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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-86553; File No. SR-FICC-2019-003]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Revise the MBSD VaR Floor

August 2, 2019

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 18, 2019, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of a proposal to change the calculation of the VaR Floor (as defined below) and the corresponding description in the FICC Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules”)³ to: (i) allow FICC, subject to the governance process set forth in the Clearing Agency Model Risk Management Framework (“Framework”)⁴ (as described below), to adjust the “VaR Floor

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Capitalized terms not defined herein are defined in the MBSD Rules, available at <http://www.dtcc.com/legal/rules-and-procedures>.

⁴ See Securities Exchange Act Release No. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (SR-DTC-2017-008; SR-FICC-2017-014; SR-NSCC-2017-008). The Framework sets forth the model risk management practices adopted by FICC, National Securities Clearing Corporation, and The Depository Trust Company. The Framework is designed to help identify, measure, monitor,

percentage” (as defined below) within a proposed range when FICC’s review of the VaR Floor percentage indicates that the VaR Floor percentage is not sufficient to cover FICC’s credit exposure to each Clearing Member fully with a high degree of confidence, (ii) state that Clearing Members would be notified in advance of any such adjustment to the VaR Floor percentage, (iii) designate that the VaR Floor percentage would be subject to at least monthly model performance monitoring, and (iv) make certain technical changes.

The proposed changes would necessitate changes to the Methodology and Model Operations Document – MBSD Quantitative Risk Model (the “QRM Methodology”).⁵ FICC is requesting confidential treatment of the QRM Methodology and has filed it separately with the Secretary of the Commission.⁶

and manage the risks associated with the design, development, implementation, use, and validation of quantitative models. The Framework describes: (i) governance of the Framework; (ii) key terms; (iii) model inventory procedures; (iv) model validation procedures; (v) model approval process; and (vi) model performance procedures.

⁵ Because FICC requested confidential treatment, the QRM Methodology was filed separately with the Commission as part of proposed rule change SR-FICC-2016-007 (the “VaR Filing”). See Securities Exchange Act Release No. 79868 (January 24, 2017), 82 FR 8780 (January 30, 2017) (SR-FICC-2016-007) (“VaR Filing Approval Order”). FICC also filed the VaR Filing proposal as an advance notice pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5465(e)(1)) and Rule 19b-4(n)(1)(i) under the Act (17 CFR 240.19b-4(n)(1)(i)), with respect to which the Commission issued a Notice of No Objection. See Securities Exchange Act Release No. 79843 (January 19, 2017), 82 FR 8555 (January 26, 2017) (SR-FICC-2016-801).

⁶ 17 CFR 240.24b-2.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. 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, B, and C below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to change the calculation of the VaR Floor (as defined below) and the corresponding description in the MBSD Rules to:

(i) allow FICC, subject to the governance process set forth in the Framework (as described below), to adjust the VaR Floor percentage (as defined below) within a proposed range when FICC's review of the VaR Floor percentage indicates that the VaR Floor percentage is not sufficient to cover FICC's credit exposure to each Clearing Member fully with a high degree of confidence, (ii) state that Clearing Members would be notified in advance of any such adjustment to the VaR Floor percentage, (iii) designate that the VaR Floor percentage would be subject to at least monthly model performance monitoring, and (iv) make certain technical changes. The proposed changes would necessitate changes to the QRM Methodology. The proposed changes are described in detail below.

Background

On January 24, 2017, the Commission approved FICC's VaR Filing to make certain enhancements to the MBSD value-at-risk ("VaR") margin calculation methodology.⁷ The VaR Filing amended the definition of VaR Charge to include the VaR Floor.⁸ The VaR Charge comprises the largest portion of a Clearing Member's Required Fund Deposit amount. The VaR Charge is calculated using a risk-based margin methodology that is intended to capture the market price risk associated with the securities in a Clearing Member's portfolio. The methodology is designed to project the potential gains or losses that could occur in connection with the liquidation of a defaulting Clearing Member's portfolio, assuming that a portfolio would take three days to hedge or liquidate in normal market conditions. The projected liquidation gains or losses are used to determine the amount of the VaR Charge, which is calculated to cover projected liquidation losses at a 99 percent confidence level.⁹

FICC uses the VaR Floor as an alternative to the VaR Charge amount calculated by the VaR model for Clearing Members' portfolios where the VaR Floor calculation is greater than the model-based calculation. The VaR Floor addresses the risk that the VaR model may calculate too low a VaR Charge for certain portfolios where the VaR model applies substantial risk offsets among long and short positions in different classes of mortgage-backed securities that have a high degree of historical price correlation. FICC

⁷ See VaR Filing Approval Order, supra note 5.

