



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74411; File No. SR-FICC-2014-09)

March 2, 2015

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Amend the Rules of the Government Securities Division and the Mortgage-Backed Securities Division Regarding the Default of Fixed Income Clearing Corporation

I. Introduction

On November 12, 2014, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2014-09 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on December 2, 2014.³ On January 9, 2015, pursuant to Section 19(b)(2)(A)(ii) of the Act,⁴ FICC consented to an extension of the time for Commission action on the proposed rule change to March 2, 2015. The Commission received no comment letters in response to the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 73682 (November 25, 2014), 79 FR 71481 (December 2, 2014) (File No. SR-FICC-2014-09).

⁴ 15 U.S.C. 78s(b)(2)(A)(ii).

II. Description

FICC filed the proposed rule change to amend the clearing rules of the Government Securities Division (“GSD”) and of the Mortgage-Backed Securities Division (“MBSD”) concerning a default by FICC.⁵ The FICC Default Rules were added to GSD’s and MBSD’s rules in 2010 and 2012, respectively, to make explicit the close-out netting of obligations between FICC and its clearing members in the event that FICC becomes insolvent or defaults on its obligations to its clearing members.⁶ FICC represented that the FICC Default Rules provide clarity to clearing member firms in their application of balance sheet netting to their positions with FICC under U.S. GAAP.⁷ FICC further represented that the FICC Default Rules allow clearing members to comply with Basel Accord Standards relating to netting, and thereby enable clearing members to calculate their capital requirements on the basis of their net credit exposure.⁸

The existing FICC Default Rules cover three general types of default: voluntary proceedings defaults; involuntary proceedings defaults; and non-insolvency related

⁵ In 2010, the Commission approved a proposed rule change filed by FICC to add Rule 22B to the GSD rules (“GSD Default Rule”). See Securities Exchange Act Release No. 63038 (October 5, 2010), 75 FR 62899 (October 13, 2010) (File No. SR-FICC-2010-04). In 2012, the Commission approved a proposed rule change filed by FICC to add Rule 17A to the MBSD rules (“MBSD Default Rule”, and together with the GSD Default Rule, “FICC Default Rules”). See Securities Exchange Act Release No. 66550 (March 9, 2012), 77 FR 15155 (March 14, 2012) (File No. SR-FICC-2008-01).

⁶ See Securities Exchange Act Release No. 63038 (October 5, 2010), 75 FR 62899 (October 13, 2010) (File No. SR-FICC-2010-04) and Securities Exchange Act Release No. 66550 (March 9, 2012), 77 FR 15155 (March 14, 2012) (File No. SR-FICC-2008-01).

⁷ See Id.

⁸ See Id.

defaults. Under the existing FICC Default Rules, FICC states that it is considered in default with respect to voluntary proceedings defaults (i) immediately upon the dissolution of FICC, (ii) the voluntary institution of proceedings by FICC seeking a judgment of insolvency or bankruptcy or other similar relief, or (iii) the voluntary presentation by FICC of a petition for its winding up or liquidation.

Under the existing FICC Default Rules, FICC is considered in default with respect to involuntary proceedings defaults on the 91st calendar day after the judgment of insolvency or bankruptcy or the entry of an order for relief (or similar order) for FICC's winding up or liquidation, or the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for all or substantially all of FICC's assets, where such judgment, order or appointment, as applicable, remains unstayed throughout the 90 calendar day grace period. FICC is considered in default with respect to non-insolvency related defaults on the 91st calendar day after it receives notice from a member of its failure to make an undisputed payment or delivery to such member that is required under the GSD Rules or the MBSD Rules, respectively, where such failure remains unremedied throughout the 90 calendar day grace period.

The existing FICC Default Rules exclude the following from the scope of what is considered a non-insolvency related default: (i) the failure on the part of FICC to satisfy obligations to members in wind-down, members in default, or members for whom FICC has ceased to act pursuant to either GSD Rule 22A or MBSD Rule 17, as applicable; (ii) the satisfaction of any payment or delivery obligation by FICC through alternate means as provided in GSD or MBSD rules, as applicable; (iii) the failure of the other division of FICC to satisfy a payment or delivery obligation to a clearing member; and (iv) the

failure to satisfy any payment or delivery obligation required to be made to a clearing member that is solely the result of an operational, technological, or administrative error or impediment, provided that FICC possesses sufficient funds or assets to satisfy the obligation.

