICC's corporate contribution, FICC would apply a mandatory fixed percentage of its General Business Risk Capital Requirement (as compared to the current Rules which provide for "up to" a percentage of retained earnings), which would provide greater transparency and accessibility to members as to how much FICC would contribute in the event of a loss or liability. By modifying the application of FICC's corporate contribution to apply to Declared Non-Default Loss Events, in addition to Defaulting Member Events, on a mandatory basis, FICC would expand the application of its

corporate contribution beyond losses and liabilities from member defaults, which would better align the interests of FICC with those of its respective Division's members by stipulating a mandatory application of the Corporate Contribution to a Declared Non-Default Loss Event prior to any allocation of the loss among Tier One Netting Members or Tier One Members, as applicable. Taken together, these proposed rule changes would enhance the overall resiliency of each Division's loss allocation process by enhancing the calculation and application of FICC's Corporate Contribution, which is one of the key elements of each Division's loss allocation process. Moreover, by providing greater transparency and accessibility to members, as stated above, the proposed rule changes regarding the Corporate Contribution, including the proposed replenishment period and proposed allocation of FICC Corporate Contribution between Divisions, would allow members to better assess the adequacy of each Division's loss allocation process.

By introducing the concept of an Event Period, FICC would be able to group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) Business Days for purposes of allocating losses to members. FICC believes that the Event Period would provide a defined structure for the loss allocation process to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or market dislocation episode. Having this structure would enhance the overall resiliency of FICC's loss allocation process because FICC would be better equipped to address losses that may arise from multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would

provide certainty for members concerning their maximum exposure to mutualized losses with respect to such events.

By introducing the concept of “rounds” (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the member withdrawal process in connection with the loss allocation process, FICC would (i) set forth a defined amount that it would allocate to members during each round (i.e., the round cap), (ii) advise members of loss allocation obligation information as well as round information through the issuance of Loss Allocation Notices, and (iii) provide members with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of FICC’s loss allocation process because they would enable FICC to continue the loss allocation process in successive rounds until all of FICC’s losses are allocated and enable FICC to identify continuing members for purposes of calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for members a clear manner and process in which they could cap their loss allocation exposure to FICC.

By implementing a revised “look-back” period to calculate a member’s loss allocation obligations and its Loss Allocation Cap, FICC would be able to capture a full calendar quarter of the member’s activities and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred. By determining a member’s loss allocation obligations based on the average of its Required Fund Deposit over a look-back period and its Loss Allocation Cap based on the greater of its Required Fund Deposit or the average thereof over a look-back period, FICC would be able to calculate a

member's pro rata share of losses and liabilities based on the amount of risk that the member brings to FICC. These proposed rule changes would enhance the overall resiliency of each Division's loss allocation process because they would align a member's loss allocation obligation and its Loss Allocation Cap with the amount of risk that the member brings to FICC.

By deleting certain vague and imprecise limiting language that could be interpreted as impairing FICC's ability to access the MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event, as well as to cover certain liquidity needs, the proposed rule change to amend FICC's permitted use of MBSD Clearing Fund would enhance FICC's ability to ensure that it can continue its operations and clearance and settlement services in an orderly manner in the event that it would be necessary or appropriate for FICC to access MBSD Clearing Fund deposits to address losses, liabilities or liquidity needs to meet its settlement obligations.

*Management of Identified Risks*

FICC is proposing the rule changes as described in detail above in order to enhance the resiliency of each Division's loss allocation process and provide transparency and accessibility to its respective members regarding each Division's loss allocation process.

*Consistency with the Clearing Supervision Act*

The proposed rule change would be consistent with Section 805(b) of the Clearing Supervision Act.<sup>50</sup> The objectives and principles of Section 805(b) of the Clearing

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<sup>50</sup> 12 U.S.C. 5464(b).

Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.<sup>51</sup>

The proposed rule change would enhance the resiliency of each Division's loss allocation process by (1) modifying the calculation and application of FICC's corporate contribution, (2) introducing an Event Period, (3) introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the member withdrawal process in connection with the loss allocation process, and (4) implementing a revised "look-back" period to calculate a member's loss allocation obligation and its Loss Allocation Cap. Together, these proposed rule changes would (i) create greater certainty for members regarding each Division's obligation towards a loss, (ii) more clearly specify each Division's and its respective members' obligations toward a loss and balance the need to manage the risk of sequential defaults and other potential loss events against members' need for certainty concerning their maximum exposures, and (iii) provide members the opportunity to limit their exposure to FICC by capping their exposure to loss allocation. Reducing the risk of uncertainty to FICC, each Division's members and the market overall would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, FICC believes that the proposed rule change to enhance the resiliency of each Division's loss allocation process is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

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<sup>51</sup> Id.



By deleting certain vague and imprecise limiting language that could be interpreted as impairing FICC's ability to access the MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event, as well as to cover certain liquidity needs, the proposed rule change to amend FICC's permitted use of MBSD Clearing Fund would enhance FICC's ability to ensure that it can continue its operations and clearance and settlement services in an orderly manner in the event that it would be necessary or appropriate for FICC to access MBSD Clearing Fund deposits to address losses, liabilities or liquidity needs to meet its settlement obligations. Enabling FICC to continue its operations and clearance and settlement services in an orderly manner under such circumstances would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, FICC believes that this proposed rule change is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change is also consistent with Rules 17Ad-22(e)(13) and 17Ad-22(e)(23)(i), promulgated under the Act.<sup>52</sup> Rule 17Ad-22(e)(13) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure each Division has the authority and operational capacity to take timely action to contain losses and continue to meet its obligations.<sup>53</sup> As described above, the proposed rule changes to (1) modify the calculation and application of FICC's corporate contribution, (2) introduce an Event

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<sup>52</sup> 17 CFR 240.17Ad-22(e)(13) and (e)(23)(i).

<sup>53</sup> 17 CFR 240.17Ad-22(e)(13).

Period, (3) introduce the concept of “rounds” (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the member withdrawal process in connection with the loss allocation process, and (4) implement a revised “look-back” period to calculate a member’s loss allocation obligation and its Loss Allocation Cap, taken together, are designed to enhance the resiliency of each Division’s loss allocation process. Having a resilient loss allocation process would help ensure that each Division can effectively and timely address losses relating to or arising out of either the default of one or more members or one or more non-default loss events, which in turn would help each Division contain losses and continue to meet its clearance and settlement obligations. Therefore, FICC believes that the proposed rule changes to enhance the resiliency of each Division’s loss allocation process are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of each Division’s default rules and procedures.<sup>54</sup> The proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) improve the overall transparency and accessibility of the provisions in the Rules governing loss allocation and (iii) make conforming and technical changes, would not only ensure that each Division’s loss allocation rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of other DTCC Clearing Agencies, but also would help to ensure that each Division’s loss allocation rules are transparent and clear to members. Aligning the

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<sup>54</sup> 17 CFR 240.17Ad-22(e)(23)(i).

loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable members to better understand the key aspects of each Division's default rules and procedures and provide members with increased predictability and certainty regarding their exposures and obligations. As such, FICC believes that the proposed rule changes to align the loss allocation rules of the DTCC Clearing Agencies as well as to improve the overall transparency and accessibility of each Division's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

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 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](mailto:rule-comments@sec.gov). Please include File Number SR-FICC-2017-806 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-2017-806. 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-2017-806 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary

**FIXED INCOME CLEARING CORPORATION**

**GOVERNMENT SECURITIES DIVISION RULEBOOK**

TEXT OF PROPOSED RULE CHANGE

**Bold and underlined text** indicates proposed added language

~~**Bold and strikethrough text**~~ indicates proposed deleted language

***Bold, double-underlined and italicized text*** indicates additional language proposed by this Amendment No. 1

~~**Bold, strikethrough and dotted underlined text**~~ indicates deleted language proposed by this Amendment No. 1

## **RULE 1 – DEFINITIONS**

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### **Actual Deposit**

**The term “Actual Deposit” shall have the meaning given that term in Section 4 of Rule 4.**

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### **Average RFD**

**The term “Average RFD” shall have the meaning given that term in Section 7 of Rule 4.**

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### **CCIT Member Termination Date**

**The term “CCIT Member Termination Date” shall have the meaning given that term in Section 6 of Rule 3B.**

### **CCIT Member Voluntary Termination Notice**

**The term “CCIT Member Voluntary Termination Notice” shall have the meaning given that term in Section 6 of Rule 3B.**

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### **Clearing Fund Cash**

**The term “Clearing Fund Cash” shall have the meaning given that term in Section 3a of Rule 4.**

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### **Corporate Contribution**

**The term “Corporate Contribution” shall have the meaning given that term in Section 7a of Rule 4.**

### **Corporation**

**The term “Corporation” means Fixed Income Clearing Corporation, the owner of the Government Securities Division. Where these Rules refer to action taken by**

**“the Corporation,” the term should be understood to mean the management of Fixed Income Clearing Corporation, unless otherwise specified.**

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**Declared Non-Default Loss Event**

**The term “Declared Non-Default Loss Event” shall have the meaning given that term in Section 7 of Rule 4.**

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**Defaulting Member Event**

**The term “Defaulting Member Event” shall have the meaning given that term in Section 7 of Rule 4.**

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**Event Period**

**The term “Event Period” shall have the meaning given that term in Section 7 of Rule 4.**

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**Excess Clearing Fund Deposit**

**The term “Excess Clearing Fund Deposit” shall have the meaning given that term in Section 10 of Rule 4.**

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**Former Sponsored Members**

**The term “Former Sponsored Members” shall have the meaning given that term in Section 2 of Rule 3A.**

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**Legal Risk**

The term “Legal Risk” shall have the meaning given that term in Section 2(n) of Rule 4.

**Lender**

**The term “Lender” shall have the meaning given that term in Section 11 of Rule 4.**



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**Loss Allocation Cap**

**The term “Loss Allocation Cap” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Notice**

**The term “Loss Allocation Notice” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Withdrawal Notice**

**The term “Loss Allocation Withdrawal Notice” shall have the meaning given that term in Section 7b of Rule 4.**

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**Sponsored Member Termination Date**

**The term “Sponsored Member Termination Date” shall have the meaning given that term in Section 3 of Rule 3A.**

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**Sponsored Member Voluntary Termination Notice**

**The term “Sponsored Member Voluntary Termination Notice” shall have the meaning given that term in Section 3 of Rule 3A.**

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**Sponsoring Member Termination Date**

**The term “Sponsoring Member Termination Date” shall have the meaning given that term in Section 2 of Rule 3A.**

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**Sponsoring Member Voluntary Termination Notice**

**The term “Sponsoring Member Voluntary Termination Notice” shall have the meaning given that term in Section 2 of Rule 3A.**

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**Termination Date**

**The term “Termination Date” shall have the meaning given that term in Section 13 of Rule 3.**

**The Corporation**

~~The term “the Corporation” means the Fixed Income Clearing Corporation, the owner of the Government Securities Division. Where these Rules refer to action taken by “the Corporation,” the term should be understood to mean the management of the Fixed Income Clearing Corporation, unless otherwise specified.~~

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**Voluntary Termination Notice**

**The term “Voluntary Termination Notice” shall have the meaning given that term in Section 13 of Rule 3.**

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### RULE 3 – ONGOING MEMBERSHIP REQUIREMENTS

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#### Section 12 – Ongoing Monitoring

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(e) The Corporation may require a Netting Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~ the provisions of Rule 4 (which additional deposit shall constitute a portion of the Netting Member's Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member. The Corporation may also retain any Excess Clearing Fund Deposits of a Netting Member that has been placed on the Watch List as provided in Section ~~9~~ 10 of Rule 4. Moreover, as regards a Netting Member that has been placed on the Watch List by the Corporation, the Corporation may suspend, during all or a portion of the time period that such Member is on the Watch List, its right under these Rules to collect a Credit Forward Mark Adjustment Payment. Moreover, if a Netting Member on the Watch List has a Collateral Allocation Entitlement as the result of its GCF Repo Transaction activity, the Corporation may, in its sole discretion, maintain possession of the securities and/or cash that comprise such Collateral Allocation Entitlement.

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#### Section 13 - Voluntary Termination

A Member that is a Comparison-Only Member may elect to terminate such membership, and a Netting Member may elect to terminate its membership in either the Corporation or in just the Netting System (and to become a Comparison-Only Member), by providing the Corporation with a 10 days written notice of such termination (“Voluntary Termination Notice”); however, the Corporation, in its discretion, may accept such termination within a shorter notice period. The Member shall specify in the Voluntary Termination Notice an effective a desired date for its withdrawal from membership (the “Termination Date”); provided, however, if the Member is terminating its membership in the Corporation, such Termination Date date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Member to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than 10 Business Days after the receipt of the Voluntary Termination Notice written notice from such Member. The Corporation's acceptance shall be evidenced by a notice to Members announcing the Member's termination and the effective date of the termination of the Member (hereinafter the “Termination Date”). As of the Termination Date, a Netting Member that terminates its membership in the Netting System, or a Comparison-Only Member or Netting

Member that terminates its membership in the Corporation, shall no longer be eligible or required to submit to the Corporation data on trades and shall no longer be eligible to have its trade data submitted by an authorized submitter, notwithstanding any provision of Rule 5, Rules 6A through 6C, or Rule 11 to the contrary, unless the Board determines otherwise in order to ensure an orderly liquidation of the Member's Net Settlement Positions. **If any trade is submitted to the Corporation either by such Member or its authorized submitter that is scheduled to settle on or after the Termination Date, such Member's Voluntary Termination Notice will be deemed void, and the Member will remain subject to these Rules as if it had not given such Voluntary Termination Notice.**

A Member's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the Termination Date. **The return of the Member's Clearing Fund deposit shall be governed by Section 8 of Rule 4. If a Member is a Tier One Netting Member and an Event Period were to occur after such Member has submitted its Voluntary Termination Notice but prior to the Termination Date, in order for such Member to benefit from its Loss Allocation Cap pursuant to Section 7 of Rule 4, the Member will need to comply with the provisions of Section 7b of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the Member.**

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### RULE 3A—SPONSORING MEMBERS AND SPONSORED MEMBERS

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#### Section 2 – Qualifications of Sponsoring Members, the Application Process and Continuance Standards

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(i) A Sponsoring Member may voluntarily elect to terminate its status as a Sponsoring Member, with respect to all Sponsored Members or with respect to one or more Sponsored Members from time to time, by providing the Corporation with ~~30 calendar days a~~ written notice of such termination (**“Sponsoring Member Voluntary Termination Notice”**). **The Sponsoring Member shall specify in the Sponsoring Member Voluntary Termination Notice an effective *a desired* date for the termination of the Sponsoring Member’s status as such (the “Sponsoring Member Termination Date”) with respect to the Sponsored Member(s) as to which the Sponsoring Member has terminated such status (the “Former Sponsored Members”), which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Sponsoring Member with respect to the Former Sponsored Members to the Corporation as of the time such Sponsoring Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.**

~~;~~ ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period.~~ Such termination will not be effective until accepted by the Corporation, **which shall be no later than 10 Business Days after the receipt of the Sponsoring Member Voluntary Termination Notice from such Sponsoring Member.** The Corporation’s acceptance shall be evidenced by a notice to all Members announcing the termination of the Sponsoring Member’s status as such with respect to the ~~Sponsored Member(s) as to which the Sponsoring Member has terminated such status (the “Former Sponsored Members”)~~ and the **effective date of such termination (hereinafter the “Sponsoring Member Termination Date”).** As of the Sponsoring Member Termination Date, the Sponsoring Member shall no longer be eligible to submit trades on behalf of its Former Sponsored Members and each of its Former Sponsored Members shall cease to be a Sponsored Member unless it is the Sponsored Member of another Sponsoring Member. **If any trade is submitted to the Corporation by the Sponsoring Member on behalf of its Former Sponsored Members that is scheduled to settle on or after the Sponsoring Member Termination Date, such Sponsoring Member’s Sponsoring Member Voluntary Termination Notice will be deemed void, and the Sponsoring Member will remain subject to this Rule as if it had not given such Sponsoring Member Voluntary Termination Notice.**

A Sponsoring Member’s voluntary termination of its status as such, in whole or in part, shall not affect its obligations to the Corporation, or the rights of the Corporation, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Trades submitted to the Corporation before the applicable Sponsoring Member Termination Date. Any Sponsored

Member Trades which have received the Corporation's guaranty of settlement and been novated to the Corporation shall continue to be processed and guaranteed by the Corporation.

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Section 3 - Qualifications of Sponsored Members, Approval Process and Continuance Standard

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(e) A Sponsored Member may voluntarily elect to terminate its membership by providing the Corporation with ~~10 calendar days~~ a written notice of such termination ("**Sponsored Member Voluntary Termination Notice**"). **The Sponsored Member shall specify in the Sponsored Member Voluntary Termination Notice an effective *a desired* date for the termination (the "**Sponsored Member Termination Date**"), which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Sponsored Member to the Corporation as of the time such Sponsored Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.**

~~;~~ ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period.~~ Such termination will not be effective until accepted by the Corporation, **which shall be no later than 10 Business Days after the receipt of the Sponsored Member Voluntary Termination Notice from such Sponsored Member.** The Corporation's acceptance shall be evidenced by a notice to all Members announcing the termination of the Sponsored Member and the effective date of such termination (hereinafter the "**Sponsored Member Termination Date**"). As of the Sponsored Member Termination Date, the relevant Sponsoring Member shall no longer be eligible to submit trades on behalf of the Sponsored Member. **If any trade is submitted to the Corporation by the relevant Sponsoring Member on behalf of the Sponsored Member that is scheduled to settle on or after the Sponsored Member Termination Date, such Sponsored Member's Sponsored Member Voluntary Termination Notice will be deemed void, and the Sponsored Member will remain subject to this Rule as if it had not given such Sponsored Member Voluntary Termination Notice.**

A Sponsored Member's voluntary termination shall not affect its obligations to the Corporation, or the rights of the Corporation, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Trades submitted to the Corporation before the Sponsored Member Termination Date, and the Sponsoring Member Guaranty shall remain in effect to cover all outstanding obligations of the Sponsored Member to the Corporation that are within the scope of such Sponsoring Member Guaranty.

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Section 10—Clearing Fund Obligations

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(d) The lesser of \$5,000,000 or 10 percent of the total amount arrived at in subsection (c) of this Section 10, with a minimum of \$100,000 must be made and maintained in cash, with

the remaining portion to be made and maintained in the form specified in, and subject to the requirements of, Section 3 of Rule 4, and subject to subsection (~~fe~~) of Section 2 of Rule 4.

(e) The Corporation shall have the right to increase the Sponsoring Member Omnibus Account Required Fund Deposit in the same way and for the same reasons as set forth in subsection (~~ed~~) of Section 2 of Rule 4.

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#### Section 12—Loss Allocation Obligations

(a) Sponsored Members shall not be obligated for allocations, pursuant to Rule 4, of loss or liability incurred by the Corporation. To the extent that a **Remaining Loss (as defined in Section 7 of Rule 4) loss or liability** is determined by the Corporation to arise in connection with Sponsored Member Trades (i.e., in connection with the insolvency or default of a Sponsoring Member), the Sponsored Members shall not be responsible for or considered in the loss allocation calculation, but rather such loss shall be allocated to Tier One Netting Members in accordance with the principles set forth in Section 7(~~d~~) of Rule 4.

(b) To the extent the Corporation incurs a **loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event** ~~Remaining Loss or an Other Loss (as defined in Section 7(f) of Rule 4)~~ and a loss allocation obligation arises that would be the responsibility of the Sponsoring Member Omnibus Account if the Sponsoring Member Omnibus Account were a Netting Member, the Corporation shall calculate such loss allocation obligation as if the affected Sponsored Members were subject to such allocations pursuant to Section 7 of Rule 4, but the Sponsoring Member shall be responsible for satisfying such obligations.

(c) The entire amount of the Required Fund Deposit associated with the Sponsoring Member's Netting System accounts and the entire amount of the Sponsoring Member's Omnibus Account Required Fund Deposit may be used to satisfy any amount allocated against a Sponsoring Member in its capacity as either a Netting Member or a Sponsoring Member. With respect to an obligation to make payment due to any loss allocation amounts assessed to a Sponsoring Member pursuant to subsection (b) above, the Sponsoring Member may instead elect provide, by the Close of Business on the Business Day on which such payment is due, written notice to the Corporation of its election to terminate its membership in the Corporation pursuant to Section 7b of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 7 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Sponsoring Member, its Required Fund Deposit shall be. ~~If such Sponsoring Member elects to terminate its membership in the Corporation, its liability for an assessed allocation pursuant to subsection (b) shall be limited to~~ the sum of its Required Fund Deposit and its Sponsoring Member's Omnibus Account Required Fund Deposit ~~on the Business Day on which the notification of such allocation is provided to the Sponsoring Member.~~

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**RULE 3B – CENTRALLY CLEARED INSTITUTIONAL  
TRIPARTY SERVICE**

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Section 6 – Voluntary Termination

A CCIT Member may voluntarily elect to terminate its membership in the Corporation by providing the Corporation with ~~10 Business Days~~<sup>2</sup> a written notice of such termination (“CCIT Member Voluntary Termination Notice”). The CCIT Member shall specify in the CCIT Member Voluntary Termination Notice an effective a desired date for the termination (the “CCIT Member Termination Date”), which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the CCIT Member to the Corporation as of the time such CCIT Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

~~;~~ ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period.~~ Such termination will not be effective until accepted by the Corporation, which shall be no later than 10 Business Days after the receipt of the ~~written notice~~ CCIT Member Voluntary Termination Notice from ~~the~~ such CCIT Member. The Corporation’s acceptance shall be evidenced by a notice to Members (including CCIT Members) announcing the CCIT Member’s termination and the effective date of the termination of the CCIT Member (hereinafter the “CCIT Member Termination Date”). As of the CCIT Member Termination Date, a CCIT Member that terminates its membership in the Corporation shall no longer be eligible or required to submit to the Corporation data on trades and shall no longer be eligible to have its trade data submitted by a Joint Account Submitter, unless the Board determines otherwise in order to ensure an orderly liquidation of the CCIT Member’s positions. If any trade is submitted to the Corporation either by such CCIT Member or a Joint Account Submitter that is scheduled to settle on or after the CCIT Member Termination Date, such CCIT Member’s CCIT Member Voluntary Termination Notice will be deemed void, and the CCIT Member will remain subject to this Rule as if it had not given such CCIT Member Voluntary Termination Notice.

A CCIT Member’s voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the CCIT Member Termination Date.

Section 7 – Loss Allocation Obligations of CCIT Members

Section 7 (~~Allocation of Loss or Liability Incurred by the Corporation~~ Loss Allocation Waterfall) of Rule 4 (Clearing Fund and Loss Allocation) shall apply to CCIT Members as Tier Two Members. CCIT Members shall be responsible for the total amount of loss allocated to them. With respect to CCIT Members with a Joint Account Submitter, loss allocation will be calculated at the Joint Account level and then applied pro rata to each CCIT Member in the Joint Account based on the trade settlement allocation instructions. If, at the time the Corporation calculates loss allocation, the trade settlement allocation instructions to the



individual CCIT Member level have not yet been received by the Corporation, the CCIT Members in the Joint Account shall be required to provide the allocation to the Corporation within the timeframes set by the Corporation in its discretion.

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## RULE 4 - CLEARING FUND AND LOSS ALLOCATION

### Section 1 – General Required Fund Deposits

Each Netting Member shall make, and maintain on an ongoing basis ~~so long as such Member is a Netting Member~~, a deposit to the Clearing Fund ~~at no less than the minimum required level set forth in this Rule (the "Required Fund Deposit")~~. ~~Deposits to the Clearing Fund shall be held by the Corporation or its designated agents, to be applied as provided in this Rule.~~ The amount of each Netting Member's required deposit shall be determined by the Corporation in accordance with this Rule and shall be referred to as the Required Fund Deposit. The timing of payment of the Required Fund Deposit shall be determined in accordance with the provisions of Section ~~8~~9 of this Rule.

A Netting Member may in its discretion maintain additional deposits at the Corporation, subject to any requirements the Corporation may establish for such excess amounts pursuant to Section 10 of this Rule. For purposes of these Rules, such additional deposits shall be deemed to be part of the Clearing Fund and the Netting Member's Actual Deposit but shall not be deemed to be part of the Netting Member's Required Fund Deposit. The Corporation shall not be required to segregate each Netting Member's Actual Deposit, but shall maintain books and records concerning the assets that constitute each Netting Member's Actual Deposit.

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### Section 2- Required Fund Deposit Requirements

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~~(b) — The lesser of \$5,000,000 or 10 percent of the Total Amount arrived at above, with a minimum of \$100,000, must, be made and maintained in cash, with the remaining portion of the Total Amount to be made and maintained in the form specified in Section 4 of this Rule. The previous sentence shall also apply to a Sponsoring Member Omnibus Account, but shall not apply to the individual Sponsored Members whose activity is presented by such Account.~~

~~(e)~~(b) The Corporation shall calculate the Sponsoring Member Omnibus Account Required Fund Deposit in the manner set forth in Section 10 of Rule 3A.

~~(d)~~(c) The initial Required Fund Deposit of each Netting Member, other than an Inter-Dealer Broker Netting Member, shall be set by the Corporation based upon the expected nature and level of such Member's activity.