⁸ The term "VaR Floor" is defined within the definition of VaR Charge. See MBSD Rule 1, supra note 3.

⁹ Unregistered Investment Pool Clearing Members are subject to a VaR Charge with a minimum targeted confidence level assumption of 99.5 percent. See MBSD Rule 4, Section 2(c), supra note 3.

applies the VaR Floor at the Clearing Member portfolio level. Because the historical price correlation may not persist in future market conditions,¹⁰ FICC believes that it is prudent to apply a VaR Floor that is based upon the market value of the gross unsettled positions in the Clearing Member's portfolio in order to protect FICC against such risk in the event that FICC is required to liquidate a mortgage-backed securities portfolio in stressed market conditions.

(i) Proposed Rule Changes Allowing FICC to Adjust the VaR Floor Percentage

The MBSD Rules currently define the VaR Floor as “5 basis points of the market value of a Clearing Member's gross unsettled positions.”¹¹ Therefore, the VaR Floor is utilized as the Clearing Member's VaR Charge if the VaR model yields an amount that is lower than 5 basis points (referred to herein as the “VaR Floor percentage”) of the market value of a Clearing Member's gross unsettled positions.

FICC is proposing to revise the definition of the VaR Floor to allow FICC, subject to the governance process set forth in the Framework, to adjust the VaR Floor percentage within a proposed range when FICC's review of the VaR Floor percentage indicates that the VaR Floor percentage is not sufficient to cover FICC's credit exposure to each Clearing Member fully with a high degree of confidence. FICC is proposing that

¹⁰ For example, certain TBAs may have highly correlated historical price returns despite having different coupons and, although the net risk exposure may be adequately modeled under current market conditions, future market conditions could cause the risk relationship to change in a way that may not be adequately captured by the model. TBA is defined in MBSD Rule 1. See MBSD Rule 1, supra note 3.

¹¹ See definition of “VaR Charge.” See MBSD Rule 1, supra note 3.

the VaR Floor percentage would be no less than 5 basis points and no more than 30 basis points of the gross unsettled positions.

FICC believes that the range of 5 to 30 basis points would allow FICC to effectively set a floor on the VaR Charge at a level that has historically impacted only a small number of Clearing Members based on the impact study discussed below.¹² In order to determine the specific VaR Floor percentage within the permissible range, FICC would review, on at least an annual basis, the impact of alternative VaR Floor parameters within the proposed range of 5 to 30 basis points to the backtesting performance and to Clearing Members' margin charges. Upon approval of this filing, FICC proposes to initially set the VaR Floor at 10 basis points based on observed backtesting coverage on actual Clearing Members' positions and hypothetical portfolios¹³ that could result in low VaR Charges.¹⁴

As stated above, any adjustment to the VaR Floor percentage would be subject to the governance process set forth in the Framework. Specifically, the Framework

¹² For the period February 27, 2017 through February 28, 2019, a 5 basis point VaR Floor would impact less than 0.4% of Clearing Members on average daily who have a VaR Charge, a 10 basis point VaR Floor would impact less than 2.3%, a 15 basis point VaR Floor would impact less than 5.0%, a 20 basis point VaR Floor would impact less than 8.2%, a 25 basis point VaR Floor would impact less than 11.4%, a 30 basis point VaR Floor would impact less than 14.4%, a 45 basis point VaR Floor would impact less than 22.3%, and a 60 basis point VaR Floor would impact less than 30.6%.

¹³ For example, FICC can create hypothetical settlement portfolios with long/short positions where the net market value is zero to identify potential settlement portfolios where historical price changes of different classes of mortgage-backed securities did not experience offsetting price moves (commonly referred to as "basis risk").

¹⁴ FICC's coverage at the Clearing Agency level is at 99%. The issue has arisen with respect to certain Clearing Members whose portfolios are achieving below 99% coverage on a 12-month rolling basis.

provides that all model performance concerns will be escalated by the Model Validation and Control Group (“MVC”) to the Model Risk Governance Committee (“MRGC”), including model performance enhancement concerns and the MRGC may further recommend certain matters for further escalation to the Management Risk Committee and/or Risk Committee of the Board.