Additionally, according to FICC, the grace period can be extended beyond 90 calendar days under the existing FICC Default Rules in a non-insolvency related default situation where a payment or delivery deadline has been suspended under GSD Rule 42 or MBSD Rule 33, as applicable, in which case the 90 calendar day grace period would commence on the date FICC receives notice from a clearing member of its failure to make an undisputed payment or delivery on the later due date determined pursuant to the suspension.

Pursuant to this rule change, as approved, FICC is now amending its FICC Default Rules in order to more closely align such rules with those of its peer central counterparties and to facilitate the participation of market participants, including registered investment companies, in FICC's services by providing members with further legal certainty regarding their rights with respect to a default by FICC. First, FICC is amending its FICC Default Rules to add the voluntary making by FICC of a general assignment for the benefit of creditors as an additional type of voluntary proceeding. Second, FICC is eliminating the 90 calendar day grace period for involuntary proceeding defaults. According to FICC, this change will result in FICC being considered in default immediately upon the judgment of insolvency or bankruptcy or the entry of an order for relief (or similar order) for FICC's winding-up or liquidation, or the appointment of a receiver, trustee or other similar official for FICC or substantially all of FICC's assets,

provided that such receiver, trustee or other similar official is appointed pursuant to the federal securities laws, particularly Section 19(i) of the Act, or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Third, FICC is reducing the grace period from 90 to 7 calendar days for non-insolvency related defaults. According to FICC, this change will result in it being in a non-insolvency related default on the 8th calendar day after it receives notice from a member of its failure to make an undisputed payment or delivery to such member that is required under the rules of GSD or MBSD, as applicable, provided that such failure has not been remedied during the 7 calendar days, and does not fall within the category of exclusions that are enumerated in clause (b)(i), sub-clauses (A), (B) and (C) of the GSD Default Rule or the MBSD Default Rule, as applicable.

Fourth, FICC is removing the provisions that provide for a potential extension of the grace period in a non-insolvency default situation where the deadline for a payment or delivery obligation of FICC has been suspended by FICC under either GSD Rule 42 or MBSD Rule 33, as applicable. As a result, the grace period will commence on the date FICC receives notice from a member of its failure to make an undisputed payment or delivery on the later due date determined pursuant to the suspension.

Fifth, FICC is removing the provisions that exclude from the scope of what can be considered a non-insolvency related default the failure to satisfy any payment or delivery obligation required to be made to a clearing member that is the result of an operational, technological, or administrative error or impediment.

Sixth, is adding language to the FICC Default Rules to clarify that no other provision within the rules of GSD or MBSD, respectively, including FICC's authority

under GSD Rule 42 and MBSD Rule 33, as applicable, can override the definition of what constitutes a default by FICC.

III. Discussion

Section 19(b)(2)(C) of the Act⁹ directs the Commission to approve a self-regulatory organization's proposed rule change if the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act¹⁰ requires, among other things, that the rules of a clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions.

After careful review, the Commission finds that FICC's rule change to amend the FICC Default Rules is consistent with Section 17A(b)(3)(F) of the Act¹¹ because the changes as proposed in FICC's filing should provide further legal certainty to FICC's clearing members regarding their close-out netting rights with respect to a default by FICC. In addition, FICC's rule changes should assist in addressing certain regulatory concerns of new market participants, including registered investment companies, which FICC believes will facilitate their participation in FICC's central counterparty services and thus facilitate the prompt and accurate clearance and settlement of securities transactions submitted by such market participants.

⁹ 15 U.S.C. 78s(b)(2)(C).

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

¹¹ Id.

IV. Conclusion

On the basis of the foregoing, the Commission concludes that the proposal is consistent with the requirements of the Act, particularly the requirements of Section 17A of the Act,¹² and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (File No. SR-FICC-2014-09) be and hereby is APPROVED.¹⁴

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Brent J. Fields
Secretary

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¹² 15 U.S.C. 78q-1.

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁵ 17 CFR 200.30-3(a)(12).