~~(e)~~(d) Notwithstanding anything to the contrary in this Rule, the Corporation may require a Netting Member to make and maintain a higher Required Fund Deposit than the amount as noted above, if the Corporation determines that such higher Required Fund Deposit is necessary to protect the Corporation and its Members from the risk (the "Legal Risk") that the

Corporation, as a result of a law, **rule or regulation** applicable to a Netting **Member, including a Netting** Member's insolvency or bankruptcy, may be delayed or prohibited from: (i) accessing any portion of the Netting Member's Required Fund Deposit, (ii) netting, closing out or liquidating transactions, or setting off obligations, or taking any other action contemplated by Rule 4 (Clearing Fund and Loss Allocation), Rule 21 (Restrictions on Access to Services), Rule 22 (insolvency of a Member) or Rule 22A (Procedures for When the Corporation Ceases to Act), or (iii) otherwise exercising its rights pursuant to these Rules.

~~(f)~~**(e)** Notwithstanding anything to the contrary in this Rule, the Corporation may require a Netting Member's Required Fund Deposit to be in proportions of cash, Eligible Clearing Fund Securities and Eligible Letters of Credit that the Corporation determines to be necessary to protect itself and its Members from Legal Risk.

~~(g)~~**(f)** Notwithstanding anything to the contrary above, the Corporation, in its sole discretion, may secure a loan made to a Repo Broker for purposes of satisfying that Repo Broker's Funds-Only Settlement Amount obligation with that Repo Broker's Clearing Fund deposit made to the Corporation.

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### Section 3 - Form of Deposit

Subject to the provisions of Section 2 of this Rule governing the computation of **deposits a Netting Member's Required Fund Deposit**, and the limitations of this Section 3, Section 3a and Section 3b, a Netting Member's deposits to the Clearing Fund may be in the form of:

- (a) cash, or
- (b) an open account indebtedness fully secured by Eligible Clearing Fund Securities.

A minimum of 40 percent of the Netting Member's Required Fund Deposit shall be made in the form of cash and/or Eligible Clearing Fund Treasury Securities.

**The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit, with a minimum of \$100,000, must be made and maintained in cash, with the remaining portion of the Required Fund Deposit to be made and maintained in the form specified in this Section 3. The previous sentence shall also apply to a Sponsoring Member Omnibus Account, but shall not apply to the individual Sponsored Members whose activity is presented by such Account.**

~~Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Netting Member may substitute and/or withdraw securities from pledge and deposit, provided that the Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour or less prior to the close of the securities FedWire on such~~

~~Day. Any interest on securities deposited by a Netting Member to secure a Clearing Fund open account indebtedness that is received by the Corporation shall be credited to the Member's cash deposits to the Clearing Fund, except in the event of a default by a Member in payment of any of its obligations to the Corporation, in which case the Corporation may first liquidate such securities and apply all or a portion thereof, including any interest thereon, as provided in Section 7 of this Rule.~~

Section 3a– Special Provisions Related to Deposits of Cash

Cash deposits to the Clearing Fund shall be made in immediately-available funds. The Corporation may invest any Cash contained cash in the Clearing Fund, including (i) cash deposited by a Netting Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, “Clearing Fund Cash”) ~~may be partially or wholly invested by the Corporation in its sole discretion, for its account in securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States, or repurchase agreements related to securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States, and to the extent not so invested shall be deposited by the Corporation in its name in a depository or depositories selected by the Corporation. Investment income, if any, on cash deposits shall be paid to Members at such intervals, in such manner and in such amounts as the Corporation from time to time may determine in accordance with the Clearing Agency Investment Policy adopted by the Corporation.~~

Each Netting Member shall be entitled to any interest earned or paid on Clearing Fund cash deposits.

Section 3b – Special Provisions Related to Eligible Clearing Fund Securities

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(c) A Member may post as eligible collateral Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, however such collateral will be subject to a premium haircut as specified in the haircut schedule.

Eligible Clearing Fund Securities that are used to secure an open account indebtedness must be pledged to the Corporation on such terms and conditions as it may require, and be delivered to ~~either~~ the Corporation or to the Corporation's account at to a depository financial institution approved/designated by the Corporation ~~that shall hold the securities on the Corporation's behalf~~. The valuation of such Eligible Clearing Fund Securities shall be at current market value, which shall be determined by the Corporation not less frequently than on a daily basis. All Eligible Clearing Fund Securities shall be subject to a haircut set forth in these

Rules; ~~the~~ The Corporation has the right, in its discretion, to refuse to accept a particular type ~~or types~~ of Eligible Clearing Fund Security as a permissible form of Clearing Fund deposit.

Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Netting Member may substitute and/or withdraw Eligible Clearing Fund Securities from pledge and deposit, provided that the Netting Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour prior to the close of the securities FedWire on such day. Any interest on Eligible Clearing Fund Securities deposited by a Netting Member to secure a Clearing Fund open account indebtedness that is received by the Corporation shall be credited to the Netting Member's cash deposits to the Clearing Fund, except in the event of a default by such Netting Member on any obligations to the Corporation under these Rules, in which case the Corporation may exercise its rights under Section 6 of this Rule.

#### Section 4 - Lien

As security for any and all obligations and liabilities of a Netting Member to the Corporation, including, without limitation, the obligations of the Netting Member's Permitted Margin Affiliate to the Corporation, any obligation or liability of a Netting Member pursuant to a Cross-Margining Agreement, any Reimbursement Obligation of a Cross-Margining Participant to the Corporation pursuant to Section 3 of Rule 43, any obligation of a Cross-Margining Beneficiary Participant to reimburse the Corporation pursuant to Section 7 of Rule 43, any obligation of a Cross-Guaranty Defaulting Member to reimburse the Corporation pursuant to Section 2 of Rule 41 or any obligation of a Cross-Guaranty Beneficiary Member to reimburse the Corporation pursuant to Section 5 of Rule 41, each such Netting Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Netting Member's open account indebtedness or all assets and property placed by a Netting Member in the possession of the Corporation (or its agents acting on its behalf), including all securities and cash on deposit with the Corporation or its agents pursuant to this Rule and Rule 13 (collectively with any Eligible Letters of Credit issued on behalf of a Netting Member in favor of the Corporation, the Netting Member's "Actual Deposit"). The Corporation shall be entitled to exercise the its-rights ~~as~~of a pledgee under common law and ~~as~~ a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such ~~collateral~~assets.

#### Section 5 - Use of ~~Deposits and Payments~~ Clearing Fund

~~The use of the Clearing Fund deposits shall be limited to satisfaction of losses or liabilities of the Corporation, losses and liabilities incurred by the Corporation under a Cross-Margining Agreement, including Cross-Guaranty Payments and Cross-Guaranty Repayments made by the Corporation pursuant to Cross-Guaranty Agreements, Cross-Margining Payments and Cross-Margining Repayments made by the Corporation~~

~~pursuant to Cross-Margining Agreements, arising from the failure of a Defaulting Member or the Member's Permitted Margin Affiliate to satisfy an obligation to the Corporation, the failure of a Cross-Guaranty Defaulting Member to satisfy an obligation to a Cross-Guaranty Counterparty, the failure of a Cross-Margining Participant or its Cross-Margining Affiliate to satisfy an obligation to an FCO that has been guaranteed by the Corporation, the failure of a Cross-Margining Participant to satisfy a Reimbursement Obligation under Rule 43, or the failure of an FCO to make payment under a Cross-Margining Guaranty or otherwise incident to the clearance and settlement business of the Corporation including losses and liabilities arising other than from such failure of such Member, and to providing the Corporation with a source of collateral both to meet its temporary financing needs, including, without limitation, any financing that is obtained by the Corporation to hold securities pending settlement, and to ensure the satisfaction of Netting Members' settlement obligations. If the Corporation pledges, hypothecates, encumbers, borrows, or applies any part of the Clearing Fund deposits, or other collateral that it has received from Members to satisfy, in whole or in part, any liability, obligation, or liquidity requirement, for more than 30 days, the Corporation, at the Close of Business on the thirtieth day (or on the first Business Day thereafter), shall consider the amount used to meet such financing as an actual loss to the Clearing Fund and immediately allocate such loss in accordance with Section 7 of this Rule.~~

The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including, without limitation, each Member's obligations with respect to any loss allocations as set forth in Section 7 of this Rule and any obligations arising from a Cross-Guaranty Agreement pursuant to Rule 41 or a Cross-Margining Agreement pursuant to Rule 43, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in Section 3a of this Rule.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the Close of Business on the 30th calendar day (or on the first Business Day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 7 of this Rule.

~~If a loss or liability incurred by the Corporation is allocated to a Member pursuant to Section 7 of this Rule, a Member that is a Cross-Margining Participant incurs a Reimbursement Obligation to the Corporation pursuant to Section 3 of Rule 43, under a Cross-Margining Agreement, a Member that is a Cross-Margining Beneficiary Participant incurs an obligation to reimburse the Corporation pursuant to Section 7 of Rule 43, a Member that is a Cross-Guaranty Defaulting Member incurs an obligation to reimburse the Corporation pursuant to Section 2 of Rule 41 or a Member that is a Cross-Guaranty Beneficiary Member incurs an obligation to reimburse the Corporation pursuant to Section 5 of Rule 41, the Corporation may apply the portion of the: (a) Member's deposit to the Clearing Fund, or (b) in the case of a Netting Member that is an Inter-Dealer Broker~~

~~Netting Member, the deposit required pursuant to Section 7 of this Rule, necessary to satisfy such allocation or obligation. In this regard, the Corporation may apply any cash, draw against any letters of credit, and liquidate any securities deposited by the Member, and may do any or all of the foregoing whether or not the Member is treated as insolvent under Rule 22.~~

Section 6 - ~~RESERVED FOR FUTURE USE~~Application of Clearing Fund Deposits and Other Amounts to Defaulting Members' Obligations

Any loss or liability incurred by the Corporation as the result of the failure of a Defaulting Member to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 6.

The Corporation shall apply (a) any Clearing Fund deposits, Funds-Only Settlement Amounts, and any other collateral or assets held by the Corporation securing such Defaulting Member's obligations to the Corporation, (b) any Clearing Fund deposits, Funds-Only Settlement Amounts, and other collateral held by the Corporation with respect to a Permitted Margin Affiliate of the Defaulting Member, (c) any proceeds of any of the foregoing, and (d) the following additional resources set forth in paragraphs (i) and (ii) below as are applicable to the Defaulting Member:

- (i) If the Defaulting Member is a Cross-Margining Participant, the Corporation shall apply any amounts available from an FCO under a Cross-Margining Guaranty either upon receipt or at the time described in Section 5(b) of Rule 43.
- (ii) If the Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement (subject to an applicable Cross-Margining Agreement) either upon receipt or at the time described in Section 3(b) of Rule 41.

If the Corporation applies a Defaulting Member's Clearing Fund deposits as permitted by this Rule, the Corporation may take any and all actions with respect to the Defaulting Member's Actual Deposit, including the assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate.

In the event that the Corporation makes a payment to an FCO under a Cross-Margining Guaranty and the Cross-Margining Participant that incurs a Reimbursement Obligation representing the amount of such payment fails to promptly satisfy the Reimbursement Obligation, the Corporation may in its discretion, and without treating such Cross-Margining Participant as a Defaulting Member, treat such payment as a loss to be allocated in accordance with this Section and Section 7 of this Rule.

Section 7 - Loss Allocation ~~of Loss or Liability Incurred by the Corporation~~ Waterfall, Off-the-Market Transactions

For the purposes of this Rule, the following terms shall have the following meanings:

“Defaulting Member” shall mean a Member for which the Corporation has ceased to act pursuant to Rule 21 or Rule 22.

“Defaulting Member Event” shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 21 or Rule 22.

“Declared Non-Default Loss Event” shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 6 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

If the Corporation incurs a loss or liability (i) relating to or arising out of or relating to incurred by the Corporation as the result of the failure of the default of a Defaulting Member that is not satisfied pursuant to Section 6 of this Rule (a “Defaulting Member Event”) or (ii) otherwise incident to the clearance and settlement business of the Corporation, as determined below (a “Declared Non-Default Loss Event”), the Corporation shall address the loss or liability as follows: to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 7 of this Rule 4.

(a) The corporation shall apply any Clearing Fund deposits, Funds-Only Settlement Amounts, other collateral held by the Corporation securing such Member's obligations to the Corporation, and any Clearing Fund deposits, Funds-Only Settlement Amounts, and other collateral held by the Corporation with respect to a Permitted Margin Affiliate of the Member, and the following additional resources set forth in paragraphs (i) and (ii) below as are applicable to the Defaulting Member:

- (i) If the Defaulting Member is a Cross-Margining Participant, the Corporation shall apply any amounts available from an FCO under a Cross-Margining Guaranty either upon receipt or at the time described in Section 5(b) of Rule 43.
- (ii) If the Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement (subject to an applicable Cross-Margining



~~Agreement) either upon receipt or the time described in Section 3(b) of Rule 41.~~

~~(b) — In the event there is any loss or liability incurred by the Corporation in respect of the Government Securities Division remaining after application of paragraph (a) above (any such loss or liability, a “Remaining Loss”), the The Corporation shall apply an amount of up to 25% of the existing retained earnings of the Corporation, or such higher amount as the Board of Directors shall determine the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. Notwithstanding the foregoing, to the extent that a loss or liability is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the data on the Off-the-Market Transaction to the Corporation; If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.~~

~~(c) — If there is any Remaining Loss after application of paragraph (b) above, If the loss or liability with respect to an Event Period results from one or more Defaulting Member Events, the Corporation shall determine the amount of such loss or liability that is attributable to Tier One Netting Members and the amount of such loss or liability that is attributable to Tier Two Members. If the loss or liability with respect to an Event Period results from one or more Declared Non-Default Loss Events, the amount of such loss or liability shall be attributable to Tier One Netting Members. Tier Two Members shall not be subject to loss allocation with respect to Declared Non-Default Loss Events.~~

~~To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction.~~

~~No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules. If the Corporation allocates losses or liabilities pursuant to this Rule and subsequently recovers amounts against such allocated losses or liabilities, in whole or in part, the net amount of the recovery shall be credited to the Persons, including the Corporation, against whom the losses were charged in proportion to the amounts charged against them.~~

~~To the extent there is a Remaining Loss attributable to Tier One Netting Members, the Corporation shall assess the Required Fund Deposit maintained by the Member an amount of up to \$50,000, in an equal basis per Tier One Netting Member, provided, however, that, in the event that the Corporation makes a payment to an FCO under a Cross-Margining Guaranty and the Cross-Margining Participant that incurs a Reimbursement Obligation representing the amount of such payment fails to promptly satisfy the Reimbursement Obligation, the Corporation may in its discretion, and without~~

~~treating such Cross-Margining Participant as a Defaulting Member, treat such payment as a Remaining Loss to be allocated in accordance with this subsection (c).~~

### Tier One Netting Members

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) Business Days (an “Event Period”) shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for a *the* Defaulting Member (or the next Business Day, if such day is not a Business Day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the determination by the Board of Directors that the applicable loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Tier One Netting Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner. *Declared Non-Default Loss Event* (or the next Business Day, if such day is not a Business Day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

~~In the case of losses and liabilities relating to or arising out of a Declared Non-Default Loss Event, all Tier One Netting Members shall be subject to loss allocation. In the case of losses and liabilities relating to or arising out of a Defaulting Member Event, only non-defaulting Tier One Netting Members shall be subject to loss allocation. After a first round of loss allocations with respect to an Event Period, only Tier One Netting Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule shall be subject to further loss allocation with respect to that Event Period. The Corporation shall notify Tier One Netting Members subject to loss allocation of the amounts being allocated to them (“Loss Allocation Notice”) in successive rounds of loss allocations.~~

*Each Tier One Netting Member that is a Tier One Netting Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Tier One Netting Member for which the Corporation ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day, shall be deemed to be a Tier One Netting Member on the first day of that Event Period.*

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Tier One Netting Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Netting Members who have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule.

Each loss allocation shall be communicated to Tier One Netting Members by the issuance of a notice that advises the Tier One Netting Members of the amount being allocated to them (“of a Loss Allocation Notice”). Each Tier One Netting Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) Business Days preceding the first day of the applicable Event Period or such shorter period of time that the Tier One Netting Member has been a Tier One Netting Member (each Tier One Netting Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Tier One Netting Members subject to loss allocation in such round.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Netting Member in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to notify the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, and thereby benefit from its Loss Allocation Cap. The “Loss Allocation Cap” of a Tier One Netting Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Tier One Netting Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule shall be subject to further loss allocation with respect to that Event Period.

Each Tier One Netting Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) Business Days preceding the first day of the applicable Event Period or such shorter period of time that the Tier One Netting Member has been a Tier One Netting Member (each Tier One Netting Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Tier One Netting Members subject to loss allocation in such round. Each Tier One Netting Member’s maximum payment obligation with respect to any loss allocation round shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period or (y) its Average RFD (such amount shall be each Tier One Netting Member’s “Loss Allocation Cap”). Notwithstanding the foregoing, however, an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect

to activity in its Segregated Repo Account, shall not be subject to an aggregate loss allocation in an amount greater than \$5 million pursuant to this Section 7 for losses and liabilities resulting from an Event Period.

For purposes of calculating the pro rata share of losses and liabilities and the Loss Allocation Cap pursuant to the previous paragraph, the Corporation shall not count toward a Tier One Netting Member's Required Fund Deposit any increased Clearing Fund deposit that the Tier One Netting Member may be subject to pursuant to Section 2(d) of this Rule.

Tier One Netting Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second Business Day after the Corporation issues any such notice. Tier One Netting Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second Business Day after the Corporation issues such notice, unless the Tier One Netting Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round, pursuant to Section 7b of this Rule.

~~Notwithstanding Section 10 of this Rule, to~~ ~~To~~ the extent that a Tier One Netting Member's Loss Allocation Cap exceeds the Tier One Netting Member's Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Tier One Netting Member, up to the Tier One Netting Member's Loss Allocation Cap.

If a Tier One Netting Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Tier One Netting Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.

If a Tier One Netting Member notifies the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Netting Member shall comply with the provisions of Section 7b of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Netting Member fails to comply with the provisions of Section 7b of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

A Tier One Netting Member that elects to withdraw pursuant to Section 7b of this Rule shall not be eligible to re-apply to become a Comparison-Only Member or a Netting Member unless, prior to submitting such application, it makes the payment(s) to the Corporation that would have been due pursuant to Section 7 of this Rule as if the Tier One Netting Member had not withdrawn, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Event Period began.

## **Tier Two Members**

To the extent there is a **Remaining Loss-loss or liability** payable by Tier Two Members, such loss **or liability** shall be allocated to Tier Two Members.

If the Tier Two Members are not CCIT Members (“Tier Two Non-CCIT Members”), the allocation will be based upon their trading activity with the Defaulting Member that resulted in a loss **or liability**. The Corporation shall assess such loss **or liability** against the Tier Two Non-CCIT Members ratably based upon their loss **or liability** as a percentage of the entire amount of the **Remaining Loss-loss or liability** attributable to such Tier Two Non-CCIT Members. Such Tier Two Non-CCIT Members with a bilateral liquidation profit will not be allocated any portion of the **Remaining Loss-loss or liability** otherwise attributable to Tier Two Members.

If the Tier Two Members are CCIT Members (“Tier Two CCIT Members”), the allocation will be based upon their open trading activity with the Defaulting Member that resulted in a loss **or liability**. The Corporation shall assess such loss **or liability** against the Tier Two CCIT Members ratably based upon a percentage of the loss **or liability** attributable to each Tier Two CCIT Member’s specific Generic CUSIP that it had open with the Defaulting Member. Such Tier Two CCIT Members with a bilateral liquidation profit will not be allocated any portion of the **Remaining Loss-loss or liability** otherwise attributable to Tier Two Members.

**If a Tier Two Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Tier Two Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.**

~~(d) If there is any Remaining Loss attributable to Tier One Netting Members after application of paragraph (c) above, it shall be allocated among Tier One FICC Members, ratably, in accordance with the amount of each Tier One Netting Member’s respective Required Fund Deposit and based on the average daily level of such deposit over the prior twelve months (or such shorter period as may be available in the case of a Member which has not maintained a deposit over such time period) (such amount, the Member’s “Average Required FICC Clearing Fund Deposit”).~~

~~(e) Notwithstanding anything to the contrary in this Section 7, however, an Inter-Dealer Broker Netting Member, or a Non-IDB Broker with respect to activity in its Segregated Broker Account, shall not be subject to an aggregate allocation of loss pursuant to this Section 7 for any single loss-allocation event, in an amount greater than \$5 million.~~

~~(f) Any loss or liability incurred by the Corporation incident to its clearance and settlement business arising from the failure of a Netting Member to pay to the Corporation an allocation made pursuant to the preceding subsections of this Section, or arising other than from a Remaining Loss (hereinafter, an “Other Loss”) shall be allocated among Tier One Netting Members, ratably, in accordance with the respective amounts of their Average Required FICC Clearing Fund Deposits.~~

~~(g) The entire amount of the Required Fund Deposit of any Netting Member at the time that the Corporation incurred Remaining Loss or Other Loss may be used to~~

~~satisfy any amount allocated against a Member as a result of such Remaining Loss or Other Loss. If notification is provided to a Member that an allocation has been made against a Member pursuant to this Rule and that application of the Member's Required Fund Deposit is not sufficient to satisfy such obligation to make payment to the Corporation, the Member shall (i) deliver to the Corporation by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by the Corporation, that amount which is necessary to eliminate any such deficiency, except that (ii) with regard to an allocation arising from any Remaining Loss allocated by the Corporation pursuant to subsection (d) of this Section 7 and any Other Loss, such Member may instead provide by the Close of Business on the Business Day on which such payment is due the Corporation written notice to the Corporation, pursuant to Section 13 of Rule 3, of its election to terminate its membership in the Corporation. If such Member elects to terminate its membership in the Corporation, its liability for an allocation arising from such Remaining Loss and Other Loss shall be limited to the amount of its Required Fund Deposit for the Business Day on which the notification of such allocation is provided to the Member. If such Member does not elect to terminate its membership in the Corporation as provided for above, it shall make such deposits to the Clearing Fund, by the Close of Business on the Business Day on which the Member is obligated to make the payment provided for above, as are necessary to satisfy its Required Fund Deposit as of such Business Day. If the Member shall fail to take the action stated in either (i) or (ii) above, the Corporation shall cease to act generally with regard to such Member pursuant to Rules 21 and 22A, and may take disciplinary action against the Member pursuant to Rule 48.~~

~~——— A Member that elects to terminate its membership pursuant to alternative (ii) of the above paragraph in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Comparison-Only Member or a Netting Member unless, prior to submitting such application, it makes the payment to the Corporation provided for in alternative (i) of the above paragraph, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Remaining Loss or Other Loss was incurred by the Corporation until the date of such payment. If a Netting Member elects to terminate its membership pursuant to alternative (ii) of the above paragraph, or if the Member fails to take any action, the Corporation will promptly make an additional assessment against the remaining Tier One Netting Members to cover the amount not paid by the Netting Member that made such election to terminate its membership.~~

~~——— (h) If a Remaining Loss or Other Loss occurs, the Corporation shall promptly notify each Member, and the SEC, of the amount involved and the reasons therefore. Any disciplinary action that the Corporation takes, or the voluntary or involuntary cessation of membership by a Member subsequent to the occurrence of the Remaining Loss or Other Loss, shall not, except as otherwise provided in this Rule, affect the obligations of the Member to the Corporation under this Rule or the Procedures thereof, or affect any remedy to which the Corporation may be entitled. If a Remaining Loss or Other Loss charged to Members is afterward recovered by the Corporation in whole or in part, the net amount of the recovery shall be credited or paid to those Persons, other than a Defaulting Member or other Person who caused in whole or part such Loss, including the~~

~~Corporation, against whom the loss was charged, in proportion to the amounts paid by them, whether or not they are still Members.~~

~~(i) For purposes of calculating the allocations in this Section 7 that are based upon a Member's Average Required FICC Clearing Fund Deposit, a Member that is subject to an increased Clearing Fund deposit requirement pursuant to subsection (f) of Section 2 of this Rule shall be deemed to have a Average Required FICC Clearing Fund Deposit amount without such increase being taken into account.~~

#### Section 7a – Corporate Contribution

For any loss allocation pursuant to Section 7 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Exchange Act. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) Business Days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution. The Corporation shall maintain one Corporate Contribution, the amount of which is available to both the Government Securities Division and the Mortgage-Backed Securities Division, and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs. In the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution shall be applied to that Division up to the amount then available. If a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution shall be applied to the respective Division in the same proportion that the aggregate Average RFDs of all members in that Division bears to the aggregate Average RFDs of all members in both Divisions.

Nothing in these Rules shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether *arising out of or relating to* a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

### Section 7b – Withdrawal Following Loss Allocation

If a Tier One Netting Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss allocation *round* as set forth in Section 7 of this Rule (“Loss Allocation Withdrawal Notice”), the Tier One Netting Member shall:

- (i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Tier One Netting Member to the Corporation, unless otherwise approved by the Corporation; and
- (ii) as of the time of such Tier One Netting Member’s submission of the Loss Allocation Withdrawal Notice to the Corporation, cease submitting transactions to the Corporation for processing, clearance or settlement, unless otherwise approved by the Corporation.

*A Tier One Netting Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).*

If the Tier One Netting Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Tier One Netting Member will remain subject to further loss allocations pursuant to Section 7 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.

### Section 8 – Return of Members’ Clearing Fund Deposits

If a Member gives notice to the Corporation of its election to withdraw from membership, the Member’s Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied.

Notwithstanding anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit and/or Cross-Margining Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 41 “Cross Guaranty Agreements” and/or Rule 43 “Cross-Margining Arrangements”, to reimburse the Corporation for any Cross-Guaranty Repayment or Cross-Margining Repayment, respectively, that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement or Cross-Margining Agreement.