(ii) Proposed Clearing Member Notifications Regarding Adjustments to the VaR Floor Percentage

For adjustments to the VaR Floor percentage that would fall within the proposed range, FICC would provide Clearing Members with 10 Business Days’ notice prior to the implementation of such adjustment. Clearing Members would be notified of the applicable VaR Floor percentage by an Important Notice issued no later than 10 Business Days prior to the implementation of the adjustment. For adjustments that would fall outside of the proposed range, FICC would submit a rule filing to the Commission. As proposed, FICC would not apply a VaR Floor percentage that is less than 5 basis points (which is the current VaR Floor percentage); however, the proposed change would allow FICC to adjust such VaR Floor percentage above 5 basis points (up to 30 basis points).

(iii) Proposed Rule Changes to Designate that the VaR Floor Percentage Would be Subject to at Least Monthly Model Performance Monitoring

The Framework provides that, as part of model performance monitoring, on at least a monthly basis, sensitivity analysis is performed on FICC’s margin model, the key parameters and assumptions for backtesting are reviewed, and modifications are considered to ensure FICC’s backtesting practices are appropriate for determining the adequacy of the applicable margin resources of FICC. The Framework also describes that MVC performs a model validation for each FICC model approved for use in

production not less than annually, including, among other things, on its margin systems and related models.¹⁵

The VaR Floor percentage is currently subject to periodic model validations as part of FICC’s margin model validation on at least an annual basis to determine if the VaR Floor percentage would remain adequate to cover FICC’s credit exposure to Clearing Members with certain types of portfolios fully with a high degree of confidence. FICC would propose, as part of model performance monitoring, to designate the VaR Floor percentage as a parameter of its VaR model that will be reviewed on at least a monthly basis per the Framework. As such, FICC proposes to amend the QRM Methodology to reference the at least monthly model performance monitoring of the VaR Floor percentage.

(iv) Proposed Technical Changes

The proposed rule change would also make technical changes to restate the calculation of the VaR Floor to provide more detail than the current provision and to use defined terms (that is, the terms Long Positions¹⁶ and Short Positions¹⁷).

Specifically, FICC would (i) delete “5 basis points of the market value of a Clearing Member’s gross unsettled positions” and replace it with “an amount designated by the Corporation” and (ii) add a new sentence that would read: “Such VaR Floor will

¹⁵ Supra note 4.

¹⁶ The term “Long Position” means a Member’s obligations with respect to the purchase of an Eligible Security or an Option Contract, as determined pursuant to the MBSD Rules. MBSD Rule 1, supra note 3.

¹⁷ The term “Short Position” means a Member’s obligation with respect to the sale of an Eligible Security or an Option Contract, as determined pursuant to the MBSD Rules. MBSD Rule 1, supra note 3.

be determined by multiplying the sum of the absolute values of Long Positions and Short Positions, at market value, by a percentage designated by the Corporation that is no less than 0.05% and no greater than 0.30%. The Corporation shall determine the percentage within this range to be applied based on factors including but not limited to a review performed at least annually of the impact of the VaR Floor parameter at different levels within the range to the backtesting performance and to Clearing Members' margin charges. The Corporation shall inform Clearing Members of the applicable percentage utilized by the VaR Floor by an Important Notice issued no later than 10 Business Days prior to the implementation of such percentage.”

In addition, FICC proposes a technical change to the QRM Methodology to reference that there will be at least annual model validation of the VaR Floor percentage; the QRM methodology currently provides that the VaR Floor percentage is reviewed annually and updated.

(v) Review and Need for VaR Floor Percentage Adjustment

FICC conducted a review of the VaR Floor percentage in June 2017 and conducted impact studies beginning in February 2017, which found that an increase in the VaR Floor percentage to 10 basis points is necessary to bring the VaR Charge to a level that would cover FICC's credit exposure to certain Clearing Members that have long-short portfolios fully with a high degree of confidence.¹⁸ The review, performed in June 2017, found that portfolios that contained long-short positions, for example, where a portfolio was long the GNMA II/FNMA basis at a higher coupon and short the GNMA II/FNMA basis at a lower coupon, were not adequately covered by a VaR Floor

¹⁸ These are portfolios that net down to a low VaR Charge amount but represent large gross positions.

percentage of 5 basis points during periods of market volatility. Increasing the VaR Floor percentage to 10 basis points would improve the backtesting coverage of this group to 99.8%. As a result, FICC began monitoring all portfolios with a VaR Charge below 10 basis points of the portfolio's gross positions for a potential Intraday Mark-to-Market Charge to ensure sufficient margin coverage during periods of market volatility.

Although a recent impact study for the twelve months ended February 2019 found the backtesting coverage of the VaR Charge for certain Clearing Members with long-short portfolios had improved to the 99% confidence level without the change to the VaR Floor percentage, FICC believes it is prudent to make the change to ensure the VaR Charge remains adequate if market conditions change. The June 2017 review of the VaR Floor percentage that included a period of market volatility also found that an increase in the VaR Floor percentage to 20 basis points if the alternative volatility calculation (which was referred to as the "Margin Proxy" in the VaR Filing¹⁹) is applied would better cover risks of portfolios with offsetting long and short positions within the same agency program, given that the Margin Proxy allows for further netting among positions within the same agency program than would occur within the VaR model.²⁰ The recent impact study for the twelve months ended February 2019 found if the VaR Floor percentage

¹⁹ The Margin Proxy is used as an alternative volatility calculation in the event that the requisite data used for the methodology (i.e., sensitivity approach) that is used to calculate the VaR Charge is unavailable for an extended period of time. See VaR Filing Approval Order, 82 FR at 8781.

²⁰ FICC proposed and received Commission approval to increase the look-back period and apply a historical stressed period to the Margin Proxy calibration. See Securities Exchange Act Release No. 85944 (May 24, 2019), 84 FR 25315 (May 31, 2019) (SR-FICC-2019-001).

were increased to 20 basis points, the backtesting coverage of the Margin Proxy²¹ would improve to 99% for eleven of the fourteen portfolios that would otherwise have been below the 99% confidence level target. Additionally, the backtesting deficiencies of the three small portfolios that would have remained below the 99% confidence target would be reduced to an average 11 backtesting deficiencies if the VaR Floor percentage were increased to 20 basis points, from an average 45 backtesting deficiencies utilizing the current VaR Floor percentage of 5 basis points. If Margin Proxy were invoked as an alternative volatility calculation, FICC would utilize the Backtesting Charge²² to further mitigate exposure to FICC caused by settlement risks that may not be adequately captured by the alternative volatility model. Upon Commission approval of this proposed rule change, FICC would provide Clearing Members with 10 Business Days' notice of the increase of the VaR Floor percentage to 10 basis points. The notice would also inform Clearing Members that in the event that the alternative volatility calculation (the Margin Proxy) would be employed, the VaR Floor percentage would be increased to 20 basis points.

(vi) Impact Study

FICC performed an impact study on Clearing Members' portfolios for the period beginning February 27, 2017, when the changes in the VaR Filing were implemented, to February 28, 2019, that showed increasing the VaR Floor percentage to 10 basis points would impact a small number of Clearing Members, and the total MBSB Clearing Fund impact would be small. Nevertheless, FICC believes this change is necessary to maintain

²¹ The Margin Proxy study was calibrated using a 10-year historical look-back period plus 1-year stress period.

²² See definition of "Backtesting Charge." See MBSB Rule 1, supra note 3.

sufficient financial resources to cover FICC's credit exposures to certain Clearing Members' portfolios fully with a high degree of confidence.

Over the study period, increasing the VaR Floor percentage to 10 basis points would have affected, on average, two portfolios per day, and the average daily margin increase to MBSD's Clearing Fund would have been approximately \$6 million per day (0.12% of the average daily VaR Charge of \$5 billion). The largest daily increase for the total VaR Charge over the study period would have been \$37 million for all Clearing Members, 1% of the total VaR Charge of \$ 3.7 billion on that day.

Although for the twelve months ended February 28, 2019, 21 portfolios would have been impacted by the increase to the VaR Floor percentage over the study period, for each portfolio the increase was less than 1% of the Clearing Member's Excess Capital²³ and 4 portfolios accounted for over 50% of the instances of margin increase. The impact study showed the largest daily increase of an individual portfolio was \$25.5 million. Given the VaR model amount for this portfolio was also below the current 5 basis point VaR Floor, an increase to a 10 basis point VaR Floor would have doubled that portfolio's VaR Charge for that day.