**Section 89 - ~~Timing of Payment of Deposit~~ Initial Required Fund Deposit and Changes in Members' Required Fund Deposits**

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A Netting Member must increase the amount of its **deposit to the Clearing Fund Required Fund Deposit** (by the deposit of cash, Eligible Netting Securities, and/or Eligible Letters of Credit subject to the requirements of this Rule) by the Required Fund Deposit Deadline on any Business Day that such Netting Member's **Actual Deposit actual deposit to the Clearing Fund** is less than its Required Fund Deposit as set forth in the Report listing such, subject to the conditions included in Section 2 of this Rule 4. **If there is an increase in a Netting Member's Required Fund Deposit, at the time the increase becomes effective, the Netting Member's obligations to the Corporation shall be determined in accordance with the increased Required Fund Deposit whether or not the Netting Member has satisfied such increased amount.**

**If the Corporation applies a Netting Member's Clearing Fund deposits as permitted pursuant to this Rule, the Corporation may take any and all actions with respect to the Netting Member's Actual Deposit, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Netting Member's Required Fund Deposit, the Netting Member shall immediately replenish it. If the Netting Member fails to do so, the Corporation may take disciplinary action against such Netting Member pursuant to Rule 21 or Rule 48. Any disciplinary action that the Corporation takes pursuant to Rule 21 or Rule 48 or the voluntary or involuntary cessation of membership shall not affect the Netting Member's obligations to the Corporation or any remedy to which the Corporation may be entitled under applicable law.**

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**Section 910 - ~~Return of Deposits and Payments~~ Excess Clearing Fund Deposits**

The Corporation shall determine with such frequency as it shall from time to time specify, whether the amount deposited by a Member in the Clearing Fund is in excess of its Required Fund Deposit (hereinafter, "Excess Clearing Fund Deposit"). On any day that the Corporation has determined that an Excess Clearing Fund Deposit exists with respect to any Member, the Corporation will, in the form and manner required by the Corporation, notify each **such** Member of such excess. **Subject to the Corporation's rights under these Rules to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) as the Member requests. Upon the request of a Member, in the form and manner required by the Corporation, the Corporation shall cause to be returned to each such Member cash on deposit (in excess of the minimum amount of cash required to be maintained in the Clearing Fund), and/or Eligible Clearing Fund Securities (valued at their**

~~market value, including accrued interest as of the end of the Business Day prior to such withdrawal), in an aggregate amount equal to such excess or such lesser amount as the Member may request; provided, however, that, any return of excess will be done in such a way that the remaining Clearing Fund on deposit meets the requirements of Section 4, 4a, and 4b of this rule. In addition Notwithstanding the foregoing, at the discretion of the Corporation, some or all of the Excess Clearing Fund Deposit may not be returned if the Member has an outstanding payment obligation to the Corporation, if the Corporation determines that the Member's anticipated Funds-Only Settlement Amounts or Net Settlement Positions in the near future may reasonably be expected to be materially different than those of the recent past or if the Member is on the Watch List.~~

In addition, the return of an Excess Clearing Fund Deposit amount to any Member is subject to the following limitations: (1) such return of Excess Clearing Fund Deposit shall not be done in a manner that would cause the Member to violate any other Section of these Rules; (2) Excess Clearing Fund Deposit shall not be returned to a Member to the extent that such return would reduce the amount of the Member's Cross-Guaranty Repayment Deposit to the Clearing Fund below the amount required to be maintained pursuant to Section 4 of Rule 41; and (3) Excess Clearing Fund Deposit shall not be returned to a Member to the extent that such return would reduce the amount of the Member's Cross-Margining Repayment Deposit to the Clearing Fund below the amount required to be maintained pursuant to Section 6 of Rule 43.

The provisions of this section shall not limit the rights or remedies of the Corporation as provided in Section 7 of Rule 3.

#### Section 10- Ceasing to be a Member

~~If a Netting Member gives notice to the Corporation pursuant to Rule 3 of its election to terminate its membership in the Netting System, the Member's deposits to the Clearing Fund in the form of cash or securities shall be returned to it within 30 calendar days thereafter, and the Member's deposits to the Clearing Fund in the form of letters of credit shall be returned to it within 90 calendar days thereafter, in each case provided that all amounts owing to the Corporation by the Member have been paid to the Corporation prior to such return and the Member has no remaining open Net Settlement Position, Fail Net Settlement Position, or Forward Net Settlement Position. Any obligation of a Member to the Corporation pursuant to this Rule that is unsatisfied at the time it ceases to be a Member shall not be effected by such cessation.~~

~~The time periods specified in the above paragraph also govern the return of any cash or securities deposited by, or letters of credit issued on behalf of, an Inter-Dealer Broker pursuant to Section 7 of this Rule.~~

~~Notwithstanding the previous two paragraphs or anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit and/or Cross-Margining Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 41 and/or Rule 43 to reimburse the Corporation for any Cross-Guaranty Repayment~~

~~or Cross-Margining Repayment, respectively, that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement or Cross-Margining Agreement.~~

#### Section 11 - Corporation's Authority to Pledge and Assign

In furtherance of the rights of the Corporation pursuant to these Rules, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign any and all **Actual Deposits: (i) cash deposits, (ii) securities, repurchase agreements, deposits or other instruments in which cash deposits of Members are invested, and (iii) any securities or letters of credit pledged or deposited by any Member to secure an open account indebtedness to the Clearing Fund or otherwise to collateralize its obligations to the Corporation, and any proceeds thereof** for the purpose of securing loans made to the Corporation **(the party making any such loan to the Corporation hereinafter referred to as the "Lender"); or other obligations incurred by the Corporation, provided that the proceeds of such loans are used for a purpose permissible under Section 3 and Section 5 of this Rule** in each case incident to the clearance and settlement business of the Corporation. Such loans ~~or obligations~~ shall be on terms and conditions deemed necessary or advisable by the Corporation **(including collateralization thereof)** in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member to the Corporation for which such property **and Eligible Letters of Credit (if any) were was** pledged to or deposited with the Corporation. Notwithstanding the above, the Corporation shall remain obligated to each **such** Member to return, and to allow substitution for or withdrawal of, cash, **and Eligible Clearing Fund Securitiessecurities**, and **Eligible HLetters of eCredit (if any)** pledged or deposited by **asuch** Member as **a** Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund~~, or otherwise to collateralize such Member's obligations to the Corporation, under the circumstances and within the timeframes specified in these Rules. **In the event of any conflict or inconsistency between this Rule 4 and any agreement between the Corporation and any Member, this Rule 4 shall govern and prevail.**

#### Section 12 – Clearance and Settlement Business of the Corporation

For purposes of this Rule 4, references to the clearance and settlement business of the Corporation shall include its business as a Securities Intermediary.

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## **RULE 13 - FUNDS-ONLY SETTLEMENT**

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### Section 5- Funds-Only Settlement Amount Payment Process

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(o) Under FRB Operating Circular No. 12, FICC's Settlement Agent has certain processing responsibilities in allocating an indemnity claim made by an FRB as a result of processing the Corporation's funds-only settlement via NSS. The Corporation shall apportion the entirety of such liability to the Netting Members for whom the Funds-Only Settling Bank to which the indemnity claim relates was acting. Such liability for each applicable Netting Member shall be in proportion to the amount of such Members' Funds-Only Settlement Amounts on the Business Day in question. If for any reason such allocation is not sufficient to fully satisfy the FRB indemnity claim, then the remaining loss shall be treated as ~~an "Other Loss" as defined by Rule 4~~ **a loss that is otherwise incident to the clearance and settlement business of the Corporation** and allocated accordingly **pursuant to Section 7 of Rule 4.**

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## **RULE 18 - SPECIAL PROVISIONS FOR REPO TRANSACTIONS**

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### Section 3 - Collateral Substitutions

(f) Upon receipt of a request for such substitution and until information regarding the New Securities Collateral is provided to the Corporation for purposes of calculating the Required Fund Deposit of the Repo Party, the Corporation shall assign to the transaction a Contract Value which is 150 percent of the Contract Value of the original securities collateral. Moreover, where the Corporation has been notified of a substitution but the New Securities Collateral has not yet been reported to the Corporation, the Corporation shall base margining with respect to the New Securities Collateral on the applicable Generic CUSIP using the methodology that is used for securities whose volatility is less amenable to statistical analysis set forth in Section ~~2(b)~~1b of Rule 4.

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**RULE 21A – WIND-DOWN OF A NETTING MEMBER**

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If the Corporation takes, or mandates, any action pursuant to this Rule, the Corporation shall, as soon as practicable thereafter, notify the SEC and such other Members as it deems proper due to the nature of such action, and shall inform Members as to whether the Corporation shall relieve Members from the loss allocation obligations of ~~Section 8 of~~ Rule 4 with respect to transactions that Members enter into with the Wind-Down Member.

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## RULE 22B – CORPORATION DEFAULT

### Corporation Default

(a) If a “Corporation Default” occurs pursuant to subsection (b) below, all Transactions which have been subject to Novation pursuant to these Rules but have not yet settled and any rights and obligations of the parties thereto shall be immediately terminated. Each relevant Member shall thereupon promptly take such market action as is commercially reasonable under the circumstances to effect a close out of any outstanding positions. Each Member will report the results of its market action to the Board and the Board shall determine a single net amount owed by or to each Member with respect to such positions, to the extent applicable, by applying the close out and application procedures of Sections 2(a) and (b) of Rule 22A **(interpreted in all such cases as if each Member were a Defaulting Member)** and **Sections 7(a) through (e) of Rule 4 (interpreted in all such cases as if each Member were a Defaulting Member)** taking into account the **other loss allocation** provisions in **these Rules relating to loss allocation, including in the event that any Member is a Defaulting Member Rule 4**. The Board shall notify each Member of the net amount so determined and Members who have been notified that they owe an amount to the Corporation shall pay that amount on or prior to the date specified by the Board, subject to any applicable setoff rights. Members who have a net claim against the Corporation shall be entitled to payment thereof along with other Members’ and any other creditors’ claims pursuant to the underlying contracts with respect thereto, these Rules and applicable law. For the avoidance of doubt, nothing herein shall limit the rights of the Corporation upon a Member default (including following a Corporation Default) including under any Cross-Guaranty Agreement with the Mortgage-Backed Securities Division or any other Cross-Guaranty Counterparty.

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## **RULE 41 - CROSS GUARANTY AGREEMENTS**

### Section 1 – Authority

The Corporation may, from time to time, enter into one or more Limited Cross-Guaranty Agreements.

In determining its available net resources pursuant to a Limited Cross-Guaranty Agreement, the Corporation shall first offset the available net resources of the Government Securities Division ~~pursuant to the Cross-Margining Agreement between the Corporation and NYPC and then~~ the Mortgage-Backed Securities Division.

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### Section 3 - Application of Cross-Guaranty Payments

The Corporation shall, in its sole discretion, either:

(a) apply any Cross-Guaranty Payment received by the Corporation on account of a Cross-Guaranty Defaulting Member: (1) to the unpaid obligations of such Cross-Guaranty Defaulting Member to the Corporation and (2) to reduce the assessments made or that otherwise would be made against other Netting Members (each, a “Cross-Guaranty Beneficiary Member”) pursuant to Section ~~8~~7 of Rule 4; or

(b) retain any Cross-Guaranty Payment received by the Corporation and not apply such Cross-Guaranty Payment to reduce any assessments against other Netting Members pursuant to Section ~~8~~7 of Rule 4 until the Corporation determines that the Corporation is no longer liable for any Cross-Guaranty Repayment, at which point the Cross-Guaranty Payment shall be treated as an amount that has been recovered pursuant to Section ~~8(k)~~7 of Rule 4.

### Section 4 - Cross-Guaranty Repayment Deposits

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In the event that the Corporation is required to make a Cross-Guaranty Repayment and it does not have a sufficient amount of Cross-Guaranty Repayment Deposits to cover the liability, the Corporation shall treat the shortfall as ~~an “Other Loss”~~a loss incurred as a result of a Defaulting Member Event to be allocated pursuant to Section ~~8(g)~~7 of Rule 4.

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## **RULE 43 - CROSS-MARGINING ARRANGEMENTS**

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### Section 6 – Cross-Margining Repayment Deposits

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In the event that the Corporation is required to make a Cross-Margining Repayment and it does not have a sufficient amount of Cross-Margining Repayment Deposits to cover the liability, the Corporation shall treat the shortfall as ~~an “Other Loss”~~ **a loss incurred as a result of a Defaulting Member Event to be allocated** pursuant to Section ~~8(g)~~**7** of Rule 4.

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## BOARD INTERPRETATIONS AND STATEMENTS OF POLICY

### ~~INTERPRETATION OF THE BOARD OF DIRECTORS OF THE GOVERNMENT SECURITIES CLEARING CORPORATION~~

~~Pursuant to Rule 47 of the Government Securities Clearing Corporation ("the Corporation"), the Board of Directors has the authority to interpret the rules of the Corporation. The purpose of this interpretation is to clarify certain provisions of the Corporation Rule 4 ("Rule 4") and the extent to which Clearing Fund and other required deposits of Netting Members may be applied to a loss or liability incurred by the Corporation.~~

~~Section 6 of Rule 4 provides that the use of the Clearing Fund shall be limited to satisfaction of losses or liabilities of the Corporation arising from the failure of a Netting Member to satisfy an obligation to the Corporation or incident to the clearance and settlement business of the Corporation other than from such failure of such Member, and to providing the Corporation with a source of collateral to meet its temporary financing needs. Section 7 of Rule 4 provides that collateral in the amount of \$1.6 million is required to be maintained by Inter-Dealer Broker Netting Members (which Members are not required to contribute to the Clearing Fund) for the purpose of collateralizing any obligations that such Member may have to the Corporation pursuant to the Shareholder Agreement and Section 8 (Allocation of Loss or Liability Incurred by the Corporation) of Rule 4.~~

- ~~1. Use of required deposits to satisfy a loss or liability arising incident to the clearance and settlement business of the Corporation~~

~~The appropriateness of the use of required deposits to satisfy in whole or part a loss or liability arising incident to the clearance and settlement business of the Corporation is best determined by the Board of Directors on a case-by-case basis. The determination as to whether a loss or liability arose incident to the clearance and settlement business of the Corporation such that the loss or liability may be covered by Netting Members' required collateral may be made only by the Board of Directors, after consideration of the circumstances that led to the loss and liability and the effect on the Corporation of the use of required collateral to cover such loss or liability.~~

- ~~2. Use of required deposits to provide the Corporation with a source of collateral to meet its temporary financing needs~~

~~The use of required deposits to provide the Corporation with a source of collateral for financing is limited to those temporary financing needs related to the clearance and settlement business of the Corporation.~~

September 13, 1989

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## INTERPRETIVE GUIDANCE WITH RESPECT TO WATCH LIST CONSEQUENCES

Being placed on the Watch List may result in Clearing Fund-related consequences as well as other consequences under the Rules:

A. *Clearing Fund-Related Consequences*

1. Additional Clearing Fund Deposits

Pursuant to Section 12(e) of Rule 3, the Corporation may require a Netting Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~ the provisions of Rule 4 or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members.

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2. Restriction on Withdrawal of Excess Clearing Fund Deposits

Pursuant to Section 910 of Rule 4, the Corporation may retain some or all of the Excess Clearing Fund Deposit of a Member who is on the Watch List. Nonetheless, the Corporation generally does not retain the Excess Clearing Fund Deposit of a Watch List Member unless the Member fails to pay the Required Fund Deposit within the required timeframes established by the Corporation, or if the Corporation has a concern that the Member will not be able to satisfy its obligation to the Corporation.

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**FIXED INCOME CLEARING CORPORATION**

**MORTGAGE-BACKED SECURITIES DIVISION**

**CLEARING RULES**

TEXT OF PROPOSED RULE CHANGE

indicates proposed added language

indicates proposed deleted language

indicates additional language proposed by this  
Amendment No. 1

indicates deleted language proposed by this  
Amendment No. 1

**RULE 1 - DEFINITIONS**

\*\*\*\*

**Actual Deposit**

**The term “Actual Deposit” shall have the meaning given that term in Section 4 of Rule 4.**

\*\*\*\*

**Average RFD**

**The term “Average RFD” shall have the meaning given that term in Section 7 of Rule 4.**

\*\*\*\*

**Clearing Fund Cash**

**The term “Clearing Fund Cash” shall have the meaning given that term in Section 3a of Rule 4.**

\*\*\*\*

**Corporate Contribution**

**The term “Corporate Contribution” shall have the meaning given that term in Section 7a of Rule 4.**

\*\*\*\*

**Declared Non-Default Loss Event**

**The term “Declared Non-Default Loss Event” shall have the meaning given that term in Section 7 of Rule 4.**

\*\*\*\*

**Defaulting Member Event**

**The term “Defaulting Member Event” shall have the meaning given that term in Section 7 of Rule 4.**

\*\*\*\*

**Event Period**

**The term “Event Period” shall have the meaning given that term in Section 7 of Rule 4.**

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**Excess Clearing Fund Deposit**

**The term “Excess Clearing Fund Deposit” shall have the meaning given that term in Section 10 of Rule 4.**

\*\*\*\*

**Lender**

**The term “Lender” shall have the meaning given that term in Section 11 of Rule 4.**

\*\*\*\*

**Loss Allocation Cap**

**The term “Loss Allocation Cap” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Notice**

**The term “Loss Allocation Notice” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Withdrawal Notice**

**The term “Loss Allocation Withdrawal Notice” shall have the meaning given that term in Section 7b of Rule 4.**

\*\*\*\*

**Termination Date**

**The term “Termination Date” shall have the meaning given that term in Section 14 of Rule 3.**

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**Voluntary Termination Notice**

**The term “Voluntary Termination Notice” shall have the meaning given that term in Section 14 of Rule 3.**

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RULE 3 - ONGOING MEMBERSHIP REQUIREMENTS

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Section 11 – Ongoing Monitoring

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(e) The Corporation may require a Clearing Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~the provisions of Rule 4 (which additional deposit shall constitute a portion of the Clearing Member's Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member. The Corporation may also retain any Excess Clearing Fund Deposits of a Clearing Member that has been placed on the Watch List as provided in Section ~~9~~10 of Rule 4.

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Section 14 - Voluntary Termination

A Member may elect to terminate its membership in the Clearing System by providing the Corporation with ~~a 10 days~~ written notice of such termination (**“Voluntary Termination Notice”**); ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period. The Member shall specify in the Voluntary Termination Notice an effective a desired date for its withdrawal from membership (the “Termination Date”), which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Member to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.~~

Such termination will not be effective until accepted by the Corporation, **which shall be no later than 10 Business Days after the receipt of the Voluntary Termination Notice from such Member.** The Corporation’s acceptance shall be evidenced by a notice to Members announcing the Member’s termination and the **effective date of the termination of the Member (hereinafter the “Termination Date”)**. As of the Termination Date, a Clearing Member that terminates its membership in the Clearing System shall no longer be eligible to submit to the Corporation data on trades unless the Board determines otherwise in order to ensure an orderly liquidation of the **Clearing Member's open obligations.** **If any trade is submitted to the Corporation by such Clearing Member that is scheduled to settle on or after the Termination Date, such Clearing Member’s Voluntary Termination Notice will be deemed void, and the Clearing Member will remain subject to these Rules as if it had not given such Voluntary Termination Notice.**

A Member's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to Transactions submitted to the Corporation before the Termination Date. The return of the Member's Clearing Fund deposit shall be governed by Section 108 of Rule 4. **If a Member is a Tier One Member and an Event Period were to occur after such Member has submitted its Voluntary Termination Notice but prior to the Termination Date, in order for such Member to benefit from its Loss Allocation Cap pursuant to Section 7 of Rule 4, the Member will need to comply with the provisions of Section 7b of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the Member.**

### **Section 15 - Indemnification**

~~Clearing Members shall indemnify the Corporation against any loss, reasonable cost or expense, damage or liability arising out of the performance, non-performance or misperformance of such duties except to the extent that the Corporation's conduct violated the standard of care set forth in Rule 30, "Limitations of Liability". In the event that any loss, cost, expense, damage or liability with respect to which the Corporation is entitled to indemnification pursuant to this Section 15 is attributable to one or more identifiable Clearing Members, an assessment shall be made against such Clearing Members. In the event that any such loss, cost, expense, damage or liability cannot be attributed to one or more identifiable Clearing Members, an assessment shall be made against Clearing Members generally in proportion to their relative usage of the facilities of the Corporation (based on fees for services) during the period in which such loss, cost, expense, damage or liability was incurred. The assessment in the immediately preceding sentence shall be subject to Section 7(g) of Rule 4.~~

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RULE 4 - CLEARING FUND AND LOSS ALLOCATION

Section 1 – General Required Fund Deposits

Each Clearing Member shall make, and maintain on an ongoing basis ~~so long as such Member is a Clearing Member~~, a deposit to the Clearing Fund ~~at no less than the minimum required level set forth in this Rule (the "Required Fund Deposit")~~. ~~Deposits to the Clearing Fund shall be held by the Corporation or its designated agents to be applied as provided in this Rule.~~ The amount of each Clearing Member's required deposit shall be determined by the Corporation in accordance with this Rule and shall be referred to as the Required Fund Deposit. The timing of payment of the Required Fund Deposit shall be determined in accordance with the provisions of Section ~~89~~ of this Rule. ~~The term "Transactions" as used in this Rule 4 includes Pool Receive Obligations, Pool Deliver Obligations, TBA Obligations, Specified Pool Trades and Stipulated Trades.~~

A Clearing Member may in its discretion maintain additional deposits at the Corporation, subject to any requirements the Corporation may establish for such excess amounts pursuant to Section 10 of this Rule. For purposes of these Rules, such additional deposits shall be deemed to be part of the Clearing Fund and the Clearing Member's Actual Deposit but shall not be deemed to be part of the Clearing Member's Required Fund Deposit. The Corporation shall not be required to segregate each Clearing Member's Actual Deposit, but shall maintain books and records concerning the assets that constitute each Clearing Member's Actual Deposit.

~~If a Member's Required Fund Deposit is charged as a result of a Clearing Fund loss solely attributable to that Member such Member shall promptly replenish the deficit in its Required Fund Deposit.~~

Section 2 – Required Fund Deposit Requirements

- (a) Mark-to-Market -- Computation of profit or loss.

The Corporation shall separately compute profit or loss for each Transaction in each Account maintained by a Clearing Member as follows: The term "Transactions" as used in this Rule 4 includes Pool Receive Obligations, Pool Deliver Obligations, TBA Obligations, Specified Pool Trades and Stipulated Trades.

\*\*\*\*

~~(d) The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit arrived at above, with a minimum of \$100,000, must, be made and maintained in cash, with the remaining portion of the Required Fund Deposit to be made and maintained in the form specified in Section 3 of this Rule.~~

~~(e)~~(d) The initial Required Fund Deposit of each Clearing Member shall be set by the Corporation based upon the expected nature and level of such Member's activity.

~~(f)~~(e) Notwithstanding anything to the contrary in this Rule, the Corporation may require a Clearing Member to make and maintain a higher Required Fund Deposit than the amount ~~calculated~~ as noted above, if the Corporation determines that such higher Required Fund Deposit is necessary to protect the Corporation and its Members from the risk (the “Legal Risk”) that the Corporation, as a result of a law, rule or regulation applicable to a Clearing Member, including a Clearing Member’s insolvency or bankruptcy, may be delayed or prohibited from: (i) accessing any portion of the Clearing Member’s Required Fund Deposit, (ii) netting, closing out or liquidating Transactions, or setting off obligations, or taking any other action contemplated by these Rules or (iii) otherwise exercising its rights pursuant to these Rules.

~~(g)~~(f) Notwithstanding anything to the contrary in this Rule, the Corporation may require a Clearing Member’s Clearing Fund deposit to be in proportions of cash, Eligible Clearing Fund Securities and Eligible Letters of Credit that the Corporation determines to be necessary to protect itself and its Members from Legal Risk. In addition, the Corporation may take all necessary action to mitigate Legal Risk, including, but not limited to, requiring the Member to post additional Clearing Fund as set forth in this Section 2 of Rule 4.

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### Section 3 - Form of Deposit

Subject to the provisions of Section 2 of this Rule 4 governing the computation of a Clearing Member’s Required Fund Deposit, and the limitations of this Section 3, Section 3a and Section 3b, a Clearing Member's deposits to the Clearing Fund may be in the form of:

- (a) cash; ~~and or~~
- (b) an open account indebtedness fully secured by Eligible Clearing Fund Securities.

~~The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit made to the Clearing Fund, with a minimum of \$100,000, must be made and maintained in cash. A minimum of 40 percent of the Clearing Member’s Required Fund Deposit shall be made in the form of cash and/or Eligible Clearing Fund Treasury Securities.~~

The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit, with a minimum of \$100,000, must be made and maintained in cash, with the remaining portion of the Required Fund Deposit to be made and maintained in the form specified in this Section 3.

~~Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Clearing Member may substitute and/or withdraw securities from pledge and deposit, provided that the Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour or less prior to the close of the securities FedWire on such Day. Any interest on securities deposited by a Clearing Member to secure a Clearing Fund~~

~~open account indebtedness that is received by the Corporation shall be credited to the Member's cash deposits to the Clearing Fund, except in the event of a default by a Member in payment of any of its obligations to the Corporation, in which case the Corporation may first liquidate such securities and apply all or a portion thereof, including any interest thereon, as provided in Section 7 of this Rule.~~

Section 3a - Special Provisions Relating to Deposits of Cash

Cash deposits to the Clearing Fund shall be paid to the Corporation in immediately available funds. ~~The Corporation may invest any Cash contained cash~~ in the Clearing Fund, including (i) cash deposited by a Clearing Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, "Clearing Fund Cash") in accordance with the Clearing Agency Investment Policy adopted by the Corporation. ~~may be partially or wholly invested by the Corporation, in its sole discretion, for the account of the Clearing Fund in debt obligations of the U.S. Government or those U.S. Government Agencies and instrumentalities of the United States guaranteed by the U.S. Government subject to reverse repurchase agreements ("repo"). Clearing Fund cash may also be partially or wholly invested for its accounts in direct purchases of: (1) U.S. Treasury Bills, Bonds or Notes, (2) Certificates of Deposit or similar deposits of FDIC insured banks ("CDs"), or (3) 2a-7 Money Market Mutual Funds rated AAA or better and to the extent not so invested shall be deposited by the Corporation in its name in a depository (commercial bank account) consistent with its Investment Policy. Investment income, if any, on cash deposits shall be paid to Members at such intervals, in such manner and in such amounts as the Corporation from time to time may determine.~~

Each Clearing Member shall be entitled to any interest earned or paid on Clearing Fund cash deposits.

Section 3b - Special Provisions Relating to Deposits of Eligible Clearing Fund Securities

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Eligible Clearing Fund Securities that are used to secure an open account indebtedness must be pledged to the Corporation on such terms and conditions as it may require, and be delivered to ~~either~~ the Corporation or to the Corporation's account at ~~to~~ a depository financial institution approved/designated by the Corporation ~~that shall hold the securities on the Corporation's behalf.~~ The valuation of such Eligible Clearing Fund Securities shall be at current market value, which shall be determined by the Corporation not less frequently than on a daily basis. All Eligible Clearing Fund Securities shall be subject to a haircut set forth in these Rules. The Corporation has the right, in its discretion, to refuse to accept a particular type ~~or types~~ of Eligible Clearing Fund Security as a permissible form of Clearing Fund deposit.

Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Clearing Member may substitute and/or withdraw Eligible Clearing Fund Securities from pledge and deposit, provided that the Clearing Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour prior to the close of the securities FedWire on such day. Any interest on Eligible Clearing Fund Securities deposited by a Clearing Member to secure a Clearing Fund open account indebtedness that is received by the Corporation shall be credited to the Clearing Member's cash deposits to the Clearing Fund, except in the event of a default by such Clearing Member on any obligations to the Corporation under these Rules, in which case the Corporation may exercise its rights under Section 6 of this Rule.

#### Section 4 - Lien

As security for any and all obligations and liabilities of a Clearing Member to the Corporation, including, without limitation, any obligation of a Cross-Guaranty Defaulting Member to reimburse the Corporation pursuant to Rule 32 or any obligation of a Cross-Guaranty Beneficiary Member to reimburse the Corporation pursuant to **Section 5 of Rule 32**, each such **Clearing Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Clearing Member's open account indebtedness or all assets and property** placed by a **Clearing Member** in the possession of the Corporation (or its agents acting on its behalf), including all securities and cash on deposit with the Corporation or its agents pursuant to ~~these~~ **this Rules and Rule 11 (collectively with any Eligible Letters of Credit issued on behalf of a Clearing Member in favor of the Corporation, the Clearing Member's "Actual Deposit")**. The Corporation shall be entitled to **exercise the its rights as of** a pledgee under common law and ~~as~~ a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such ~~collateral~~ **assets**.

#### Section 5 - Use of Deposits and Payments Clearing Fund

~~The use of the Clearing Fund deposits and assets and property on which the Corporation has a lien shall be limited to satisfaction of losses or liabilities of the Corporation, including Cross-Guaranty Payments and Cross-Guaranty Repayments made by the Corporation pursuant to Cross-Guaranty Agreements, arising from the failure of a Defaulting Member to satisfy an obligation to the Corporation, the failure of a Cross-Guaranty Defaulting Member to satisfy an obligation to a Cross-Guaranty Counterparty, or otherwise incident to the clearance and settlement business of the Corporation with respect to losses and liabilities to meet unexpected or unusual requirements for funds that represent a small percentage of the Clearing Fund, and to provide the Corporation with a source of collateral both to meet its temporary financing needs (through an appropriate financing method determined by the Corporation in its sole discretion) for any financing that is obtained by the Corporation to hold securities pending settlement, to ensure the satisfaction of Members' settlement obligations and to meet unexpected or unusual~~

~~requirements for funds that represent a small percentage of the Clearing Fund. If the Corporation pledges, hypothecates, encumbers, borrows, or applies any part of the Clearing Fund deposits, or other collateral that it has received from Members to satisfy, in whole or in part, any liability, obligation, or liquidity requirement, for more than 30 days, the Corporation, at the Close of Business on the thirtieth day (or on the first Business Day thereafter), shall consider the amount used to meet such financing as an actual loss to the Clearing Fund and immediately allocate such loss in accordance with Section 7 of this Rule. Whenever the Clearing Fund is charged for any reason other than to satisfy a clearing loss attributable to a Member solely from that Member's Clearing Fund deposit, each Member will be provided the reasons for the charge.~~

The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including, without limitation, each Member's obligations with respect to any loss allocations as set forth in Section 7 of this Rule and any obligations arising from a Cross-Guaranty Agreement pursuant to Rule 32, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in Section 3a of this Rule.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the Close of Business on the 30th calendar day (or on the first Business Day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 7 of this Rule.

~~If a loss or liability incurred by the Corporation is allocated to a Member pursuant to Section 7 of this Rule, a Member that is a Cross-Guaranty Defaulting Member incurs an obligation to reimburse the Corporation pursuant to Rule 32, or a Member that is a Cross-Guaranty Beneficiary Member incurs an obligation to reimburse the Corporation pursuant to Rule 32, the Corporation may apply the portion of the Member's deposit to the Clearing Fund necessary to satisfy such allocation obligation. In this regard, the Corporation may apply any cash, draw against any letters of credit, and liquidate any securities deposited by the Member, and may do any or all of the foregoing whether or not the Corporation has ceased to act for the Member.~~

Section 6 – ~~[RESERVED FOR FUTURE USE]~~Application of Clearing Fund Deposits and Other Amounts to Defaulting Members' Obligations

Any loss or liability incurred by the Corporation as the result of the failure of a Defaulting Member to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 6.

The Corporation shall apply any Clearing Fund deposits, Cash Settlement Amounts, funds-only payments amounts, and any other collateral or assets held by the Corporation securing such Defaulting Member's obligations to the Corporation, and any

proceeds of any of the foregoing. To the extent that a Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement either upon receipt or the time described in Section 3(b) of Rule 32.

If the Corporation applies a Defaulting Member's Clearing Fund deposits as permitted by this Rule, the Corporation may take any and all actions with respect to the Defaulting Member's Actual Deposit, including the assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate.

Section 7 - Loss Allocation Waterfall, Off-the-Market Transactions of Loss or Liability Incurred by the Corporation

For the purposes of this Rule, the following terms shall have the following meanings:

"Defaulting Member" shall mean a Member for which the Corporation has ceased to act pursuant to Rule 14 or Rule 16.

"Defaulting Member Event" shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 14 or Rule 16.

"Declared Non-Default Loss Event" shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 6 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

If the Corporation incurs a Any loss or liability (i) relating to or arising out of or relating to incurred by the Corporation as the result of the failure of the default of a Defaulting Member that is not satisfied pursuant to Section 6 of this Rule (a "Defaulting Member Event") or (ii) otherwise incident to the clearance and settlement business of the Corporation, as determined below (a "Declared Non-Default Loss Event"), the Corporation shall address the loss or liability as follows to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 7 of this Rule 4:

(a) — First, by application of any Clearing Fund deposits, Cash Settlement Amounts, funds-only payment amounts, and any other collateral held by the Corporation securing such Member's obligations to the Corporation;

~~(b) — Second, if the Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement either upon receipt or the time described in Rule 32;~~

~~(e) In the event there is any loss or liability incurred by the Corporation in respect of the Mortgage-Backed Securities Division remaining after application of paragraph (a) above (any such loss or liability, a “Remaining Loss”), the Corporation shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. an amount of up to 25% of the existing retained earnings of the Corporation, or such higher amount as the Board of Directors shall determine. Notwithstanding the foregoing, to the extent that a loss or liability is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the data on the Off-the-Market Transaction to the Corporation; If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.~~

~~d) — If there is any Remaining Loss after application of paragraph (e) above, If the loss or liability with respect to an Event Period results from one or more Defaulting Member Events, the Corporation shall determine the amount of such loss or liability that is attributable to Tier One Members and the amount of such loss or liability that is attributable to Tier Two Members. If the loss or liability with respect to an Event Period results from one or more Declared Non-Default Loss Events, the amount of such loss or liability shall be attributable to Tier One Members. Tier Two Members shall not be subject to loss allocation with respect to Declared Non-Default Loss Events.~~

To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction.

*No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules.* If the Corporation allocates losses or liabilities pursuant to this Rule and subsequently recovers amounts against such allocated losses or liabilities, in whole or in part, the net amount of the recovery shall be credited to the Persons, including the Corporation, against whom the losses were charged in proportion to the amounts charged against them.

~~To the extent there is a Remaining Loss attributable to Tier One Members, the Corporation shall assess the Required Fund Deposit maintained by each such Member an amount of up to \$50,000, in an equal basis per Tier One Member.~~

## Tier One Members

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) Business Days (an “Event Period”) shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for a *the* Defaulting Member (or the next Business Day, if such day is not a Business Day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the determination by the Board of Directors that the applicable loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Tier One Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner. *Declared Non-Default Loss Event* (or the next Business Day, if such day is not a Business Day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

In the case of losses and liabilities relating to or arising out of a Declared Non-Default Loss Event, all Tier One Members shall be subject to loss allocation. In the case of losses and liabilities relating to or arising out of a Defaulting Member Event, only non-defaulting Tier One Members shall be subject to loss allocation. After a first round of loss allocations with respect to an Event Period, only Tier One Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule shall be subject to further loss allocation with respect to that Event Period. The Corporation shall notify Tier One Members subject to loss allocation of the amounts being allocated to them (“Loss Allocation Notice”) in successive rounds of loss allocations.

*Each Tier One Member that is a Tier One Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Tier One Member for which the Corporation ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day, shall be deemed to be a Tier One Member on the first day of that Event Period.*

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Tier One Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable



Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule.

Each loss allocation shall be communicated to Tier One Members by the issuance of a notice that advises the Tier One Members of the amount being allocated to them (“of a Loss Allocation Notice”). Each Tier One Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) Business Days preceding the first day of the applicable Event Period or such shorter period of time that the Tier One Member has been a Tier One Member (each Tier One Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Tier One Members subject to loss allocation in such round.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Member in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to notify the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, and thereby benefit from its Loss Allocation Cap. The “Loss Allocation Cap” of a Tier One Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Tier One Netting Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule shall be subject to further loss allocation with respect to that Event Period.

Each Tier One Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) Business Days preceding the first day of the applicable Event Period or such shorter period of time that the Tier One Member has been a Tier One Member (each Tier One Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Tier One Members subject to loss allocation in such round. Each Tier One Member’s maximum payment obligation with respect to any loss allocation round shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period or (y) its Average RFD (such amount shall be each Tier One Member’s “Loss Allocation Cap”).

For purposes of calculating the pro rata share of losses and liabilities and the Loss Allocation Cap pursuant to the previous paragraph, the Corporation shall not count toward a Tier One Member’s Required Fund Deposit any increased Clearing Fund deposit that the Tier One Member may be subject to pursuant to Section 2(e) of this Rule.

Tier One Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second Business Day after the Corporation issues any

such notice. Tier One Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second Business Day after the Corporation issues such notice, unless the Tier One Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round, pursuant to Section 7b of this Rule.

~~Notwithstanding Section 10 of this Rule, to~~To the extent that a Tier One Member's Loss Allocation Cap exceeds the Tier One Member's Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Tier One Member, up to the Tier One Member's Loss Allocation Cap.

If a Tier One Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Tier One Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.

If a Tier One Member notifies the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Member shall comply with the provisions of Section 7b of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Member fails to comply with the provisions of Section 7b of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

A Tier One Member that elects to withdraw pursuant to Section 7b of this Rule shall not be eligible to re-apply to become a Clearing Member unless, prior to submitting such application, it makes the payment(s) to the Corporation that would have been due pursuant to Section 7 of this Rule as if the Tier One Member had not withdrawn, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Event Period began.

### Tier Two Members

To the extent there is a loss or liability payable by Tier Two ~~Remaining Loss Members, the Tier Two Remaining Loss~~ such loss or liability shall be allocated to Tier Two Members based upon their trading activity with the Defaulting Member that resulted in a loss or liability. The Corporation shall assess such loss or liability against the Tier Two Members ratably based upon their loss or liability as a percentage of the entire amount of the ~~Remaining Loss~~ loss or liability attributable to Tier Two Members. Tier Two Members with a bilateral liquidation profit will not be allocated any portion of the ~~Remaining Loss~~ loss or liability attributable to Tier Two ~~Remaining Loss~~ Members.

If a Tier Two Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Tier Two Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.

~~(e) — If there is any Remaining Loss attributable to Tier One Members after application of paragraph (d) above, it shall be allocated among Tier One Members, ratably, in accordance with the amount of each Tier One Member's respective Required Fund Deposit and based on the average daily level of such deposit over the prior twelve months (or such shorter period as may be available in the case of a Member which has not maintained a deposit over such time period) (such amount, the Member's "Average Required Clearing Fund Deposit").~~

~~(f) — Any loss or liability incurred by the Corporation incident to its clearance and settlement business arising from the failure of a Clearing Member to pay to the Corporation an allocation made pursuant to the preceding subsections of this Section or arising other than from a Remaining Loss (hereinafter, an "Other Loss"), shall be allocated among Tier One Members, ratably, in accordance with the respective amounts of their Average Required Clearing Fund Deposits.~~

~~(g) — The entire amount of the Required Fund Deposit of any Clearing Member at the time that the Corporation incurred an applicable Remaining Loss or Other Loss may be used to satisfy any amount allocated against a Member as a result of such Remaining Loss or Other Loss. If notification is provided to a Member that an allocation has been made against a Member pursuant to this Rule and that application of the Member's Required Fund Deposit is not sufficient to satisfy such obligation to make payment to the Corporation, the Member shall (i) deliver to the Corporation by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by the Corporation, that amount which is necessary to eliminate any such deficiency, except that (ii) with regard to an allocation arising from any Remaining Loss allocated by the Corporation pursuant to subsection (e) of this Section 7 and any Other Loss, such Member may instead provide by the Close of Business on the Business Day on which such payment is due the Corporation written notice to the Corporation, pursuant to Section 13 of Rule 3, of its election to terminate its membership in the Corporation. If such Member elects to terminate its membership in the Corporation, its liability for an allocation arising from such Remaining Loss and Other Loss shall be limited to the amount of its Required Fund Deposit for the Business Day on which the notification of such allocation is provided to the Member. If such Member does not elect to terminate its membership in the Corporation as provided for above, it shall make such deposits to the Clearing Fund, by the Close of Business on the Business Day on which the Member is obligated to make the payment provided for above, as are necessary to satisfy its Required Fund Deposit as of such Business Day. If the Member shall fail to take the action stated in either (i) or (ii) above, the Corporation shall cease to act generally with regard to such Member pursuant to Rules 14 and 17, and may take disciplinary action against the Member pursuant to Rule 38.~~

~~A Member that elects to terminate its membership pursuant to alternative (ii) of the above paragraph in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Clearing Member unless, prior to submitting such application, it makes the payment to the Corporation provided for in alternative (i) of the above paragraph, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date~~

~~on which the Remaining Loss or Other Loss was incurred by the Corporation until the date of such payment. If a Clearing Member elects to terminate its membership pursuant to alternative (ii) of the above paragraph, or if the Member fails to take any action, the Corporation will promptly make an additional assessment against the remaining Tier One to cover the amount not paid by the Clearing Member that made such election to terminate its membership.~~

~~(h) — If a Remaining Loss or Other Loss occurs, the Corporation shall promptly notify each Member, and the SEC, of the amount involved and the reasons therefor. Any disciplinary action that the Corporation takes, or the voluntary or involuntary cessation of membership by a Clearing Member subsequent to the occurrence of the Remaining Loss or Other Loss, shall not, except as otherwise provided in this Rule, affect the obligations of the Clearing Member to the Corporation under this Rule or the procedures thereof, or affect any remedy to which the Corporation may be entitled. If a Remaining Loss or Other Loss charged to Members is afterward recovered by the Corporation in whole or in part, the net amount of the recovery shall be credited or paid to those Persons, other than a Defaulting Member or other Person who caused in whole or part such Loss, including the Corporation, against whom the loss was charged, in proportion to the amounts paid by them, whether or not they are still Members.~~

~~(i) — For purposes of calculating the allocations in this Section 7 that are based upon a Member's Average Required Fund Deposit, a Clearing Member that is subject to an increased Required Fund Deposit pursuant to provisions of this Rule regarding special charges or such other premium applied pursuant to these Rules shall be deemed to have an Average Required Clearing Fund Deposit amount without such increases being taken into account.~~

#### Section 7a – Corporate Contribution

For any loss allocation pursuant to Section 7 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Exchange Act. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) Business Days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution. The Corporation shall maintain one Corporate Contribution, the amount of which is available to both the Government Securities Division

and the Mortgage-Backed Securities Division, and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs. In the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution shall be applied to that Division up to the amount then available. If a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution shall be applied to the respective Division in the same proportion that the aggregate Average RFDs of all members in that Division bears to the aggregate Average RFDs of all members in both Divisions.

Nothing in these Rules shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether *arising out of or relating to* a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

#### Section 7b – Withdrawal Following Loss Allocation

If a Tier One Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss allocation *round* as set forth in Section 7 of this Rule (“Loss Allocation Withdrawal Notice”), the Tier One Member shall:

- (i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Tier One Member to the Corporation, unless otherwise approved by the Corporation; and
- (ii) as of the time of such Tier One Member’s submission of the Loss Allocation Withdrawal Notice to the Corporation, cease submitting transactions to the Corporation for processing, clearance or settlement, unless otherwise approved by the Corporation.

*A Tier One Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).*

If the Tier One Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Tier One Member will remain subject to further loss allocations pursuant to Section 7 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.

## **Section 8 – Return of Members’ Clearing Fund Deposits**

**If a Member gives notice to the Corporation of its election to withdraw from membership, the Member’s Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied.**

**Notwithstanding anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 32 “Cross Guaranty Agreements”, to reimburse the Corporation for any Cross-Guaranty Repayment that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement.**

## **Section 89 - ~~Timing of Payment of Deposit~~ Initial Required Fund Deposit and Changes in Members’ Required Fund Deposits**

The initial Required Fund Deposit of a Clearing Member shall be required to be deposited into the Clearing Fund ~~by the Close of Business on the Business Day immediately~~ prior to the Business Day on which each such Person becomes a Clearing Member in accordance with the Corporation’s procedures.

A **Clearing** Member must increase the amount of its **deposit to the Clearing Fund**~~Required Fund Deposit~~ (by the deposit of cash, Eligible Securities, and/or Eligible Letters of Credit subject to the requirements of this Rule) by the Required Fund Deposit Deadline on any Business Day that such Clearing Member’s ~~Actual D~~**deposit to the Clearing Fund** is less than its Required Fund Deposit as set forth in the Report listing such, subject to the conditions included in Section 3 of this Rule 4. **If there is an increase in a Clearing Member’s Required Fund Deposit, at the time the increase becomes effective, the Clearing Member’s obligations to the Corporation shall be determined in accordance with the increased Required Fund Deposit whether or not the Clearing Member has satisfied such increased amount.**

**If the Corporation applies a Clearing Member’s Clearing Fund deposits as permitted pursuant to this Rule, the Corporation may take any and all actions with respect to the Clearing Member’s Actual Deposit, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Clearing Member’s Required Fund Deposit, the Clearing Member shall immediately replenish it. If the Clearing Member fails to do so, the Corporation may take disciplinary action against such Clearing Member pursuant to Rule 14 or Rule 38. Any disciplinary action that the Corporation takes pursuant to Rule 14 or Rule 38 or the voluntary or involuntary cessation of membership shall not affect the Clearing Member’s obligations to the Corporation or any remedy to which the Corporation may be entitled under applicable law.**

The Corporation retains the discretion to extend the Required Fund Deposit Deadline on any Business Day if there are operational or system difficulties that would reasonably prevent Members from satisfying Required Fund Deposit deficits by the time specified in the Corporation's procedures.

Notwithstanding the foregoing, the Corporation may require a **Clearing** Member or **Clearing** Members generally to deposit additional amounts to their Clearing Fund on an intraday basis if the Corporation believes such action is necessary in order to protect itself and its Members.

#### **Section 910 - Return of Deposits and Payments Excess Clearing Fund Deposits**

The Corporation shall determine with such frequency as it shall from time to time specify, whether the amount deposited by a Member in the Clearing Fund is in excess of its Required Fund Deposit (hereinafter, "Excess Clearing Fund Deposit"). On any day that the Corporation has determined that an Excess Clearing Fund Deposit exists with respect to any Member, the Corporation will, in the form and manner determined by the Corporation, notify each **such** Member of such excess. **Subject to the Corporation's rights under these Rules to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) as the Member requests. Upon the request of a Member, in the form and manner determined by the Corporation, the Corporation shall cause to be returned to each such Member cash on deposit (in excess of the minimum amount of cash the Member is required to maintain in the Clearing Fund), and/or Eligible Clearing Fund Securities (valued at their current market value, including accrued interest as of the end of the Business Day prior to such withdrawal), in an aggregate amount equal to such excess or such lesser amount as the Member may request; provided, however, that, any return of excess will be done in such a way that the remaining Clearing Fund on deposit meets the requirements of this Rule. In addition**Notwithstanding the foregoing, at the discretion of the Corporation, some or all of the Excess Clearing Fund Deposit may not be returned if the Member has an outstanding payment obligation to the Corporation, if the Corporation determines that the Member's anticipated Cash Settlement obligations, Pool Net Obligations or Transactions ~~over the next 90 calendar days in the near future~~ may reasonably be expected to be materially different than ~~during the prior 90 calendar days,~~ **those of the recent past** or if the Member is on the Watch List.

In addition, the return of an Excess Clearing Fund Deposit amount to any Member is subject to the following limitations: (1) such return of Excess Clearing Fund Deposit shall not be done in a manner that would cause the Member to violate any other Section of these Rules; and (2) Excess Clearing Fund Deposit shall not be returned to a Member to the extent that such return would reduce the amount of the Member's Cross-Guaranty Repayment Deposit to the Clearing Fund below the amount to be maintained by the Member pursuant to **Section 4 of Rule 32, "Cross Guaranty Agreements."**

The provisions of this section shall not limit the rights or remedies of the Corporation as provided in Section 6 of Rule 3.

Section 10 – Ceasing to be a Member

~~If a Clearing Member gives notice to the Corporation pursuant to these Rules of its election to terminate its membership in the Clearing System, the Member's deposits to the Clearing Fund shall be returned to it when the Corporation is satisfied that all of the Member's obligations arising under these Rules have been satisfied. However, the Corporation in its discretion may return Clearing Fund amounts to a Member notwithstanding any obligations such Member may have to the Corporation, provided such obligations are de minimis. Any obligation of a Member to the Corporation pursuant to this Rule that is unsatisfied at the time it ceases to be a Member shall not be affected by such cessation.~~

~~Notwithstanding the previous paragraph or anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 32, "Cross-Guaranty Agreements" to reimburse the Corporation for any Cross-Guaranty that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement.~~

Section 11 - Corporation's Authority to Pledge and Assign

In furtherance of the rights of the Corporation pursuant to these Rules, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign any and all Actual Deposits: (i) cash deposits, (ii) securities, repurchase agreements, deposits or other instruments in which cash deposits of Members are invested, and (iii) any securities or letters of credit pledged or deposited by any Member to secure an open account indebtedness to the Clearing Fund or otherwise to collateralize its obligations to the Corporation or in the possession of the Corporation, and any proceeds thereof for the purpose of securing loans made to the Corporation (the party making such loan to the Corporation hereinafter referred to as the "Lender"); or other obligations incurred by the Corporation, provided that the proceeds of such loans are used for a purpose permissible under Section 3 and Section 5 of this Rule in each case incident to the clearance and settlement business of the Corporation. Such loans ~~or obligations~~ shall be on terms and conditions deemed necessary or advisable by the Corporation (including collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member to the Corporation for which such property and Eligible Letters of Credit (if any) werewas pledged to or deposited with the Corporation. Notwithstanding the above, the Corporation shall remain obligated to each such Member to return, and to allow substitution for or withdrawal of, cash, and Eligible Clearing Fund Securities, and Eligible Letters of eCredit (if any) pledged or deposited by asuch Member as a Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund~~, or otherwise to collateralize such Member's obligations to the Corporation, under the circumstances and within the timeframes specified in these Rules. In the event of any conflict or



**inconsistency between this Rule 4 and any agreement between the Corporation and any Member, this Rule 4 shall govern and prevail.**

**Section 12 – Clearance and Settlement Business of the Corporation**

For purposes of this Rule 4, references to the clearance and settlement business of the Corporation shall include its business as a Securities Intermediary.

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RULE 5 – TRADE COMPARISON

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Section 8 – Binding Nature of Comparisons

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If trade input with respect to a Transaction in Eligible Securities involving a Broker has not compared or has Partially Compared, the Dealer(s) for which trade input has not compared will be furnished a Report noting such uncomparing or Partially Compared Transaction. The Dealer may then either affirm the Transaction or submit a DK of the Transaction as described in Section 9 of this Rule **45**. Unless the Dealer receiving the Unmatched Margin Report submits a DK of such transaction in accordance with the Corporation's procedures, the Total Required Fund Deposit shall be payable by the Dealer with respect to such Transaction pursuant to these Rules, the same as if such transaction had been listed in such Dealer's Open Commitment Report.