2. Statutory Basis

FICC believes that this proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency.

Specifically, FICC believes that this proposal is consistent with Section 17A(b)(3)(F) of

²³ The term "Excess Capital" means Excess Net Capital, net assets, or equity capital as applicable to a Clearing Member based on its type of regulation. MBSD Rule 1, supra note 3.

the Act²⁴ and Rules 17Ad-22(e)(4)(i), (e)(6)(i) and (e)(23)(ii), each promulgated under the Act,²⁵ for the reasons described below.

Section 17A(b)(3)(F) of the Act requires, in part, that the MBSD Rules be designed to (i) promote the prompt and accurate clearance and settlement of securities transactions and (ii) assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.²⁶

The proposed changes described in Item II(A)1(i) above would allow FICC, subject to the governance process in the Framework, to adjust the VaR Floor percentage within a proposed range when FICC's review of the VaR Floor percentage indicates that the VaR Floor percentage is not sufficient to cover FICC's credit exposure to each Clearing Member fully with a high degree of confidence. FICC believes these proposed changes would assure the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible. Specifically, the proposed changes would provide FICC with discretion to adjust the VaR Floor percentage, subject to governance, to cover FICC's credit exposure to each Clearing Member with a high degree of confidence. Covering FICC's exposure to each Clearing Member with a high degree of confidence would help FICC ensure that it maintains an appropriate level of margin to address its risk management needs. Therefore, FICC believes the proposed changes described in Item II(A)1(i) above would safeguard the securities and funds that are in the

²⁴ 15 U.S.C. 78q-1(b)(3)(F).

²⁵ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i) and (e)(23)(ii).

²⁶ 15 U.S.C. 78q-1(b)(3)(F).

custody and control of FICC or for which it is responsible, consistent with Section 17A(b)(3)(F) of the Act.²⁷

FICC believes that the proposed changes described in Item II(A)1(ii) above to state that Clearing Members would be notified in advance of any adjustment to the VaR Floor percentage would promote the prompt and accurate clearance and settlement of securities transactions. Specifically, FICC believes that providing notice in advance of the implementation of any adjustment would provide Clearing Members with time to adjust to any new VaR Charge amounts that result from any adjustments to the VaR Floor percentage. FICC believes 10 Business Days' prior notice would provide Clearing Members with sufficient time to prepare for any new VaR Charge amounts and thereby ensure that the Clearing Members have the funds to satisfy their new VaR Charge amounts. This in turn would help FICC ensure that FICC has an adequate margin to address its risk management needs. Therefore, FICC believes the proposed changes described in Item II(A)1(ii) above would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.²⁸

In addition, FICC believes that the proposed changes described in Item II(A)1(iii) above to the QRM Methodology to state that the VaR Floor percentage would be subject to at least monthly performance monitoring would assure the safeguarding of securities and funds which are in the custody and control of FICC or for which it is responsible, consistent with Section 17A(b)(3)(F) the Act.²⁹ Specifically, this would require FICC to

²⁷ Id.

²⁸ Id.

²⁹ Id.

monitor the VaR Floor percentage frequently. This would help FICC ensure that there is an appropriate level of margin as FICC would be monitoring the VaR Floor percentage at least monthly. This change would also alert FICC of the need to make any adjustments to the VaR Floor percentage. As such, FICC believes the proposed changes described in Item II(A)1(iii) above would safeguard the securities and funds that are in the custody and control of FICC or for which it is responsible, consistent with Section 17A(b)(3)(F) of the Act.³⁰

FICC believes that the proposed technical changes to the MBSD Rules described in Item II(A)1(iv) above would promote the prompt and accurate clearance and settlement of securities transactions by ensuring that the MBSD Rules remain clear and accurate to Clearing Members. Having clear and accurate MBSD Rules would facilitate Clearing Members' understanding of those rules and provide Clearing Members with increased predictability and certainty regarding their obligations. FICC also believes that proposed technical changes to the QRM Methodology described in Item II(A)1(iv) above would enhance the clarity of the QRM Methodology for FICC. As the QRM Methodology is used by FICC Risk Management personnel regarding the frequency of model validation of the VaR Floor percentage, FICC believes that enhancing clarity of the description as to how often this review should be conducted would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) the Act.³¹

³⁰ Id.

³¹ Id.