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RULE 11 – CASH SETTLEMENT

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Section 9 – Cash Settlement

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(o) Under FRB Operating Circular No. 12, FICC's Settlement Agent has certain processing responsibilities in allocating an indemnity claim made by an FRB as a result of processing the Corporation's cash settlement via NSS. The Corporation shall apportion the entirety of such liability to the Member or Members for whom the Cash Settling Bank to which the indemnity claim relates was acting. Such liability for each applicable Member shall be in proportion to the amount of such Members' Cash Settlement amounts on the Business Day in question. If for any reason such allocation is not sufficient to fully satisfy the FRB indemnity claim, then the remaining loss shall be treated as ~~an "Other Loss" as defined by Rule 4~~ **a loss that is otherwise incident to the clearance and settlement business of the Corporation** and allocated accordingly **pursuant to Section 7 of Rule 4.**

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RULE 17A – CORPORATION DEFAULT

(a) If a "Corporation Default" occurs pursuant to subsection (b) below, all Transactions which have been subject to Novation pursuant to these Rules but have not yet settled and any rights and obligations of the parties thereto shall be immediately terminated and the Board shall determine a single net amount owed by or to each Member with respect to such Transactions by applying the close out and application procedures in Section 2 of Rule 17 (**interpreted in all such cases as if each Member were a Defaulting Member**) and ~~Section 7 of Rule 4~~ (~~**interpreted in all such cases as if each Member were a Defaulting Member**~~) taking into account the ~~other loss allocation~~ provisions in ~~these Rules relating to loss allocation, including in the event that any Member is a Defaulting Member~~ **Rule 4**. For purposes of this Rule 17A and notwithstanding any other provision to the contrary, Pool Deliver Obligations and Pool Receive Obligations shall be established with respect to all Transactions, at the time at which the data submitted in respect of such Transactions are compared and such Transactions constitute Compared Trades. The Board shall notify each Member of the net amount so determined and Members who have been notified that they owe an amount to the Corporation shall pay that amount on or prior to the date specified by the Board, subject to any applicable setoff rights. Members who have a net claim against the Corporation shall be entitled to payment thereof along with other Members' and any other creditors' claims pursuant to the underlying Contracts with respect thereto, these Rules and applicable law. Nothing herein shall limit the rights of the Corporation upon a Member default (including following a Corporation Default) including under any Cross-Guaranty Agreement with the Government Securities Division or any other Cross-Guaranty Counterparty.

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RULE 32 - CROSS GUARANTY AGREEMENTS

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Section 3 - Application of Cross-Guaranty Payments

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(b) retain any Cross-Guaranty Payment received by the Corporation and not apply such Cross-Guaranty Payment to reduce any assessments against other Members pursuant to Section 7 of Rule 4 until the Corporation determines that the Corporation is no longer liable for any Cross-Guaranty Repayment, at which point the Cross-Guaranty Payment shall be treated as an amount that has been recovered pursuant to Section 7(i) of Rule 4.

Section 4 - Cross-Guaranty Repayment Deposits

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In the event that the Corporation is required to make a Cross-Guaranty Repayment and it does not have a sufficient amount of Cross-Guaranty Repayment Deposits to cover the liability, the Corporation shall treat the shortfall as ~~an "Other Loss"~~ **a loss incurred as a result of a Defaulting Member Event to be allocated** pursuant to Section 7 of Rule 4.

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## INTERPRETIVE GUIDANCE WITH RESPECT TO WATCH LIST CONSEQUENCES

Being placed on the Watch List may result in Clearing Fund-related consequences under the Rules:

A. *Clearing Fund-Related Consequences*

1. Additional Clearing Fund Deposits

Pursuant to Section 11(e) of Rule 3, the Corporation may require a Clearing Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~the provisions of Rule 4 or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members.

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Furthermore, pursuant to Section 2(~~g~~f) of Rule 4, the Corporation may subject a Clearing Member to an intraday VaR Charge if the Clearing Member is on the Watch List.

2. Restriction on Withdrawal of Excess Clearing Fund Deposits

Pursuant to Section 910 of Rule 4, the Corporation may retain some or all of the Excess Clearing Fund Deposit of a Member who is on the Watch List. Nonetheless, the Corporation generally does not retain the Excess Clearing Fund Deposit of a Watch List Member unless the Member fails to pay the Required Fund Deposit within the required timeframes established by the Corporation, or if the Corporation has a concern that the Member will not be able to satisfy its obligation to the Corporation.

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SR-FICC-2017-806 Amendment No. 1

EXHIBIT 5

**FIXED INCOME CLEARING CORPORATION**

**GOVERNMENT SECURITIES DIVISION RULEBOOK**

TEXT OF PROPOSED RULE CHANGE

**Bold and underlined text** indicates proposed added language

**~~Bold and strikethrough text~~** indicates proposed deleted language

## **RULE 1 – DEFINITIONS**

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### **Actual Deposit**

**The term “Actual Deposit” shall have the meaning given that term in Section 4 of Rule 4.**

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### **Average RFD**

**The term “Average RFD” shall have the meaning given that term in Section 7 of Rule 4.**

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### **CCIT Member Termination Date**

**The term “CCIT Member Termination Date” shall have the meaning given that term in Section 6 of Rule 3B.**

### **CCIT Member Voluntary Termination Notice**

**The term “CCIT Member Voluntary Termination Notice” shall have the meaning given that term in Section 6 of Rule 3B.**

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### **Clearing Fund Cash**

**The term “Clearing Fund Cash” shall have the meaning given that term in Section 3a of Rule 4.**

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### **Corporate Contribution**

**The term “Corporate Contribution” shall have the meaning given that term in Section 7a of Rule 4.**

### **Corporation**

**The term “Corporation” means Fixed Income Clearing Corporation, the owner of the Government Securities Division. Where these Rules refer to action taken by**



**“the Corporation,” the term should be understood to mean the management of Fixed Income Clearing Corporation, unless otherwise specified.**

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**Declared Non-Default Loss Event**

**The term “Declared Non-Default Loss Event” shall have the meaning given that term in Section 7 of Rule 4.**

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**Defaulting Member Event**

**The term “Defaulting Member Event” shall have the meaning given that term in Section 7 of Rule 4.**

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**Event Period**

**The term “Event Period” shall have the meaning given that term in Section 7 of Rule 4.**

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**Excess Clearing Fund Deposit**

**The term “Excess Clearing Fund Deposit” shall have the meaning given that term in Section 10 of Rule 4.**

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**Former Sponsored Members**

**The term “Former Sponsored Members” shall have the meaning given that term in Section 2 of Rule 3A.**

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**Legal Risk**

The term “Legal Risk” shall have the meaning given that term in Section 2(n) of Rule 4.

**Lender**

**The term “Lender” shall have the meaning given that term in Section 11 of Rule 4.**

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**Loss Allocation Cap**

**The term “Loss Allocation Cap” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Notice**

**The term “Loss Allocation Notice” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Withdrawal Notice**

**The term “Loss Allocation Withdrawal Notice” shall have the meaning given that term in Section 7b of Rule 4.**

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**Sponsored Member Termination Date**

**The term “Sponsored Member Termination Date” shall have the meaning given that term in Section 3 of Rule 3A.**

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**Sponsored Member Voluntary Termination Notice**

**The term “Sponsored Member Voluntary Termination Notice” shall have the meaning given that term in Section 3 of Rule 3A.**

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**Sponsoring Member Termination Date**

**The term “Sponsoring Member Termination Date” shall have the meaning given that term in Section 2 of Rule 3A.**

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**Sponsoring Member Voluntary Termination Notice**

**The term “Sponsoring Member Voluntary Termination Notice” shall have the meaning given that term in Section 2 of Rule 3A.**

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**Termination Date**

**The term “Termination Date” shall have the meaning given that term in Section 13 of Rule 3.**

**The Corporation**

~~The term “the Corporation” means the Fixed Income Clearing Corporation, the owner of the Government Securities Division. Where these Rules refer to action taken by “the Corporation,” the term should be understood to mean the management of the Fixed Income Clearing Corporation, unless otherwise specified.~~

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**Voluntary Termination Notice**

**The term “Voluntary Termination Notice” shall have the meaning given that term in Section 13 of Rule 3.**

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### RULE 3 – ONGOING MEMBERSHIP REQUIREMENTS

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#### Section 12 – Ongoing Monitoring

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(e) The Corporation may require a Netting Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~ the provisions of Rule 4 (which additional deposit shall constitute a portion of the Netting Member's Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member. The Corporation may also retain any Excess Clearing Fund Deposits of a Netting Member that has been placed on the Watch List as provided in Section ~~9~~ 10 of Rule 4. Moreover, as regards a Netting Member that has been placed on the Watch List by the Corporation, the Corporation may suspend, during all or a portion of the time period that such Member is on the Watch List, its right under these Rules to collect a Credit Forward Mark Adjustment Payment. Moreover, if a Netting Member on the Watch List has a Collateral Allocation Entitlement as the result of its GCF Repo Transaction activity, the Corporation may, in its sole discretion, maintain possession of the securities and/or cash that comprise such Collateral Allocation Entitlement.

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#### Section 13 - Voluntary Termination

A Member that is a Comparison-Only Member may elect to terminate such membership, and a Netting Member may elect to terminate its membership in either the Corporation or in just the Netting System (and to become a Comparison-Only Member), by providing the Corporation with ~~a 10 days~~ written notice of such termination (“Voluntary Termination Notice”); however, the Corporation, in its discretion, may accept such termination within a shorter notice period. The Member shall specify in the Voluntary Termination Notice a desired date for its withdrawal from membership; provided, however, if the Member is terminating its membership in the Corporation, such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Member to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than 10 Business Days after the receipt of the Voluntary Termination Notice ~~written notice~~ from such Member. The Corporation's acceptance shall be evidenced by a notice to Members announcing the Member's termination and the effective date of the termination of the Member (hereinafter the “Termination Date”). As of the Termination Date, a Netting Member that terminates its membership in the Netting System, or a Comparison-Only Member or Netting Member that terminates its membership in the Corporation, shall no longer be eligible or

required to submit to the Corporation data on trades and shall no longer be eligible to have its trade data submitted by an authorized submitter, notwithstanding any provision of Rule 5, Rules 6A through 6C, or Rule 11 to the contrary, unless the Board determines otherwise in order to ensure an orderly liquidation of the Member's Net Settlement Positions. **If any trade is submitted to the Corporation either by such Member or its authorized submitter that is scheduled to settle on or after the Termination Date, such Member's Voluntary Termination Notice will be deemed void, and the Member will remain subject to these Rules as if it had not given such Voluntary Termination Notice.**

A Member's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the Termination Date. **The return of the Member's Clearing Fund deposit shall be governed by Section 8 of Rule 4. If a Member is a Tier One Netting Member and an Event Period were to occur after such Member has submitted its Voluntary Termination Notice but prior to the Termination Date, in order for such Member to benefit from its Loss Allocation Cap pursuant to Section 7 of Rule 4, the Member will need to comply with the provisions of Section 7b of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the Member.**

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### RULE 3A—SPONSORING MEMBERS AND SPONSORED MEMBERS

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#### Section 2 – Qualifications of Sponsoring Members, the Application Process and Continuance Standards

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(i) A Sponsoring Member may voluntarily elect to terminate its status as a Sponsoring Member, with respect to all Sponsored Members or with respect to one or more Sponsored Members from time to time, by providing the Corporation with ~~30 calendar days a~~ written notice of such termination (**“Sponsoring Member Voluntary Termination Notice”**). **The Sponsoring Member shall specify in the Sponsoring Member Voluntary Termination Notice a desired date for the termination of the Sponsoring Member’s status as such with respect to the Sponsored Member(s) as to which the Sponsoring Member has terminated such status (the “Former Sponsored Members”), which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Sponsoring Member with respect to the Former Sponsored Members to the Corporation as of the time such Sponsoring Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.**

~~;~~ ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period.~~ Such termination will not be effective until accepted by the Corporation, **which shall be no later than 10 Business Days after the receipt of the Sponsoring Member Voluntary Termination Notice from such Sponsoring Member.** The Corporation’s acceptance shall be evidenced by a notice to all Members announcing the termination of the Sponsoring Member’s status as such with respect to the ~~Sponsored Member(s) as to which the Sponsoring Member has terminated such status (the “Former Sponsored Members”)~~ and the effective date of such termination (hereinafter the “Sponsoring Member Termination Date”). As of the Sponsoring Member Termination Date, the Sponsoring Member shall no longer be eligible to submit trades on behalf of its Former Sponsored Members and each of its Former Sponsored Members shall cease to be a Sponsored Member unless it is the Sponsored Member of another Sponsoring Member. **If any trade is submitted to the Corporation by the Sponsoring Member on behalf of its Former Sponsored Members that is scheduled to settle on or after the Sponsoring Member Termination Date, such Sponsoring Member’s Sponsoring Member Voluntary Termination Notice will be deemed void, and the Sponsoring Member will remain subject to this Rule as if it had not given such Sponsoring Member Voluntary Termination Notice.**

A Sponsoring Member’s voluntary termination of its status as such, in whole or in part, shall not affect its obligations to the Corporation, or the rights of the Corporation, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Trades submitted to the Corporation before the applicable Sponsoring Member Termination Date. Any Sponsored

Member Trades which have received the Corporation's guaranty of settlement and been novated to the Corporation shall continue to be processed and guaranteed by the Corporation.

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Section 3 - Qualifications of Sponsored Members, Approval Process and Continuance Standard

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(e) A Sponsored Member may voluntarily elect to terminate its membership by providing the Corporation with ~~10 calendar days~~ a written notice of such termination ("**Sponsored Member Voluntary Termination Notice**"). **The Sponsored Member shall specify in the Sponsored Member Voluntary Termination Notice a desired date for the termination, which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Sponsored Member to the Corporation as of the time such Sponsored Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.**

~~;~~ ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period.~~ Such termination will not be effective until accepted by the Corporation, **which shall be no later than 10 Business Days after the receipt of the Sponsored Member Voluntary Termination Notice from such Sponsored Member.** The Corporation's acceptance shall be evidenced by a notice to all Members announcing the termination of the Sponsored Member and the effective date of such termination (hereinafter the "Sponsored Member Termination Date"). As of the Sponsored Member Termination Date, the relevant Sponsoring Member shall no longer be eligible to submit trades on behalf of the Sponsored Member. **If any trade is submitted to the Corporation by the relevant Sponsoring Member on behalf of the Sponsored Member that is scheduled to settle on or after the Sponsored Member Termination Date, such Sponsored Member's Sponsored Member Voluntary Termination Notice will be deemed void, and the Sponsored Member will remain subject to this Rule as if it had not given such Sponsored Member Voluntary Termination Notice.**

A Sponsored Member's voluntary termination shall not affect its obligations to the Corporation, or the rights of the Corporation, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Trades submitted to the Corporation before the Sponsored Member Termination Date, and the Sponsoring Member Guaranty shall remain in effect to cover all outstanding obligations of the Sponsored Member to the Corporation that are within the scope of such Sponsoring Member Guaranty.

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Section 10—Clearing Fund Obligations

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(d) The lesser of \$5,000,000 or 10 percent of the total amount arrived at in subsection (c) of this Section 10, with a minimum of \$100,000 must be made and maintained in cash, with

the remaining portion to be made and maintained in the form specified in, and subject to the requirements of, Section 3 of Rule 4, and subject to subsection (~~fe~~) of Section 2 of Rule 4.

(e) The Corporation shall have the right to increase the Sponsoring Member Omnibus Account Required Fund Deposit in the same way and for the same reasons as set forth in subsection (~~ed~~) of Section 2 of Rule 4.

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#### Section 12—Loss Allocation Obligations

(a) Sponsored Members shall not be obligated for allocations, pursuant to Rule 4, of loss or liability incurred by the Corporation. To the extent that a **Remaining Loss (as defined in Section 7 of Rule 4) loss or liability** is determined by the Corporation to arise in connection with Sponsored Member Trades (i.e., in connection with the insolvency or default of a Sponsoring Member), the Sponsored Members shall not be responsible for or considered in the loss allocation calculation, but rather such loss shall be allocated to Tier One Netting Members in accordance with the principles set forth in Section 7(~~d~~) of Rule 4.

(b) To the extent the Corporation incurs a **loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event** ~~Remaining Loss or an Other Loss (as defined in Section 7(f) of Rule 4)~~ and a loss allocation obligation arises that would be the responsibility of the Sponsoring Member Omnibus Account if the Sponsoring Member Omnibus Account were a Netting Member, the Corporation shall calculate such loss allocation obligation as if the affected Sponsored Members were subject to such allocations pursuant to Section 7 of Rule 4, but the Sponsoring Member shall be responsible for satisfying such obligations.

(c) The entire amount of the Required Fund Deposit associated with the Sponsoring Member's Netting System accounts and the entire amount of the Sponsoring Member's Omnibus Account Required Fund Deposit may be used to satisfy any amount allocated against a Sponsoring Member in its capacity as either a Netting Member or a Sponsoring Member. With respect to an obligation to make payment due to any loss allocation amounts assessed to a Sponsoring Member pursuant to subsection (b) above, the Sponsoring Member may instead **elect provide, by the Close of Business on the Business Day on which such payment is due, written notice to the Corporation of its election** to terminate its membership in the Corporation **pursuant to Section 7b of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 7 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Sponsoring Member, its Required Fund Deposit shall be.** ~~If such Sponsoring Member elects to terminate its membership in the Corporation, its liability for an assessed allocation pursuant to subsection (b) shall be limited to~~ the sum of its Required Fund Deposit and its Sponsoring Member's Omnibus Account Required Fund Deposit ~~on the Business Day on which the notification of such allocation is provided to the Sponsoring Member.~~

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**RULE 3B – CENTRALLY CLEARED INSTITUTIONAL  
TRIPARTY SERVICE**

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Section 6 – Voluntary Termination

A CCIT Member may voluntarily elect to terminate its membership in the Corporation by providing the Corporation with ~~10 Business Days~~<sup>2</sup> a written notice of such termination (“CCIT Member Voluntary Termination Notice”). The CCIT Member shall specify in the CCIT Member Voluntary Termination Notice a desired date for the termination, which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the CCIT Member to the Corporation as of the time such CCIT Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

~~;~~ ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period.~~ Such termination will not be effective until accepted by the Corporation, which shall be no later than 10 Business Days after the receipt of the ~~written notice~~ CCIT Member Voluntary Termination Notice from ~~the~~ such CCIT Member. The Corporation’s acceptance shall be evidenced by a notice to Members (including CCIT Members) announcing the CCIT Member’s termination and the effective date of the termination of the CCIT Member (hereinafter the “CCIT Member Termination Date”). As of the CCIT Member Termination Date, a CCIT Member that terminates its membership in the Corporation shall no longer be eligible or required to submit to the Corporation data on trades and shall no longer be eligible to have its trade data submitted by a Joint Account Submitter, unless the Board determines otherwise in order to ensure an orderly liquidation of the CCIT Member’s positions. If any trade is submitted to the Corporation either by such CCIT Member or a Joint Account Submitter that is scheduled to settle on or after the CCIT Member Termination Date, such CCIT Member’s CCIT Member Voluntary Termination Notice will be deemed void, and the CCIT Member will remain subject to this Rule as if it had not given such CCIT Member Voluntary Termination Notice.

A CCIT Member’s voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the CCIT Member Termination Date.

Section 7 – Loss Allocation Obligations of CCIT Members

Section 7 (~~Allocation of Loss or Liability Incurred by the Corporation~~ Loss Allocation Waterfall) of Rule 4 (Clearing Fund and Loss Allocation) shall apply to CCIT Members as Tier Two Members. CCIT Members shall be responsible for the total amount of loss allocated to them. With respect to CCIT Members with a Joint Account Submitter, loss allocation will be calculated at the Joint Account level and then applied pro rata to each CCIT Member in the Joint Account based on the trade settlement allocation instructions. If, at the time the Corporation calculates loss allocation, the trade settlement allocation instructions to the

individual CCIT Member level have not yet been received by the Corporation, the CCIT Members in the Joint Account shall be required to provide the allocation to the Corporation within the timeframes set by the Corporation in its discretion.

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## RULE 4 - CLEARING FUND AND LOSS ALLOCATION

### Section 1 – General Required Fund Deposits

Each Netting Member shall make, and maintain on an ongoing basis ~~so long as such Member is a Netting Member~~, a deposit to the Clearing Fund ~~at no less than the minimum required level set forth in this Rule (the "Required Fund Deposit")~~. ~~Deposits to the Clearing Fund shall be held by the Corporation or its designated agents, to be applied as provided in this Rule.~~ The amount of each Netting Member's required deposit shall be determined by the Corporation in accordance with this Rule and shall be referred to as the Required Fund Deposit. The timing of payment of the Required Fund Deposit shall be determined in accordance with the provisions of Section ~~8~~9 of this Rule.

A Netting Member may in its discretion maintain additional deposits at the Corporation, subject to any requirements the Corporation may establish for such excess amounts pursuant to Section 10 of this Rule. For purposes of these Rules, such additional deposits shall be deemed to be part of the Clearing Fund and the Netting Member's Actual Deposit but shall not be deemed to be part of the Netting Member's Required Fund Deposit. The Corporation shall not be required to segregate each Netting Member's Actual Deposit, but shall maintain books and records concerning the assets that constitute each Netting Member's Actual Deposit.

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### Section 2- Required Fund Deposit Requirements

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~~(b) — The lesser of \$5,000,000 or 10 percent of the Total Amount arrived at above, with a minimum of \$100,000, must, be made and maintained in cash, with the remaining portion of the Total Amount to be made and maintained in the form specified in Section 4 of this Rule. The previous sentence shall also apply to a Sponsoring Member Omnibus Account, but shall not apply to the individual Sponsored Members whose activity is presented by such Account.~~

~~(e)~~(b) The Corporation shall calculate the Sponsoring Member Omnibus Account Required Fund Deposit in the manner set forth in Section 10 of Rule 3A.

~~(d)~~(c) The initial Required Fund Deposit of each Netting Member, other than an Inter-Dealer Broker Netting Member, shall be set by the Corporation based upon the expected nature and level of such Member's activity.

~~(e)~~(d) Notwithstanding anything to the contrary in this Rule, the Corporation may require a Netting Member to make and maintain a higher Required Fund Deposit than the amount as noted above, if the Corporation determines that such higher Required Fund Deposit is necessary to protect the Corporation and its Members from the risk (the "Legal Risk") that the

Corporation, as a result of a law, **rule or regulation** applicable to a Netting **Member, including a Netting** Member's insolvency or bankruptcy, may be delayed or prohibited from: (i) accessing any portion of the Netting Member's Required Fund Deposit, (ii) netting, closing out or liquidating transactions, or setting off obligations, or taking any other action contemplated by Rule 4 (Clearing Fund and Loss Allocation), Rule 21 (Restrictions on Access to Services), Rule 22 (insolvency of a Member) or Rule 22A (Procedures for When the Corporation Ceases to Act), or (iii) otherwise exercising its rights pursuant to these Rules.

~~(f)~~(e) Notwithstanding anything to the contrary in this Rule, the Corporation may require a Netting Member's Required Fund Deposit to be in proportions of cash, Eligible Clearing Fund Securities and Eligible Letters of Credit that the Corporation determines to be necessary to protect itself and its Members from Legal Risk.

~~(g)~~(f) Notwithstanding anything to the contrary above, the Corporation, in its sole discretion, may secure a loan made to a Repo Broker for purposes of satisfying that Repo Broker's Funds-Only Settlement Amount obligation with that Repo Broker's Clearing Fund deposit made to the Corporation.

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### Section 3 - Form of Deposit

Subject to the provisions of Section 2 of this Rule governing the computation of **deposits a Netting Member's Required Fund Deposit**, and the limitations of this Section 3, Section 3a and Section 3b, a Netting Member's deposits to the Clearing Fund may be in the form of:

- (a) cash, or
- (b) an open account indebtedness fully secured by Eligible Clearing Fund Securities.

A minimum of 40 percent of the Netting Member's Required Fund Deposit shall be made in the form of cash and/or Eligible Clearing Fund Treasury Securities.

**The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit, with a minimum of \$100,000, must be made and maintained in cash, with the remaining portion of the Required Fund Deposit to be made and maintained in the form specified in this Section 3. The previous sentence shall also apply to a Sponsoring Member Omnibus Account, but shall not apply to the individual Sponsored Members whose activity is presented by such Account.**

~~Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Netting Member may substitute and/or withdraw securities from pledge and deposit, provided that the Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour or less prior to the close of the securities FedWire on such~~

~~Day. Any interest on securities deposited by a Netting Member to secure a Clearing Fund open account indebtedness that is received by the Corporation shall be credited to the Member's cash deposits to the Clearing Fund, except in the event of a default by a Member in payment of any of its obligations to the Corporation, in which case the Corporation may first liquidate such securities and apply all or a portion thereof, including any interest thereon, as provided in Section 7 of this Rule.~~

Section 3a– Special Provisions Related to Deposits of Cash

Cash deposits to the Clearing Fund shall be made in immediately-available funds. The Corporation may invest any Cash contained cash in the Clearing Fund, including (i) cash deposited by a Netting Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, “Clearing Fund Cash”) ~~may be partially or wholly invested by the Corporation in its sole discretion, for its account in securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States, or repurchase agreements related to securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States, and to the extent not so invested shall be deposited by the Corporation in its name in a depository or depositories selected by the Corporation. Investment income, if any, on cash deposits shall be paid to Members at such intervals, in such manner and in such amounts as the Corporation from time to time may determine in accordance with the Clearing Agency Investment Policy adopted by the Corporation.~~

Each Netting Member shall be entitled to any interest earned or paid on Clearing Fund cash deposits.

Section 3b – Special Provisions Related to Eligible Clearing Fund Securities

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(c) A Member may post as eligible collateral Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, however such collateral will be subject to a premium haircut as specified in the haircut schedule.

Eligible Clearing Fund Securities that are used to secure an open account indebtedness must be pledged to the Corporation on such terms and conditions as it may require, and be delivered to ~~either~~ the Corporation or to the Corporation's account at to a depository financial institution approved/designated by the Corporation ~~that shall hold the securities on the Corporation's behalf~~. The valuation of such Eligible Clearing Fund Securities shall be at current market value, which shall be determined by the Corporation not less frequently than on a daily basis. All Eligible Clearing Fund Securities shall be subject to a haircut set forth in these

Rules; ~~the~~ The Corporation has the right, in its discretion, to refuse to accept a particular type ~~or types~~ of Eligible Clearing Fund Security as a permissible form of Clearing Fund deposit.

Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Netting Member may substitute and/or withdraw Eligible Clearing Fund Securities from pledge and deposit, provided that the Netting Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour prior to the close of the securities FedWire on such day. Any interest on Eligible Clearing Fund Securities deposited by a Netting Member to secure a Clearing Fund open account indebtedness that is received by the Corporation shall be credited to the Netting Member's cash deposits to the Clearing Fund, except in the event of a default by such Netting Member on any obligations to the Corporation under these Rules, in which case the Corporation may exercise its rights under Section 6 of this Rule.

#### Section 4 - Lien

As security for any and all obligations and liabilities of a Netting Member to the Corporation, including, without limitation, the obligations of the Netting Member's Permitted Margin Affiliate to the Corporation, any obligation or liability of a Netting Member pursuant to a Cross-Margining Agreement, any Reimbursement Obligation of a Cross-Margining Participant to the Corporation pursuant to Section 3 of Rule 43, any obligation of a Cross-Margining Beneficiary Participant to reimburse the Corporation pursuant to Section 7 of Rule 43, any obligation of a Cross-Guaranty Defaulting Member to reimburse the Corporation pursuant to Section 2 of Rule 41 or any obligation of a Cross-Guaranty Beneficiary Member to reimburse the Corporation pursuant to Section 5 of Rule 41, each such Netting Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Netting Member's open account indebtedness or all assets and property placed by a Netting Member in the possession of the Corporation (or its agents acting on its behalf), including all securities and cash on deposit with the Corporation or its agents pursuant to this Rule and Rule 13 (collectively with any Eligible Letters of Credit issued on behalf of a Netting Member in favor of the Corporation, the Netting Member's "Actual Deposit"). The Corporation shall be entitled to exercise the its-rights ~~as~~of a pledgee under common law and ~~as~~ a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such ~~collateral~~assets.

#### Section 5 - Use of ~~Deposits and Payments~~ Clearing Fund

~~The use of the Clearing Fund deposits shall be limited to satisfaction of losses or liabilities of the Corporation, losses and liabilities incurred by the Corporation under a Cross-Margining Agreement, including Cross-Guaranty Payments and Cross-Guaranty Repayments made by the Corporation pursuant to Cross-Guaranty Agreements, Cross-Margining Payments and Cross-Margining Repayments made by the Corporation~~

~~pursuant to Cross-Margining Agreements, arising from the failure of a Defaulting Member or the Member's Permitted Margin Affiliate to satisfy an obligation to the Corporation, the failure of a Cross-Guaranty Defaulting Member to satisfy an obligation to a Cross-Guaranty Counterparty, the failure of a Cross-Margining Participant or its Cross-Margining Affiliate to satisfy an obligation to an FCO that has been guaranteed by the Corporation, the failure of a Cross-Margining Participant to satisfy a Reimbursement Obligation under Rule 43, or the failure of an FCO to make payment under a Cross-Margining Guaranty or otherwise incident to the clearance and settlement business of the Corporation including losses and liabilities arising other than from such failure of such Member, and to providing the Corporation with a source of collateral both to meet its temporary financing needs, including, without limitation, any financing that is obtained by the Corporation to hold securities pending settlement, and to ensure the satisfaction of Netting Members' settlement obligations. If the Corporation pledges, hypothecates, encumbers, borrows, or applies any part of the Clearing Fund deposits, or other collateral that it has received from Members to satisfy, in whole or in part, any liability, obligation, or liquidity requirement, for more than 30 days, the Corporation, at the Close of Business on the thirtieth day (or on the first Business Day thereafter), shall consider the amount used to meet such financing as an actual loss to the Clearing Fund and immediately allocate such loss in accordance with Section 7 of this Rule.~~

The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including, without limitation, each Member's obligations with respect to any loss allocations as set forth in Section 7 of this Rule and any obligations arising from a Cross-Guaranty Agreement pursuant to Rule 41 or a Cross-Margining Agreement pursuant to Rule 43, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in Section 3a of this Rule.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the Close of Business on the 30th calendar day (or on the first Business Day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 7 of this Rule.

~~If a loss or liability incurred by the Corporation is allocated to a Member pursuant to Section 7 of this Rule, a Member that is a Cross-Margining Participant incurs a Reimbursement Obligation to the Corporation pursuant to Section 3 of Rule 43, under a Cross-Margining Agreement, a Member that is a Cross-Margining Beneficiary Participant incurs an obligation to reimburse the Corporation pursuant to Section 7 of Rule 43, a Member that is a Cross-Guaranty Defaulting Member incurs an obligation to reimburse the Corporation pursuant to Section 2 of Rule 41 or a Member that is a Cross-Guaranty Beneficiary Member incurs an obligation to reimburse the Corporation pursuant to Section 5 of Rule 41, the Corporation may apply the portion of the: (a) Member's deposit to the Clearing Fund, or (b) in the case of a Netting Member that is an Inter-Dealer Broker~~

~~Netting Member, the deposit required pursuant to Section 7 of this Rule, necessary to satisfy such allocation or obligation. In this regard, the Corporation may apply any cash, draw against any letters of credit, and liquidate any securities deposited by the Member, and may do any or all of the foregoing whether or not the Member is treated as insolvent under Rule 22.~~

Section 6 - ~~RESERVED FOR FUTURE USE~~Application of Clearing Fund Deposits and Other Amounts to Defaulting Members' Obligations

Any loss or liability incurred by the Corporation as the result of the failure of a Defaulting Member to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 6.

The Corporation shall apply (a) any Clearing Fund deposits, Funds-Only Settlement Amounts, and any other collateral or assets held by the Corporation securing such Defaulting Member's obligations to the Corporation, (b) any Clearing Fund deposits, Funds-Only Settlement Amounts, and other collateral held by the Corporation with respect to a Permitted Margin Affiliate of the Defaulting Member, (c) any proceeds of any of the foregoing, and (d) the following additional resources set forth in paragraphs (i) and (ii) below as are applicable to the Defaulting Member:

- (i) If the Defaulting Member is a Cross-Margining Participant, the Corporation shall apply any amounts available from an FCO under a Cross-Margining Guaranty either upon receipt or at the time described in Section 5(b) of Rule 43.
- (ii) If the Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement (subject to an applicable Cross-Margining Agreement) either upon receipt or at the time described in Section 3(b) of Rule 41.

If the Corporation applies a Defaulting Member's Clearing Fund deposits as permitted by this Rule, the Corporation may take any and all actions with respect to the Defaulting Member's Actual Deposit, including the assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate.

In the event that the Corporation makes a payment to an FCO under a Cross-Margining Guaranty and the Cross-Margining Participant that incurs a Reimbursement Obligation representing the amount of such payment fails to promptly satisfy the Reimbursement Obligation, the Corporation may in its discretion, and without treating such Cross-Margining Participant as a Defaulting Member, treat such payment as a loss to be allocated in accordance with this Section and Section 7 of this Rule.



Section 7 - Loss Allocation ~~of Loss or Liability Incurred by the Corporation~~ Waterfall, Off-the-Market Transactions

For the purposes of this Rule, the following terms shall have the following meanings:

“Defaulting Member” shall mean a Member for which the Corporation has ceased to act pursuant to Rule 21 or Rule 22.

“Defaulting Member Event” shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 21 or Rule 22.

“Declared Non-Default Loss Event” shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 6 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

If the Corporation incurs ~~a~~Any loss or liability arising out of or relating to ~~incurred by the Corporation as the result of the failure of a Defaulting Member a Defaulting Member Event or a Declared Non-Default Loss Event~~, the Corporation shall address the loss or liability as follows: ~~to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 7 of this Rule 4.~~

(a) ~~The corporation shall apply any Clearing Fund deposits, Funds-Only Settlement Amounts, other collateral held by the Corporation securing such Member's obligations to the Corporation, and any Clearing Fund deposits, Funds-Only Settlement Amounts, and other collateral held by the Corporation with respect to a Permitted Margin Affiliate of the Member, and the following additional resources set forth in paragraphs (i) and (ii) below as are applicable to the Defaulting Member:~~

- (i) ~~If the Defaulting Member is a Cross-Margining Participant, the Corporation shall apply any amounts available from an FCO under a Cross-Margining Guaranty either upon receipt or at the time described in Section 5(b) of Rule 43.~~
- (ii) ~~If the Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement (subject to an applicable Cross-Margining~~

~~Agreement) either upon receipt or the time described in Section 3(b) of Rule 41.~~

~~(b) — In the event there is any loss or liability incurred by the Corporation in respect of the Government Securities Division remaining after application of paragraph (a) above (any such loss or liability, a “Remaining Loss”), the The Corporation shall apply an amount of up to 25% of the existing retained earnings of the Corporation, or such higher amount as the Board of Directors shall determine the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. Notwithstanding the foregoing, to the extent that a loss or liability is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the data on the Off-the-Market Transaction to the Corporation; If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.~~

~~(c) — If there is any Remaining Loss after application of paragraph (b) above, If the loss or liability with respect to an Event Period results from one or more Defaulting Member Events, the Corporation shall determine the amount of such loss or liability that is attributable to Tier One Netting Members and the amount of such loss or liability that is attributable to Tier Two Members. If the loss or liability with respect to an Event Period results from one or more Declared Non-Default Loss Events, the amount of such loss or liability shall be attributable to Tier One Netting Members. Tier Two Members shall not be subject to loss allocation with respect to Declared Non-Default Loss Events.~~

To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction.

No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules. If the Corporation allocates losses or liabilities pursuant to this Rule and subsequently recovers amounts against such allocated losses or liabilities, in whole or in part, the net amount of the recovery shall be credited to the Persons, including the Corporation, against whom the losses were charged in proportion to the amounts charged against them.

~~To the extent there is a Remaining Loss attributable to Tier One Netting Members, the Corporation shall assess the Required Fund Deposit maintained by the Member an amount of up to \$50,000, in an equal basis per Tier One Netting Member, provided, however, that, in the event that the Corporation makes a payment to an FCO under a Cross-Margining Guaranty and the Cross-Margining Participant that incurs a Reimbursement Obligation representing the amount of such payment fails to promptly satisfy the Reimbursement Obligation, the Corporation may in its discretion, and without~~

~~treating such Cross-Margining Participant as a Defaulting Member, treat such payment as a Remaining Loss to be allocated in accordance with this subsection (c).~~

### Tier One Netting Members

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) Business Days (an “Event Period”) shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for the Defaulting Member (or the next Business Day, if such day is not a Business Day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Each Tier One Netting Member that is a Tier One Netting Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Tier One Netting Member for which the Corporation ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day, shall be deemed to be a Tier One Netting Member on the first day of that Event Period.

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Tier One Netting Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Netting Members who have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule.

Each loss allocation shall be communicated to Tier One Netting Members by the issuance of a notice that advises the Tier One Netting Members of the amount being allocated to them (“Loss Allocation Notice”). Each Tier One Netting Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) Business Days preceding the first day of the applicable Event Period or such shorter period of time that the Tier One Netting Member

has been a Tier One Netting Member (each Tier One Netting Member's "Average RFD"), divided by (ii) the sum of Average RFD amounts of all Tier One Netting Members subject to loss allocation in such round.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Netting Member in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to notify the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, and thereby benefit from its Loss Allocation Cap. The "Loss Allocation Cap" of a Tier One Netting Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Tier One Netting Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule shall be subject to further loss allocation with respect to that Event Period.

Notwithstanding the foregoing, however, an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, shall not be subject to an aggregate loss allocation in an amount greater than \$5 million pursuant to this Section 7 for losses and liabilities resulting from an Event Period.

For purposes of calculating the pro rata share of losses and liabilities and the Loss Allocation Cap pursuant to the previous paragraph, the Corporation shall not count toward a Tier One Netting Member's Required Fund Deposit any increased Clearing Fund deposit that the Tier One Netting Member may be subject to pursuant to Section 2(d) of this Rule.

Tier One Netting Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second Business Day after the Corporation issues any such notice. Tier One Netting Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second Business Day after the Corporation issues such notice, unless the Tier One Netting Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round, pursuant to Section 7b of this Rule.

To the extent that a Tier One Netting Member's Loss Allocation Cap exceeds the Tier One Netting Member's Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Tier One Netting Member, up to the Tier One Netting Member's Loss Allocation Cap.

If a Tier One Netting Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the

**right to proceed against such Tier One Netting Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.**

**If a Tier One Netting Member notifies the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Netting Member shall comply with the provisions of Section 7b of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Netting Member fails to comply with the provisions of Section 7b of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.**

**A Tier One Netting Member that elects to withdraw pursuant to Section 7b of this Rule shall not be eligible to re-apply to become a Comparison-Only Member or a Netting Member unless, prior to submitting such application, it makes the payment(s) to the Corporation that would have been due pursuant to Section 7 of this Rule as if the Tier One Netting Member had not withdrawn, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Event Period began.**

### **Tier Two Members**

To the extent there is a ~~Remaining Loss~~ **loss or liability** payable by Tier Two Members, such loss **or liability** shall be allocated to Tier Two Members.

If the Tier Two Members are not CCIT Members (“Tier Two Non-CCIT Members”), the allocation will be based upon their trading activity with the Defaulting Member that resulted in a loss **or liability**. The Corporation shall assess such loss **or liability** against the Tier Two Non-CCIT Members ratably based upon their loss **or liability** as a percentage of the entire amount of the ~~Remaining Loss~~ **loss or liability** attributable to such Tier Two Non-CCIT Members. Such Tier Two Non-CCIT Members with a bilateral liquidation profit will not be allocated any portion of the ~~Remaining Loss~~ **loss or liability** otherwise attributable to Tier Two Members.

If the Tier Two Members are CCIT Members (“Tier Two CCIT Members”), the allocation will be based upon their open trading activity with the Defaulting Member that resulted in a loss **or liability**. The Corporation shall assess such loss **or liability** against the Tier Two CCIT Members ratably based upon a percentage of the loss **or liability** attributable to each Tier Two CCIT Member’s specific Generic CUSIP that it had open with the Defaulting Member. Such Tier Two CCIT Members with a bilateral liquidation profit will not be allocated any portion of the ~~Remaining Loss~~ **loss or liability** otherwise attributable to Tier Two Members.

**If a Tier Two Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Tier Two Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.**

~~(d) If there is any Remaining Loss attributable to Tier One Netting Members after application of paragraph (c) above, it shall be allocated among Tier One FICC Members, ratably, in accordance with the amount of each Tier One Netting Member’s~~

~~respective Required Fund Deposit and based on the average daily level of such deposit over the prior twelve months (or such shorter period as may be available in the case of a Member which has not maintained a deposit over such time period) (such amount, the Member's "Average Required FICC Clearing Fund Deposit").~~

~~(e) Notwithstanding anything to the contrary in this Section 7, however, an Inter-Dealer Broker Netting Member, or a Non-IDB Broker with respect to activity in its Segregated Broker Account, shall not be subject to an aggregate allocation of loss pursuant to this Section 7 for any single loss-allocation event, in an amount greater than \$5 million.~~

~~(f) Any loss or liability incurred by the Corporation incident to its clearance and settlement business arising from the failure of a Netting Member to pay to the Corporation an allocation made pursuant to the preceding subsections of this Section, or arising other than from a Remaining Loss (hereinafter, an "Other Loss") shall be allocated among Tier One Netting Members, ratably, in accordance with the respective amounts of their Average Required FICC Clearing Fund Deposits.~~

~~(g) The entire amount of the Required Fund Deposit of any Netting Member at the time that the Corporation incurred Remaining Loss or Other Loss may be used to satisfy any amount allocated against a Member as a result of such Remaining Loss or Other Loss. If notification is provided to a Member that an allocation has been made against a Member pursuant to this Rule and that application of the Member's Required Fund Deposit is not sufficient to satisfy such obligation to make payment to the Corporation, the Member shall (i) deliver to the Corporation by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by the Corporation, that amount which is necessary to eliminate any such deficiency, except that (ii) with regard to an allocation arising from any Remaining Loss allocated by the Corporation pursuant to subsection (d) of this Section 7 and any Other Loss, such Member may instead provide by the Close of Business on the Business Day on which such payment is due the Corporation written notice to the Corporation, pursuant to Section 13 of Rule 3, of its election to terminate its membership in the Corporation. If such Member elects to terminate its membership in the Corporation, its liability for an allocation arising from such Remaining Loss and Other Loss shall be limited to the amount of its Required Fund Deposit for the Business Day on which the notification of such allocation is provided to the Member. If such Member does not elect to terminate its membership in the Corporation as provided for above, it shall make such deposits to the Clearing Fund, by the Close of Business on the Business Day on which the Member is obligated to make the payment provided for above, as are necessary to satisfy its Required Fund Deposit as of such Business Day. If the Member shall fail to take the action stated in either (i) or (ii) above, the Corporation shall cease to act generally with regard to such Member pursuant to Rules 21 and 22A, and may take disciplinary action against the Member pursuant to Rule 48.~~

~~— A Member that elects to terminate its membership pursuant to alternative (ii) of the above paragraph in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Comparison-Only Member or a Netting Member unless, prior to submitting such application, it makes the~~

~~payment to the Corporation provided for in alternative (i) of the above paragraph, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Remaining Loss or Other Loss was incurred by the Corporation until the date of such payment. If a Netting Member elects to terminate its membership pursuant to alternative (ii) of the above paragraph, or if the Member fails to take any action, the Corporation will promptly make an additional assessment against the remaining Tier One Netting Members to cover the amount not paid by the Netting Member that made such election to terminate its membership.~~

~~(h) If a Remaining Loss or Other Loss occurs, the Corporation shall promptly notify each Member, and the SEC, of the amount involved and the reasons therefore. Any disciplinary action that the Corporation takes, or the voluntary or involuntary cessation of membership by a Member subsequent to the occurrence of the Remaining Loss or Other Loss, shall not, except as otherwise provided in this Rule, affect the obligations of the Member to the Corporation under this Rule or the Procedures thereof, or affect any remedy to which the Corporation may be entitled. If a Remaining Loss or Other Loss charged to Members is afterward recovered by the Corporation in whole or in part, the net amount of the recovery shall be credited or paid to those Persons, other than a Defaulting Member or other Person who caused in whole or part such Loss, including the Corporation, against whom the loss was charged, in proportion to the amounts paid by them, whether or not they are still Members.~~

~~(i) For purposes of calculating the allocations in this Section 7 that are based upon a Member's Average Required FICC Clearing Fund Deposit, a Member that is subject to an increased Clearing Fund deposit requirement pursuant to subsection (f) of Section 2 of this Rule shall be deemed to have a Average Required FICC Clearing Fund Deposit amount without such increase being taken into account.~~

#### Section 7a – Corporate Contribution

For any loss allocation pursuant to Section 7 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Exchange Act. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) Business Days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution. The Corporation shall maintain one Corporate

Contribution, the amount of which is available to both the Government Securities Division and the Mortgage-Backed Securities Division, and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs. In the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution shall be applied to that Division up to the amount then available. If a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution shall be applied to the respective Division in the same proportion that the aggregate Average RFDs of all members in that Division bears to the aggregate Average RFDs of all members in both Divisions.

Nothing in these Rules shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

#### Section 7b – Withdrawal Following Loss Allocation

If a Tier One Netting Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss allocation round as set forth in Section 7 of this Rule (“Loss Allocation Withdrawal Notice”), the Tier One Netting Member shall:

- (i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Tier One Netting Member to the Corporation, unless otherwise approved by the Corporation; and
- (ii) as of the time of such Tier One Netting Member’s submission of the Loss Allocation Withdrawal Notice to the Corporation, cease submitting transactions to the Corporation for processing, clearance or settlement, unless otherwise approved by the Corporation.

A Tier One Netting Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

If the Tier One Netting Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Tier One Netting Member will remain subject to further loss allocations pursuant to Section 7 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.



## Section 8 – Return of Members’ Clearing Fund Deposits

If a Member gives notice to the Corporation of its election to withdraw from membership, the Member’s Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied.

Notwithstanding anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit and/or Cross-Margining Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 41 “Cross Guaranty Agreements” and/or Rule 43 “Cross-Margining Arrangements”, to reimburse the Corporation for any Cross-Guaranty Repayment or Cross-Margining Repayment, respectively, that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement or Cross-Margining Agreement.

## Section 89 - ~~Timing of Payment of Deposit~~ Initial Required Fund Deposit and Changes in Members’ Required Fund Deposits

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A Netting Member must increase the amount of its deposit to the Clearing Fund ~~Required Fund Deposit~~ (by the deposit of cash, Eligible Netting Securities, and/or Eligible Letters of Credit subject to the requirements of this Rule) by the Required Fund Deposit Deadline on any Business Day that such Netting Member’s Actual Deposit ~~actual deposit to the Clearing Fund~~ is less than its Required Fund Deposit as set forth in the Report listing such, subject to the conditions included in Section 2 of this Rule 4. If there is an increase in a Netting Member’s Required Fund Deposit, at the time the increase becomes effective, the Netting Member’s obligations to the Corporation shall be determined in accordance with the increased Required Fund Deposit whether or not the Netting Member has satisfied such increased amount.

If the Corporation applies a Netting Member’s Clearing Fund deposits as permitted pursuant to this Rule, the Corporation may take any and all actions with respect to the Netting Member’s Actual Deposit, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Netting Member’s Required Fund Deposit, the Netting Member shall immediately replenish it. If the Netting Member fails to do so, the Corporation may take disciplinary action against such Netting Member pursuant to Rule 21 or Rule 48. Any disciplinary action that the Corporation takes pursuant to Rule 21 or Rule 48 or the voluntary or involuntary cessation of membership shall not affect the Netting Member’s obligations to the Corporation or any remedy to which the Corporation may be entitled under applicable law.

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**Section 910 - Return of Deposits and Payments Excess Clearing Fund Deposits**

The Corporation shall determine with such frequency as it shall from time to time specify, whether the amount deposited by a Member in the Clearing Fund is in excess of its Required Fund Deposit (hereinafter, "Excess Clearing Fund Deposit"). On any day that the Corporation has determined that an Excess Clearing Fund Deposit exists with respect to any Member, the Corporation will, in the form and manner required by the Corporation, notify each such Member of such excess. **Subject to the Corporation's rights under these Rules to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) as the Member requests. Upon the request of a Member, in the form and manner required by the Corporation, the Corporation shall cause to be returned to each such Member cash on deposit (in excess of the minimum amount of cash required to be maintained in the Clearing Fund), and/or Eligible Clearing Fund Securities (valued at their market value, including accrued interest as of the end of the Business Day prior to such withdrawal), in an aggregate amount equal to such excess or such lesser amount as the Member may request; provided, however, that, any return of excess will be done in such a way that the remaining Clearing Fund on deposit meets the requirements of Section 4, 4a, and 4b of this rule. In addition Notwithstanding the foregoing,** at the discretion of the Corporation, some or all of the Excess Clearing Fund Deposit may not be returned if the Member has an outstanding payment obligation to the Corporation, if the Corporation determines that the Member's anticipated Funds-Only Settlement Amounts or Net Settlement Positions in the near future may reasonably be expected to be materially different than those of the recent past or if the Member is on the Watch List.

In addition, the return of an Excess Clearing Fund Deposit amount to any Member is subject to the following limitations: (1) such return of Excess Clearing Fund Deposit shall not be done in a manner that would cause the Member to violate any other Section of these Rules; (2) Excess Clearing Fund Deposit shall not be returned to a Member to the extent that such return would reduce the amount of the Member's Cross-Guaranty Repayment Deposit to the Clearing Fund below the amount required to be maintained pursuant to Section 4 of Rule 41; and (3) Excess Clearing Fund Deposit shall not be returned to a Member to the extent that such return would reduce the amount of the Member's Cross-Margining Repayment Deposit to the Clearing Fund below the amount required to be maintained pursuant to Section 6 of Rule 43.

**The provisions of this section shall not limit the rights or remedies of the Corporation as provided in Section 7 of Rule 3.**

**Section 10- Ceasing to be a Member**

~~If a Netting Member gives notice to the Corporation pursuant to Rule 3 of its election to terminate its membership in the Netting System, the Member's deposits to the~~

~~Clearing Fund in the form of cash or securities shall be returned to it within 30 calendar days thereafter, and the Member's deposits to the Clearing Fund in the form of letters of credit shall be returned to it within 90 calendar days thereafter, in each case provided that all amounts owing to the Corporation by the Member have been paid to the Corporation prior to such return and the Member has no remaining open Net Settlement Position, Fail Net Settlement Position, or Forward Net Settlement Position. Any obligation of a Member to the Corporation pursuant to this Rule that is unsatisfied at the time it ceases to be a Member shall not be effected by such cessation.~~

~~The time periods specified in the above paragraph also govern the return of any cash or securities deposited by, or letters of credit issued on behalf of, an Inter-Dealer Broker pursuant to Section 7 of this Rule.~~

~~Notwithstanding the previous two paragraphs or anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit and/or Cross-Margining Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 41 and/or Rule 43 to reimburse the Corporation for any Cross-Guaranty Repayment or Cross-Margining Repayment, respectively, that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement or Cross-Margining Agreement.~~

#### Section 11 - Corporation's Authority to Pledge and Assign

In furtherance of the rights of the Corporation pursuant to these Rules, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign any and all Actual Deposits: (i) cash deposits, (ii) securities, repurchase agreements, deposits or other instruments in which cash deposits of Members are invested, and (iii) any securities or letters of credit pledged or deposited by any Member to secure an open account indebtedness to the Clearing Fund or otherwise to collateralize its obligations to the Corporation, and any proceeds thereof for the purpose of securing loans made to the Corporation (the party making any such loan to the Corporation hereinafter referred to as the "Lender"); or other obligations incurred by the Corporation, provided that the proceeds of such loans are used for a purpose permissible under Section 3 and Section 5 of this Rule in each case incident to the clearance and settlement business of the Corporation. Such loans ~~or obligations~~ shall be on terms and conditions deemed necessary or advisable by the Corporation (including collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member to the Corporation for which such property and Eligible Letters of Credit (if any) were was pledged to or deposited with the Corporation. Notwithstanding the above, the Corporation shall remain obligated to each such Member to return, and to allow substitution for or withdrawal of, cash, and Eligible Clearing Fund Securitiessecurities, and Eligible HLetters of eCredit (if any) pledged or deposited by asuch Member as a Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund~~, or otherwise to collateralize such Member's obligations to the Corporation, under the circumstances and within the timeframes specified in these Rules. In the event of any conflict or inconsistency between this Rule 4 and any agreement between the Corporation and any Member, this Rule 4 shall govern and prevail.

Section 12 – Clearance and Settlement Business of the Corporation

For purposes of this Rule 4, references to the clearance and settlement business of the Corporation shall include its business as a Securities Intermediary.

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## **RULE 13 - FUNDS-ONLY SETTLEMENT**

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### Section 5- Funds-Only Settlement Amount Payment Process

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(o) Under FRB Operating Circular No. 12, FICC's Settlement Agent has certain processing responsibilities in allocating an indemnity claim made by an FRB as a result of processing the Corporation's funds-only settlement via NSS. The Corporation shall apportion the entirety of such liability to the Netting Members for whom the Funds-Only Settling Bank to which the indemnity claim relates was acting. Such liability for each applicable Netting Member shall be in proportion to the amount of such Members' Funds-Only Settlement Amounts on the Business Day in question. If for any reason such allocation is not sufficient to fully satisfy the FRB indemnity claim, then the remaining loss shall be treated as ~~an "Other Loss" as defined by Rule 4~~ **a loss that is otherwise incident to the clearance and settlement business of the Corporation** and allocated accordingly **pursuant to Section 7 of Rule 4.**

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## **RULE 18 - SPECIAL PROVISIONS FOR REPO TRANSACTIONS**

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### Section 3 - Collateral Substitutions

(f) Upon receipt of a request for such substitution and until information regarding the New Securities Collateral is provided to the Corporation for purposes of calculating the Required Fund Deposit of the Repo Party, the Corporation shall assign to the transaction a Contract Value which is 150 percent of the Contract Value of the original securities collateral. Moreover, where the Corporation has been notified of a substitution but the New Securities Collateral has not yet been reported to the Corporation, the Corporation shall base margining with respect to the New Securities Collateral on the applicable Generic CUSIP using the methodology that is used for securities whose volatility is less amenable to statistical analysis set forth in Section ~~2(b)~~1b of Rule 4.

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**RULE 21A – WIND-DOWN OF A NETTING MEMBER**

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If the Corporation takes, or mandates, any action pursuant to this Rule, the Corporation shall, as soon as practicable thereafter, notify the SEC and such other Members as it deems proper due to the nature of such action, and shall inform Members as to whether the Corporation shall relieve Members from the loss allocation obligations of ~~Section 8 of~~ Rule 4 with respect to transactions that Members enter into with the Wind-Down Member.

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## **RULE 22B – CORPORATION DEFAULT**

### Corporation Default

(a) If a “Corporation Default” occurs pursuant to subsection (b) below, all Transactions which have been subject to Novation pursuant to these Rules but have not yet settled and any rights and obligations of the parties thereto shall be immediately terminated. Each relevant Member shall thereupon promptly take such market action as is commercially reasonable under the circumstances to effect a close out of any outstanding positions. Each Member will report the results of its market action to the Board and the Board shall determine a single net amount owed by or to each Member with respect to such positions, to the extent applicable, by applying the close out and application procedures of Sections 2(a) and (b) of Rule 22A **(interpreted in all such cases as if each Member were a Defaulting Member)** and ~~Sections 7(a) through (e) of Rule 4 (interpreted in all such cases as if each Member were a Defaulting Member)~~ taking into account the **other loss allocation** provisions in ~~these Rules relating to loss allocation, including in the event that any Member is a Defaulting Member~~ **Rule 4**. The Board shall notify each Member of the net amount so determined and Members who have been notified that they owe an amount to the Corporation shall pay that amount on or prior to the date specified by the Board, subject to any applicable setoff rights. Members who have a net claim against the Corporation shall be entitled to payment thereof along with other Members’ and any other creditors’ claims pursuant to the underlying contracts with respect thereto, these Rules and applicable law. For the avoidance of doubt, nothing herein shall limit the rights of the Corporation upon a Member default (including following a Corporation Default) including under any Cross-Guaranty Agreement with the Mortgage-Backed Securities Division or any other Cross-Guaranty Counterparty.

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## **RULE 41 - CROSS GUARANTY AGREEMENTS**

### Section 1 – Authority

The Corporation may, from time to time, enter into one or more Limited Cross-Guaranty Agreements.

In determining its available net resources pursuant to a Limited Cross-Guaranty Agreement, the Corporation shall first offset the available net resources of the Government Securities Division ~~pursuant to the Cross-Margining Agreement between the Corporation and NYPC and then~~ the Mortgage-Backed Securities Division.

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### Section 3 - Application of Cross-Guaranty Payments

The Corporation shall, in its sole discretion, either:

(a) apply any Cross-Guaranty Payment received by the Corporation on account of a Cross-Guaranty Defaulting Member: (1) to the unpaid obligations of such Cross-Guaranty Defaulting Member to the Corporation and (2) to reduce the assessments made or that otherwise would be made against other Netting Members (each, a “Cross-Guaranty Beneficiary Member”) pursuant to Section ~~8~~7 of Rule 4; or

(b) retain any Cross-Guaranty Payment received by the Corporation and not apply such Cross-Guaranty Payment to reduce any assessments against other Netting Members pursuant to Section ~~8~~7 of Rule 4 until the Corporation determines that the Corporation is no longer liable for any Cross-Guaranty Repayment, at which point the Cross-Guaranty Payment shall be treated as an amount that has been recovered pursuant to Section ~~8(k)~~7 of Rule 4.

### Section 4 - Cross-Guaranty Repayment Deposits

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In the event that the Corporation is required to make a Cross-Guaranty Repayment and it does not have a sufficient amount of Cross-Guaranty Repayment Deposits to cover the liability, the Corporation shall treat the shortfall as ~~an “Other Loss”~~a loss incurred as a result of a Defaulting Member Event to be allocated pursuant to Section ~~8(g)~~7 of Rule 4.

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## **RULE 43 - CROSS-MARGINING ARRANGEMENTS**

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### Section 6 – Cross-Margining Repayment Deposits

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In the event that the Corporation is required to make a Cross-Margining Repayment and it does not have a sufficient amount of Cross-Margining Repayment Deposits to cover the liability, the Corporation shall treat the shortfall as ~~an “Other Loss”~~ **a loss incurred as a result of a Defaulting Member Event to be allocated** pursuant to Section ~~8(g)~~**7** of Rule 4.

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## BOARD INTERPRETATIONS AND STATEMENTS OF POLICY

### ~~INTERPRETATION OF THE BOARD OF DIRECTORS OF THE GOVERNMENT SECURITIES CLEARING CORPORATION~~

~~Pursuant to Rule 47 of the Government Securities Clearing Corporation ("the Corporation"), the Board of Directors has the authority to interpret the rules of the Corporation. The purpose of this interpretation is to clarify certain provisions of the Corporation Rule 4 ("Rule 4") and the extent to which Clearing Fund and other required deposits of Netting Members may be applied to a loss or liability incurred by the Corporation.~~

~~Section 6 of Rule 4 provides that the use of the Clearing Fund shall be limited to satisfaction of losses or liabilities of the Corporation arising from the failure of a Netting Member to satisfy an obligation to the Corporation or incident to the clearance and settlement business of the Corporation other than from such failure of such Member, and to providing the Corporation with a source of collateral to meet its temporary financing needs. Section 7 of Rule 4 provides that collateral in the amount of \$1.6 million is required to be maintained by Inter-Dealer Broker Netting Members (which Members are not required to contribute to the Clearing Fund) for the purpose of collateralizing any obligations that such Member may have to the Corporation pursuant to the Shareholder Agreement and Section 8 (Allocation of Loss or Liability Incurred by the Corporation) of Rule 4.~~

- ~~1. Use of required deposits to satisfy a loss or liability arising incident to the clearance and settlement business of the Corporation~~

~~The appropriateness of the use of required deposits to satisfy in whole or part a loss or liability arising incident to the clearance and settlement business of the Corporation is best determined by the Board of Directors on a case-by-case basis. The determination as to whether a loss or liability arose incident to the clearance and settlement business of the Corporation such that the loss or liability may be covered by Netting Members' required collateral may be made only by the Board of Directors, after consideration of the circumstances that led to the loss and liability and the effect on the Corporation of the use of required collateral to cover such loss or liability.~~

- ~~2. Use of required deposits to provide the Corporation with a source of collateral to meet its temporary financing needs~~

~~The use of required deposits to provide the Corporation with a source of collateral for financing is limited to those temporary financing needs related to the clearance and settlement business of the Corporation.~~

September 13, 1989

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## INTERPRETIVE GUIDANCE WITH RESPECT TO WATCH LIST CONSEQUENCES

Being placed on the Watch List may result in Clearing Fund-related consequences as well as other consequences under the Rules:

A. *Clearing Fund-Related Consequences*

1. Additional Clearing Fund Deposits

Pursuant to Section 12(e) of Rule 3, the Corporation may require a Netting Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~ the provisions of Rule 4 or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members.

\*\*\*\*

2. Restriction on Withdrawal of Excess Clearing Fund Deposits

Pursuant to Section 910 of Rule 4, the Corporation may retain some or all of the Excess Clearing Fund Deposit of a Member who is on the Watch List. Nonetheless, the Corporation generally does not retain the Excess Clearing Fund Deposit of a Watch List Member unless the Member fails to pay the Required Fund Deposit within the required timeframes established by the Corporation, or if the Corporation has a concern that the Member will not be able to satisfy its obligation to the Corporation.

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**FIXED INCOME CLEARING CORPORATION**

**MORTGAGE-BACKED SECURITIES DIVISION**

**CLEARING RULES**

TEXT OF PROPOSED RULE CHANGE

**Bold and underlined text** indicates proposed added language

**~~Bold and strikethrough text~~** indicates proposed deleted language

**RULE 1 - DEFINITIONS**

\*\*\*\*

**Actual Deposit**

**The term “Actual Deposit” shall have the meaning given that term in Section 4 of Rule 4.**

\*\*\*\*

**Average RFD**

**The term “Average RFD” shall have the meaning given that term in Section 7 of Rule 4.**

\*\*\*\*

**Clearing Fund Cash**

**The term “Clearing Fund Cash” shall have the meaning given that term in Section 3a of Rule 4.**

\*\*\*\*

**Corporate Contribution**

**The term “Corporate Contribution” shall have the meaning given that term in Section 7a of Rule 4.**

\*\*\*\*

**Declared Non-Default Loss Event**

**The term “Declared Non-Default Loss Event” shall have the meaning given that term in Section 7 of Rule 4.**

\*\*\*\*

**Defaulting Member Event**

**The term “Defaulting Member Event” shall have the meaning given that term in Section 7 of Rule 4.**

\*\*\*\*

**Event Period**

**The term “Event Period” shall have the meaning given that term in Section 7 of Rule 4.**

\*\*\*\*

**Excess Clearing Fund Deposit**

**The term “Excess Clearing Fund Deposit” shall have the meaning given that term in Section 10 of Rule 4.**

\*\*\*\*

**Lender**

**The term “Lender” shall have the meaning given that term in Section 11 of Rule 4.**

\*\*\*\*

**Loss Allocation Cap**

**The term “Loss Allocation Cap” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Notice**

**The term “Loss Allocation Notice” shall have the meaning given that term in Section 7 of Rule 4.**

**Loss Allocation Withdrawal Notice**

**The term “Loss Allocation Withdrawal Notice” shall have the meaning given that term in Section 7b of Rule 4.**

\*\*\*\*

**Termination Date**

**The term “Termination Date” shall have the meaning given that term in Section 14 of Rule 3.**

\*\*\*\*

**Voluntary Termination Notice**

**The term “Voluntary Termination Notice” shall have the meaning given that term in Section 14 of Rule 3.**

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RULE 3 - ONGOING MEMBERSHIP REQUIREMENTS

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Section 11 – Ongoing Monitoring

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(e) The Corporation may require a Clearing Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~the provisions of Rule 4 (which additional deposit shall constitute a portion of the Clearing Member's Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member. The Corporation may also retain any Excess Clearing Fund Deposits of a Clearing Member that has been placed on the Watch List as provided in Section ~~9~~10 of Rule 4.

\*\*\*\*

Section 14 - Voluntary Termination

A Member may elect to terminate its membership in the Clearing System by providing the Corporation with ~~a 10 days~~ written notice of such termination (**“Voluntary Termination Notice”**); ~~however, the Corporation, in its discretion, may accept such termination within a shorter notice period. The Member shall specify in the Voluntary Termination Notice a desired date for its withdrawal from membership, which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Member to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.~~

Such termination will not be effective until accepted by the Corporation, **which shall be no later than 10 Business Days after the receipt of the Voluntary Termination Notice from such Member.** The Corporation's acceptance shall be evidenced by a notice to Members announcing the Member's termination and the effective date of the termination of the Member (hereinafter the "Termination Date"). As of the Termination Date, a Clearing Member that terminates its membership in the Clearing System shall no longer be eligible to submit to the Corporation data on trades unless the Board determines otherwise in order to ensure an orderly liquidation of the Clearing Member's open obligations. **If any trade is submitted to the Corporation by such Clearing Member that is scheduled to settle on or after the Termination Date, such Clearing Member's Voluntary Termination Notice will be deemed void, and the Clearing Member will remain subject to these Rules as if it had not given such Voluntary Termination Notice.**



A Member's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to Transactions submitted to the Corporation before the Termination Date. The return of the Member's Clearing Fund deposit shall be governed by Section ~~108~~ of Rule 4. **If a Member is a Tier One Member and an Event Period were to occur after such Member has submitted its Voluntary Termination Notice but prior to the Termination Date, in order for such Member to benefit from its Loss Allocation Cap pursuant to Section 7 of Rule 4, the Member will need to comply with the provisions of Section 7b of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the Member.**

#### **Section 15 - Indemnification**

~~Clearing Members shall indemnify the Corporation against any loss, reasonable cost or expense, damage or liability arising out of the performance, non-performance or misperformance of such duties except to the extent that the Corporation's conduct violated the standard of care set forth in Rule 30, "Limitations of Liability". In the event that any loss, cost, expense, damage or liability with respect to which the Corporation is entitled to indemnification pursuant to this Section 15 is attributable to one or more identifiable Clearing Members, an assessment shall be made against such Clearing Members. In the event that any such loss, cost, expense, damage or liability cannot be attributed to one or more identifiable Clearing Members, an assessment shall be made against Clearing Members generally in proportion to their relative usage of the facilities of the Corporation (based on fees for services) during the period in which such loss, cost, expense, damage or liability was incurred. The assessment in the immediately preceding sentence shall be subject to Section 7(g) of Rule 4.~~

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RULE 4 - CLEARING FUND AND LOSS ALLOCATION

Section 1 – General Required Fund Deposits

Each Clearing Member shall make, and maintain on an ongoing basis ~~so long as such Member is a Clearing Member~~, a deposit to the Clearing Fund ~~at no less than the minimum required level set forth in this Rule (the "Required Fund Deposit")~~. ~~Deposits to the Clearing Fund shall be held by the Corporation or its designated agents to be applied as provided in this Rule.~~ The amount of each Clearing Member's required deposit shall be determined by the Corporation in accordance with this Rule and shall be referred to as the Required Fund Deposit. The timing of payment of the Required Fund Deposit shall be determined in accordance with the provisions of Section ~~89~~ of this Rule. ~~The term "Transactions" as used in this Rule 4 includes Pool Receive Obligations, Pool Deliver Obligations, TBA Obligations, Specified Pool Trades and Stipulated Trades.~~

A Clearing Member may in its discretion maintain additional deposits at the Corporation, subject to any requirements the Corporation may establish for such excess amounts pursuant to Section 10 of this Rule. For purposes of these Rules, such additional deposits shall be deemed to be part of the Clearing Fund and the Clearing Member's Actual Deposit but shall not be deemed to be part of the Clearing Member's Required Fund Deposit. The Corporation shall not be required to segregate each Clearing Member's Actual Deposit, but shall maintain books and records concerning the assets that constitute each Clearing Member's Actual Deposit.

~~If a Member's Required Fund Deposit is charged as a result of a Clearing Fund loss solely attributable to that Member such Member shall promptly replenish the deficit in its Required Fund Deposit.~~

Section 2 – Required Fund Deposit Requirements

- (a) Mark-to-Market -- Computation of profit or loss.

The Corporation shall separately compute profit or loss for each Transaction in each Account maintained by a Clearing Member as follows: The term "Transactions" as used in this Rule 4 includes Pool Receive Obligations, Pool Deliver Obligations, TBA Obligations, Specified Pool Trades and Stipulated Trades.

\*\*\*\*

~~(d) The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit arrived at above, with a minimum of \$100,000, must, be made and maintained in cash, with the remaining portion of the Required Fund Deposit to be made and maintained in the form specified in Section 3 of this Rule.~~

~~(e)~~(d) The initial Required Fund Deposit of each Clearing Member shall be set by the Corporation based upon the expected nature and level of such Member's activity.

~~(f)~~(e) Notwithstanding anything to the contrary in this Rule, the Corporation may require a Clearing Member to make and maintain a higher Required Fund Deposit than the amount ~~calculated~~ as noted above, if the Corporation determines that such higher Required Fund Deposit is necessary to protect the Corporation and its Members from the risk (the “Legal Risk”) that the Corporation, as a result of a law, rule or regulation applicable to a Clearing Member, including a Clearing Member’s insolvency or bankruptcy, may be delayed or prohibited from: (i) accessing any portion of the Clearing Member’s Required Fund Deposit, (ii) netting, closing out or liquidating Transactions, or setting off obligations, or taking any other action contemplated by these Rules or (iii) otherwise exercising its rights pursuant to these Rules.

~~(g)~~(f) Notwithstanding anything to the contrary in this Rule, the Corporation may require a Clearing Member’s Clearing Fund deposit to be in proportions of cash, Eligible Clearing Fund Securities and Eligible Letters of Credit that the Corporation determines to be necessary to protect itself and its Members from Legal Risk. In addition, the Corporation may take all necessary action to mitigate Legal Risk, including, but not limited to, requiring the Member to post additional Clearing Fund as set forth in this Section 2 of Rule 4.

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### Section 3 - Form of Deposit

Subject to the provisions of Section 2 of this Rule 4 governing the computation of a Clearing Member’s Required Fund Deposit, and the limitations of this Section 3, Section 3a and Section 3b, a Clearing Member's deposits to the Clearing Fund may be in the form of:

- (a) cash; ~~and or~~
- (b) an open account indebtedness fully secured by Eligible Clearing Fund Securities.

~~The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit made to the Clearing Fund, with a minimum of \$100,000, must be made and maintained in cash. A minimum of 40 percent of the Clearing Member’s Required Fund Deposit shall be made in the form of cash and/or Eligible Clearing Fund Treasury Securities.~~

The lesser of \$5,000,000 or 10 percent of the Required Fund Deposit, with a minimum of \$100,000, must be made and maintained in cash, with the remaining portion of the Required Fund Deposit to be made and maintained in the form specified in this Section 3.

~~Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Clearing Member may substitute and/or withdraw securities from pledge and deposit, provided that the Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour or less prior to the close of the securities FedWire on such Day. Any interest on securities deposited by a Clearing Member to secure a Clearing Fund~~

~~open account indebtedness that is received by the Corporation shall be credited to the Member's cash deposits to the Clearing Fund, except in the event of a default by a Member in payment of any of its obligations to the Corporation, in which case the Corporation may first liquidate such securities and apply all or a portion thereof, including any interest thereon, as provided in Section 7 of this Rule.~~

Section 3a - Special Provisions Relating to Deposits of Cash

Cash deposits to the Clearing Fund shall be paid to the Corporation in immediately available funds. ~~The Corporation may invest any Cash contained cash~~ in the Clearing Fund, including (i) cash deposited by a Clearing Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, "Clearing Fund Cash") in accordance with the Clearing Agency Investment Policy adopted by the Corporation. ~~may be partially or wholly invested by the Corporation, in its sole discretion, for the account of the Clearing Fund in debt obligations of the U.S. Government or those U.S. Government Agencies and instrumentalities of the United States guaranteed by the U.S. Government subject to reverse repurchase agreements ("repo"). Clearing Fund cash may also be partially or wholly invested for its accounts in direct purchases of: (1) U.S. Treasury Bills, Bonds or Notes, (2) Certificates of Deposit or similar deposits of FDIC insured banks ("CDs"), or (3) 2a-7 Money Market Mutual Funds rated AAA or better and to the extent not so invested shall be deposited by the Corporation in its name in a depository (commercial bank account) consistent with its Investment Policy. Investment income, if any, on cash deposits shall be paid to Members at such intervals, in such manner and in such amounts as the Corporation from time to time may determine.~~

Each Clearing Member shall be entitled to any interest earned or paid on Clearing Fund cash deposits.

Section 3b - Special Provisions Relating to Deposits of Eligible Clearing Fund Securities

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Eligible Clearing Fund Securities that are used to secure an open account indebtedness must be pledged to the Corporation on such terms and conditions as it may require, and be delivered to ~~either~~ the Corporation or to the Corporation's account at ~~to~~ a depository financial institution approved/designated by the Corporation ~~that shall hold the securities on the Corporation's behalf~~. The valuation of such Eligible Clearing Fund Securities shall be at current market value, which shall be determined by the Corporation not less frequently than on a daily basis. All Eligible Clearing Fund Securities shall be subject to a haircut set forth in these Rules. The Corporation has the right, in its discretion, to refuse to accept a particular type ~~or types~~ of Eligible Clearing Fund Security as a permissible form of Clearing Fund deposit.

Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Clearing Member may substitute and/or withdraw Eligible Clearing Fund Securities from pledge and deposit, provided that the Clearing Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour prior to the close of the securities FedWire on such day. Any interest on Eligible Clearing Fund Securities deposited by a Clearing Member to secure a Clearing Fund open account indebtedness that is received by the Corporation shall be credited to the Clearing Member's cash deposits to the Clearing Fund, except in the event of a default by such Clearing Member on any obligations to the Corporation under these Rules, in which case the Corporation may exercise its rights under Section 6 of this Rule.

#### Section 4 - Lien

As security for any and all obligations and liabilities of a Clearing Member to the Corporation, including, without limitation, any obligation of a Cross-Guaranty Defaulting Member to reimburse the Corporation pursuant to Rule 32 or any obligation of a Cross-Guaranty Beneficiary Member to reimburse the Corporation pursuant to **Section 5 of Rule 32**, each such **Clearing Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Clearing Member's open account indebtedness or all assets and property** placed by a **Clearing Member** in the possession of the Corporation (or its agents acting on its behalf), including all securities and cash on deposit with the Corporation or its agents pursuant to ~~these~~ **this Rules and Rule 11 (collectively with any Eligible Letters of Credit issued on behalf of a Clearing Member in favor of the Corporation, the Clearing Member's "Actual Deposit")**. The Corporation shall be entitled to **exercise the its rights as of** a pledgee under common law and ~~as~~ a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such ~~collateral~~ **assets**.

#### Section 5 - Use of Deposits and Payments Clearing Fund

~~The use of the Clearing Fund deposits and assets and property on which the Corporation has a lien shall be limited to satisfaction of losses or liabilities of the Corporation, including Cross-Guaranty Payments and Cross-Guaranty Repayments made by the Corporation pursuant to Cross-Guaranty Agreements, arising from the failure of a Defaulting Member to satisfy an obligation to the Corporation, the failure of a Cross-Guaranty Defaulting Member to satisfy an obligation to a Cross-Guaranty Counterparty, or otherwise incident to the clearance and settlement business of the Corporation with respect to losses and liabilities to meet unexpected or unusual requirements for funds that represent a small percentage of the Clearing Fund, and to provide the Corporation with a source of collateral both to meet its temporary financing needs (through an appropriate financing method determined by the Corporation in its sole discretion) for any financing that is obtained by the Corporation to hold securities pending settlement, to ensure the satisfaction of Members' settlement obligations and to meet unexpected or unusual~~

~~requirements for funds that represent a small percentage of the Clearing Fund. If the Corporation pledges, hypothecates, encumbers, borrows, or applies any part of the Clearing Fund deposits, or other collateral that it has received from Members to satisfy, in whole or in part, any liability, obligation, or liquidity requirement, for more than 30 days, the Corporation, at the Close of Business on the thirtieth day (or on the first Business Day thereafter), shall consider the amount used to meet such financing as an actual loss to the Clearing Fund and immediately allocate such loss in accordance with Section 7 of this Rule. Whenever the Clearing Fund is charged for any reason other than to satisfy a clearing loss attributable to a Member solely from that Member's Clearing Fund deposit, each Member will be provided the reasons for the charge.~~

The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including, without limitation, each Member's obligations with respect to any loss allocations as set forth in Section 7 of this Rule and any obligations arising from a Cross-Guaranty Agreement pursuant to Rule 32, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in Section 3a of this Rule.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the Close of Business on the 30th calendar day (or on the first Business Day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 7 of this Rule.

~~If a loss or liability incurred by the Corporation is allocated to a Member pursuant to Section 7 of this Rule, a Member that is a Cross-Guaranty Defaulting Member incurs an obligation to reimburse the Corporation pursuant to Rule 32, or a Member that is a Cross-Guaranty Beneficiary Member incurs an obligation to reimburse the Corporation pursuant to Rule 32, the Corporation may apply the portion of the Member's deposit to the Clearing Fund necessary to satisfy such allocation obligation. In this regard, the Corporation may apply any cash, draw against any letters of credit, and liquidate any securities deposited by the Member, and may do any or all of the foregoing whether or not the Corporation has ceased to act for the Member.~~

Section 6 – ~~[RESERVED FOR FUTURE USE]~~Application of Clearing Fund Deposits and Other Amounts to Defaulting Members' Obligations

Any loss or liability incurred by the Corporation as the result of the failure of a Defaulting Member to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 6.

The Corporation shall apply any Clearing Fund deposits, Cash Settlement Amounts, funds-only payments amounts, and any other collateral or assets held by the Corporation securing such Defaulting Member's obligations to the Corporation, and any

proceeds of any of the foregoing. To the extent that a Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement either upon receipt or the time described in Section 3(b) of Rule 32.

If the Corporation applies a Defaulting Member's Clearing Fund deposits as permitted by this Rule, the Corporation may take any and all actions with respect to the Defaulting Member's Actual Deposit, including the assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate.

Section 7 - Loss Allocation Waterfall, Off-the-Market Transactions of Loss or Liability Incurred by the Corporation

For the purposes of this Rule, the following terms shall have the following meanings:

"Defaulting Member" shall mean a Member for which the Corporation has ceased to act pursuant to Rule 14 or Rule 16.

"Defaulting Member Event" shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 14 or Rule 16.

"Declared Non-Default Loss Event" shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 6 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

If the Corporation incurs aAny loss or liability arising out of or relating to incurred by the Corporation as the result of the failure of a Defaulting Member a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation shall address the loss or liability as follows~~to fulfill its obligations to the Corporation shall be satisfied as set forth in this Section 7 of this Rule 4:~~

~~(a) First, by application of any Clearing Fund deposits, Cash Settlement Amounts, funds-only payment amounts, and any other collateral held by the Corporation securing such Member's obligations to the Corporation;~~

~~(b) — Second, if the Defaulting Member is a Cross-Guaranty Defaulting Member, the Corporation shall apply any amounts available under a Cross-Guaranty Agreement either upon receipt or the time described in Rule 32;~~

~~(e) In the event there is any loss or liability incurred by the Corporation in respect of the Mortgage-Backed Securities Division remaining after application of paragraph (a) above (any such loss or liability, a “Remaining Loss”), the Corporation shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. an amount of up to 25% of the existing retained earnings of the Corporation, or such higher amount as the Board of Directors shall determine. Notwithstanding the foregoing, to the extent that a loss or liability is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the data on the Off-the-Market Transaction to the Corporation; If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.~~

~~d) — If there is any Remaining Loss after application of paragraph (e) above, If the loss or liability with respect to an Event Period results from one or more Defaulting Member Events, the Corporation shall determine the amount of such loss or liability that is attributable to Tier One Members and the amount of such loss or liability that is attributable to Tier Two Members. If the loss or liability with respect to an Event Period results from one or more Declared Non-Default Loss Events, the amount of such loss or liability shall be attributable to Tier One Members. Tier Two Members shall not be subject to loss allocation with respect to Declared Non-Default Loss Events.~~

To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction.

No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules. If the Corporation allocates losses or liabilities pursuant to this Rule and subsequently recovers amounts against such allocated losses or liabilities, in whole or in part, the net amount of the recovery shall be credited to the Persons, including the Corporation, against whom the losses were charged in proportion to the amounts charged against them.

~~To the extent there is a Remaining Loss attributable to Tier One Members, the Corporation shall assess the Required Fund Deposit maintained by each such Member an amount of up to \$50,000, in an equal basis per Tier One Member.~~



## Tier One Members

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) Business Days (an “Event Period”) shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for the Defaulting Member (or the next Business Day, if such day is not a Business Day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Each Tier One Member that is a Tier One Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Tier One Member for which the Corporation ceases to act on a non-Business Day, triggering an Event Period that commences on the next Business Day, shall be deemed to be a Tier One Member on the first day of that Event Period.

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Tier One Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule.

Each loss allocation shall be communicated to Tier One Members by the issuance of a notice that advises the Tier One Members of the amount being allocated to them (“Loss Allocation Notice”). Each Tier One Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) Business Days preceding the first day of the applicable Event Period or such shorter period of time that the Tier One Member has been a Tier One Member (each Tier One Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Tier One Members subject to loss allocation in such round.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Member in that round has five (5) Business Days from the issuance of such first Loss Allocation Notice for the round to notify the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, and thereby benefit from its Loss Allocation Cap. The “Loss Allocation Cap” of a Tier One Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Tier One Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 7b of this Rule shall be subject to further loss allocation with respect to that Event Period.

For purposes of calculating the pro rata share of losses and liabilities and the Loss Allocation Cap pursuant to the previous paragraph, the Corporation shall not count toward a Tier One Member’s Required Fund Deposit any increased Clearing Fund deposit that the Tier One Member may be subject to pursuant to Section 2(e) of this Rule.

Tier One Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second Business Day after the Corporation issues any such notice. Tier One Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second Business Day after the Corporation issues such notice, unless the Tier One Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round, pursuant to Section 7b of this Rule.

To the extent that a Tier One Member’s Loss Allocation Cap exceeds the Tier One Member’s Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Tier One Member, up to the Tier One Member’s Loss Allocation Cap.

If a Tier One Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Tier One Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.

If a Tier One Member notifies the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Member shall comply with the provisions of Section 7b of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 7b of this Rule, the Tier One Member fails to comply with the provisions of Section 7b of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

A Tier One Member that elects to withdraw pursuant to Section 7b of this Rule shall not be eligible to re-apply to become a Clearing Member unless, prior to submitting such application, it makes the payment(s) to the Corporation that would have been due pursuant to Section 7 of this Rule as if the Tier One Member had not withdrawn, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Event Period began.

### Tier Two Members

To the extent there is a loss or liability payable by Tier Two ~~Remaining Loss Members, the Tier Two Remaining Loss~~ such loss or liability shall be allocated to Tier Two Members based upon their trading activity with the Defaulting Member that resulted in a loss or liability. The Corporation shall assess such loss or liability against the Tier Two Members ratably based upon their loss or liability as a percentage of the entire amount of the ~~Remaining Loss~~ loss or liability attributable to Tier Two Members. Tier Two Members with a bilateral liquidation profit will not be allocated any portion of the ~~Remaining Loss~~ loss or liability attributable to Tier Two ~~Remaining Loss~~ Members.

If a Tier Two Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Tier Two Member as a Defaulting Member that has failed to satisfy an obligation in accordance with Section 6 of this Rule.

~~(e) — If there is any Remaining Loss attributable to Tier One Members after application of paragraph (d) above, it shall be allocated among Tier One Members, ratably, in accordance with the amount of each Tier One Member's respective Required Fund Deposit and based on the average daily level of such deposit over the prior twelve months (or such shorter period as may be available in the case of a Member which has not maintained a deposit over such time period) (such amount, the Member's "Average Required Clearing Fund Deposit").~~

~~(f) — Any loss or liability incurred by the Corporation incident to its clearance and settlement business arising from the failure of a Clearing Member to pay to the Corporation an allocation made pursuant to the preceding subsections of this Section or arising other than from a Remaining Loss (hereinafter, an "Other Loss"), shall be allocated among Tier One Members, ratably, in accordance with the respective amounts of their Average Required Clearing Fund Deposits.~~

~~(g) — The entire amount of the Required Fund Deposit of any Clearing Member at the time that the Corporation incurred an applicable Remaining Loss or Other Loss may be used to satisfy any amount allocated against a Member as a result of such Remaining Loss or Other Loss. If notification is provided to a Member that an allocation has been made against a Member pursuant to this Rule and that application of the Member's Required Fund Deposit is not sufficient to satisfy such obligation to make payment to the Corporation, the Member shall (i) deliver to the Corporation by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by the Corporation, that amount which is necessary to~~

~~eliminate any such deficiency, except that (ii) with regard to an allocation arising from any Remaining Loss allocated by the Corporation pursuant to subsection (c) of this Section 7 and any Other Loss, such Member may instead provide by the Close of Business on the Business Day on which such payment is due the Corporation written notice to the Corporation, pursuant to Section 13 of Rule 3, of its election to terminate its membership in the Corporation. If such Member elects to terminate its membership in the Corporation, its liability for an allocation arising from such Remaining Loss and Other Loss shall be limited to the amount of its Required Fund Deposit for the Business Day on which the notification of such allocation is provided to the Member. If such Member does not elect to terminate its membership in the Corporation as provided for above, it shall make such deposits to the Clearing Fund, by the Close of Business on the Business Day on which the Member is obligated to make the payment provided for above, as are necessary to satisfy its Required Fund Deposit as of such Business Day. If the Member shall fail to take the action stated in either (i) or (ii) above, the Corporation shall cease to act generally with regard to such Member pursuant to Rules 14 and 17, and may take disciplinary action against the Member pursuant to Rule 38.~~

~~A Member that elects to terminate its membership pursuant to alternative (ii) of the above paragraph in lieu of being liable to pay an additional assessment amount above its Required Fund Deposit shall not be eligible to re-apply to become a Clearing Member unless, prior to submitting such application, it makes the payment to the Corporation provided for in alternative (i) of the above paragraph, together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the Remaining Loss or Other Loss was incurred by the Corporation until the date of such payment. If a Clearing Member elects to terminate its membership pursuant to alternative (ii) of the above paragraph, or if the Member fails to take any action, the Corporation will promptly make an additional assessment against the remaining Tier One to cover the amount not paid by the Clearing Member that made such election to terminate its membership.~~

~~(h) — If a Remaining Loss or Other Loss occurs, the Corporation shall promptly notify each Member, and the SEC, of the amount involved and the reasons therefor. Any disciplinary action that the Corporation takes, or the voluntary or involuntary cessation of membership by a Clearing Member subsequent to the occurrence of the Remaining Loss or Other Loss, shall not, except as otherwise provided in this Rule, affect the obligations of the Clearing Member to the Corporation under this Rule or the procedures thereof, or affect any remedy to which the Corporation may be entitled. If a Remaining Loss or Other Loss charged to Members is afterward recovered by the Corporation in whole or in part, the net amount of the recovery shall be credited or paid to those Persons, other than a Defaulting Member or other Person who caused in whole or part such Loss, including the Corporation, against whom the loss was charged, in proportion to the amounts paid by them, whether or not they are still Members.~~

~~(i) — For purposes of calculating the allocations in this Section 7 that are based upon a Member's Average Required Fund Deposit, a Clearing Member that is subject to an increased Required Fund Deposit pursuant to provisions of this Rule regarding special charges or such other premium applied pursuant to these Rules shall be deemed to have an~~

~~Average Required Clearing Fund Deposit amount without such increases being taken into account.~~

### Section 7a – Corporate Contribution

For any loss allocation pursuant to Section 7 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Exchange Act. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) Business Days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution. The Corporation shall maintain one Corporate Contribution, the amount of which is available to both the Government Securities Division and the Mortgage-Backed Securities Division, and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs. In the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution shall be applied to that Division up to the amount then available. If a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution shall be applied to the respective Division in the same proportion that the aggregate Average RFDs of all members in that Division bears to the aggregate Average RFDs of all members in both Divisions.

Nothing in these Rules shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

### Section 7b – Withdrawal Following Loss Allocation

If a Tier One Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss allocation round as set forth in Section 7 of this Rule ("Loss Allocation Withdrawal Notice"), the Tier One Member shall:

- (i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the Tier One Member to the Corporation, unless otherwise approved by the Corporation; and
- (ii) as of the time of such Tier One Member's submission of the Loss Allocation Withdrawal Notice to the Corporation, cease submitting transactions to the Corporation for processing, clearance or settlement, unless otherwise approved by the Corporation.

A Tier One Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

If the Tier One Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Tier One Member will remain subject to further loss allocations pursuant to Section 7 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.

#### Section 8 – Return of Members' Clearing Fund Deposits

If a Member gives notice to the Corporation of its election to withdraw from membership, the Member's Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied.

Notwithstanding anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 32 "Cross Guaranty Agreements", to reimburse the Corporation for any Cross-Guaranty Repayment that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement.

#### Section ~~89~~ - ~~Timing of Payment of Deposit~~ Initial Required Fund Deposit and Changes in Members' Required Fund Deposits

The initial Required Fund Deposit of a Clearing Member shall be required to be deposited into the Clearing Fund ~~by the Close of Business on the Business Day immediately~~ prior to the Business Day on which each such Person becomes a Clearing Member in accordance with the Corporation's procedures.

A Clearing Member must increase the amount of its deposit to the Clearing Fund~~Required Fund Deposit~~ (by the deposit of cash, Eligible Securities, and/or Eligible Letters

of Credit subject to the requirements of this Rule) by the Required Fund Deposit Deadline on any Business Day that such Clearing Member's ~~Actual Deposit to the Clearing Fund~~ is less than its Required Fund Deposit as set forth in the Report listing such, subject to the conditions included in Section 3 of this Rule 4. **If there is an increase in a Clearing Member's Required Fund Deposit, at the time the increase becomes effective, the Clearing Member's obligations to the Corporation shall be determined in accordance with the increased Required Fund Deposit whether or not the Clearing Member has satisfied such increased amount.**

**If the Corporation applies a Clearing Member's Clearing Fund deposits as permitted pursuant to this Rule, the Corporation may take any and all actions with respect to the Clearing Member's Actual Deposit, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Clearing Member's Required Fund Deposit, the Clearing Member shall immediately replenish it. If the Clearing Member fails to do so, the Corporation may take disciplinary action against such Clearing Member pursuant to Rule 14 or Rule 38. Any disciplinary action that the Corporation takes pursuant to Rule 14 or Rule 38 or the voluntary or involuntary cessation of membership shall not affect the Clearing Member's obligations to the Corporation or any remedy to which the Corporation may be entitled under applicable law.**

The Corporation retains the discretion to extend the Required Fund Deposit Deadline on any Business Day if there are operational or system difficulties that would reasonably prevent Members from satisfying Required Fund Deposit deficits by the time specified in the Corporation's procedures.

Notwithstanding the foregoing, the Corporation may require a **Clearing** Member or **Clearing** Members generally to deposit additional amounts to their Clearing Fund on an intraday basis if the Corporation believes such action is necessary in order to protect itself and its Members.

#### **Section 910 - ~~Return of Deposits and Payments Excess Clearing Fund Deposits~~**

The Corporation shall determine with such frequency as it shall from time to time specify, whether the amount deposited by a Member in the Clearing Fund is in excess of its Required Fund Deposit (hereinafter, "Excess Clearing Fund Deposit"). On any day that the Corporation has determined that an Excess Clearing Fund Deposit exists with respect to any Member, the Corporation will, in the form and manner determined by the Corporation, notify each **such** Member of such excess. **Subject to the Corporation's rights under these Rules to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) as the Member requests. Upon the request of a Member, in the form and manner determined by the Corporation, the Corporation shall cause to be returned to each such Member cash on deposit (in excess of the minimum amount of cash the Member**

~~is required to maintain in the Clearing Fund), and/or Eligible Clearing Fund Securities (valued at their current market value, including accrued interest as of the end of the Business Day prior to such withdrawal), in an aggregate amount equal to such excess or such lesser amount as the Member may request; provided, however, that, any return of excess will be done in such a way that the remaining Clearing Fund on deposit meets the requirements of this Rule. In addition~~Notwithstanding the foregoing, at the discretion of the Corporation, some or all of the Excess Clearing Fund Deposit may not be returned if the Member has an outstanding payment obligation to the Corporation, if the Corporation determines that the Member's anticipated Cash Settlement obligations, Pool Net Obligations or Transactions ~~over the next 90 calendar days in the near future~~ may reasonably be expected to be materially different than ~~during the prior 90 calendar days,~~ those of the recent past or if the Member is on the Watch List.

In addition, the return of an Excess Clearing Fund Deposit amount to any Member is subject to the following limitations: (1) such return of Excess Clearing Fund Deposit shall not be done in a manner that would cause the Member to violate any other Section of these Rules; and (2) Excess Clearing Fund Deposit shall not be returned to a Member to the extent that such return would reduce the amount of the Member's Cross-Guaranty Repayment Deposit to the Clearing Fund below the amount to be maintained by the Member pursuant to Section 4 of Rule 32, "Cross Guaranty Agreements."

The provisions of this section shall not limit the rights or remedies of the Corporation as provided in Section 6 of Rule 3.

#### Section 10 - Ceasing to be a Member

~~If a Clearing Member gives notice to the Corporation pursuant to these Rules of its election to terminate its membership in the Clearing System, the Member's deposits to the Clearing Fund shall be returned to it when the Corporation is satisfied that all of the Member's obligations arising under these Rules have been satisfied. However, the Corporation in its discretion may return Clearing Fund amounts to a Member notwithstanding any obligations such Member may have to the Corporation, provided such obligations are de minimis. Any obligation of a Member to the Corporation pursuant to this Rule that is unsatisfied at the time it ceases to be a Member shall not be affected by such cessation.~~

~~Notwithstanding the previous paragraph or anything else contained in these Rules, the Corporation may retain an amount equal to any Cross-Guaranty Repayment Deposit of any Member until such time as the Corporation determines that such Member is no longer liable to the Corporation under Rule 32, "Cross Guaranty Agreements" to reimburse the Corporation for any Cross-Guaranty that the Corporation may be obligated to make under any relevant Cross-Guaranty Agreement.~~

#### Section 11 - Corporation's Authority to Pledge and Assign

In furtherance of the rights of the Corporation pursuant to these Rules, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security



interest in, or assign any and all **Actual Deposits: (i) cash deposits, (ii) securities, repurchase agreements, deposits or other instruments in which cash deposits of Members are invested, and (iii) any securities or letters of credit pledged or deposited by any Member to secure an open account indebtedness to the Clearing Fund or otherwise to collateralize its obligations to the Corporation or in the possession of the Corporation, and any proceeds thereof** for the purpose of securing loans made to the Corporation **(the party making such loan to the Corporation hereinafter referred to as the "Lender"); or other obligations incurred by the Corporation, provided that the proceeds of such loans are used for a purpose permissible under Section 3 and Section 5 of this Rule in each case incident to the clearance and settlement business of the Corporation.** Such loans ~~or obligations~~ shall be on terms and conditions deemed necessary or advisable by the Corporation **(including collateralization thereof)** in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member to the Corporation for which such property **and Eligible Letters of Credit (if any) were** pledged to or deposited with the Corporation. Notwithstanding the above, the Corporation shall remain obligated to each **such** Member to return, and to allow substitution for or withdrawal of, cash, **and Eligible Clearing Fund Securities, and Eligible Letters of Credit (if any)** pledged or deposited by **asuch** Member as a Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund~~, or otherwise to collateralize such Member's obligations to the Corporation, under the circumstances and within the timeframes specified in these Rules. **In the event of any conflict or inconsistency between this Rule 4 and any agreement between the Corporation and any Member, this Rule 4 shall govern and prevail.**

#### Section 12 – Clearance and Settlement Business of the Corporation

For purposes of this Rule 4, references to the clearance and settlement business of the Corporation shall include its business as a Securities Intermediary.

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RULE 5 – TRADE COMPARISON

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Section 8 – Binding Nature of Comparisons

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If trade input with respect to a Transaction in Eligible Securities involving a Broker has not compared or has Partially Compared, the Dealer(s) for which trade input has not compared will be furnished a Report noting such uncomparing or Partially Compared Transaction. The Dealer may then either affirm the Transaction or submit a DK of the Transaction as described in Section 9 of this Rule **45**. Unless the Dealer receiving the Unmatched Margin Report submits a DK of such transaction in accordance with the Corporation's procedures, the Total Required Fund Deposit shall be payable by the Dealer with respect to such Transaction pursuant to these Rules, the same as if such transaction had been listed in such Dealer's Open Commitment Report.

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RULE 11 – CASH SETTLEMENT

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Section 9 – Cash Settlement

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(o) Under FRB Operating Circular No. 12, FICC's Settlement Agent has certain processing responsibilities in allocating an indemnity claim made by an FRB as a result of processing the Corporation's cash settlement via NSS. The Corporation shall apportion the entirety of such liability to the Member or Members for whom the Cash Settling Bank to which the indemnity claim relates was acting. Such liability for each applicable Member shall be in proportion to the amount of such Members' Cash Settlement amounts on the Business Day in question. If for any reason such allocation is not sufficient to fully satisfy the FRB indemnity claim, then the remaining loss shall be treated as ~~an "Other Loss" as defined by Rule 4~~ **a loss that is otherwise incident to the clearance and settlement business of the Corporation** and allocated accordingly **pursuant to Section 7 of Rule 4.**

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RULE 17A – CORPORATION DEFAULT

(a) If a "Corporation Default" occurs pursuant to subsection (b) below, all Transactions which have been subject to Novation pursuant to these Rules but have not yet settled and any rights and obligations of the parties thereto shall be immediately terminated and the Board shall determine a single net amount owed by or to each Member with respect to such Transactions by applying the close out and application procedures in Section 2 of Rule 17 (**interpreted in all such cases as if each Member were a Defaulting Member**) and ~~Section 7 of Rule 4~~ (~~**interpreted in all such cases as if each Member were a Defaulting Member**~~) taking into account the ~~other loss allocation~~ provisions in ~~these Rules relating to loss allocation, including in the event that any Member is a Defaulting Member~~ **Rule 4**. For purposes of this Rule 17A and notwithstanding any other provision to the contrary, Pool Deliver Obligations and Pool Receive Obligations shall be established with respect to all Transactions, at the time at which the data submitted in respect of such Transactions are compared and such Transactions constitute Compared Trades. The Board shall notify each Member of the net amount so determined and Members who have been notified that they owe an amount to the Corporation shall pay that amount on or prior to the date specified by the Board, subject to any applicable setoff rights. Members who have a net claim against the Corporation shall be entitled to payment thereof along with other Members' and any other creditors' claims pursuant to the underlying Contracts with respect thereto, these Rules and applicable law. Nothing herein shall limit the rights of the Corporation upon a Member default (including following a Corporation Default) including under any Cross-Guaranty Agreement with the Government Securities Division or any other Cross-Guaranty Counterparty.

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RULE 32 - CROSS GUARANTY AGREEMENTS

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Section 3 - Application of Cross-Guaranty Payments

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(b) retain any Cross-Guaranty Payment received by the Corporation and not apply such Cross-Guaranty Payment to reduce any assessments against other Members pursuant to Section 7 of Rule 4 until the Corporation determines that the Corporation is no longer liable for any Cross-Guaranty Repayment, at which point the Cross-Guaranty Payment shall be treated as an amount that has been recovered pursuant to Section 7(i) of Rule 4.

Section 4 - Cross-Guaranty Repayment Deposits

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In the event that the Corporation is required to make a Cross-Guaranty Repayment and it does not have a sufficient amount of Cross-Guaranty Repayment Deposits to cover the liability, the Corporation shall treat the shortfall as ~~an "Other Loss"~~ **a loss incurred as a result of a Defaulting Member Event to be allocated** pursuant to Section 7 of Rule 4.

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## INTERPRETIVE GUIDANCE WITH RESPECT TO WATCH LIST CONSEQUENCES

Being placed on the Watch List may result in Clearing Fund-related consequences under the Rules:

A. *Clearing Fund-Related Consequences*

1. Additional Clearing Fund Deposits

Pursuant to Section 11(e) of Rule 3, the Corporation may require a Clearing Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with ~~Section 2~~the provisions of Rule 4 or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members.

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Furthermore, pursuant to Section 2(~~g~~f) of Rule 4, the Corporation may subject a Clearing Member to an intraday VaR Charge if the Clearing Member is on the Watch List.

2. Restriction on Withdrawal of Excess Clearing Fund Deposits

Pursuant to Section 910 of Rule 4, the Corporation may retain some or all of the Excess Clearing Fund Deposit of a Member who is on the Watch List. Nonetheless, the Corporation generally does not retain the Excess Clearing Fund Deposit of a Watch List Member unless the Member fails to pay the Required Fund Deposit within the required timeframes established by the Corporation, or if the Corporation has a concern that the Member will not be able to satisfy its obligation to the Corporation.

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