Rule 17Ad-22(e)(4)(i) under the Act³² requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those exposures arising from its payment, clearing, and settlement processes by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. The proposed changes described in Item II(A)1(i) would allow adjustment of the VaR Floor percentage (subject to FICC's governance). This change would allow FICC to limit its credit exposures to Clearing Members in the event that the VaR model yields too low a VaR Charge for such portfolios. Under the proposed rule changes, the VaR Floor percentage would be subject to at least monthly model performance monitoring and continue to be subject to at least annual model validations by FICC. In the event the review reveals that the VaR Floor percentage is not resulting in coverage with a high degree of confidence, FICC would adjust the VaR Floor percentage within the proposed range after going through its required governance (and providing Clearing Members with the 10 Business Days' notice as described above). Therefore, FICC believes the proposed changes are consistent with the requirements of Rule 17Ad-22(e)(4)(i) under the Act.³³

Rule 17Ad-22(e)(6)(i) under the Act³⁴ requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover, if the covered clearing agency provides central counterparty services,

³² 17 CFR 240.17Ad-22(e)(4)(i).

³³ Id.

³⁴ 17 CFR 240.17Ad-22(e)(6)(i).

its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market. FICC, which provides central counterparty services, believes that the proposed changes to allow FICC, subject to its governance, to adjust the VaR Floor percentage within a proposed range (as described in Item II(A)1(i) above) are consistent with the requirements of Rule 17Ad-22(e)(6)(i) cited above. Specifically, FICC believes the proposed changes would provide FICC with the discretion (subject to its governance) to appropriately limit FICC's credit exposure to Clearing Members in the event that the VaR model yields too low a VaR Charge. The proposed changes would therefore allow FICC to continue to produce margin levels commensurate with the risks and particular attributes of each relevant product, portfolio, and market. As such, FICC believes that the proposed changes are consistent with the requirements of Rule 17Ad-22(e)(6)(i) under the Act.³⁵

The proposed technical changes to the MBSD Rules described in Item II(A)1(iv) above are designed to be consistent with Rule 17Ad-22(e)(23)(ii) under the Act.³⁶ Rule 17Ad-22(e)(23)(ii) under the Act requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency.³⁷ The proposed technical changes to the MBSD Rules would provide more details as to

³⁵ Id.

³⁶ 17 CFR 240.17Ad-22(e)(23)(ii).

³⁷ Id.

how the VaR Floor is calculated than is currently set forth in the MBSD Rules. As such, FICC believes the proposed changes would enable Clearing Members to have a better understanding of the operation of the VaR Floor because there would be more clarity as to how the VaR Floor to which they are subject is calculated. FICC believes the additional details would provide Clearing Members with sufficient information to enable them to evaluate the costs they incur by participating in FICC. As such, FICC believes that the proposed technical changes to the MBSD Rules described in Item II(A)1(iv) above are consistent with Rule 17Ad-22(e)(23)(ii) under the Act.³⁸

(B) Clearing Agency's Statement on Burden on Competition

FICC believes the proposed rule changes described in Item II(A)1(i) above to allow FICC, subject to its governance, to adjust the VaR Floor percentage within a proposed range in the circumstances described above could both promote competition and could impose a burden on competition. In circumstances where FICC exercises its authority to decrease the VaR Floor percentage within the proposed range, Clearing Members would experience decreases in their VaR Charge. FICC believes this may promote competition because Clearing Members would have a lower VaR Charge, and therefore could use their funds for other purposes.

However, FICC also believes that the proposed changes described in Item II(A)1(i) above could impose a burden on competition. Specifically, in circumstances where FICC exercises its authority to increase the VaR Floor percentage within the proposed range, Clearing Members who are affected by the VaR Floor would experience increases in their VaR Charge. Such increases could burden Clearing Members that have

³⁸ Id.

lower operating margins or higher costs of capital than other Clearing Members. It is not clear whether the burden on competition would necessarily be significant because it would depend on whether the affected Clearing Members were similarly situated in terms of business type and size. Regardless of whether the burden on competition is significant, FICC believes that any burden on competition that derives from the proposed rule changes described in Item II(A)1(i) above would be necessary and appropriate in furtherance of the purposes of the Act.³⁹

Specifically, FICC believes that the proposed rule changes described in Item II(A)1(i) above would be necessary in furtherance of the purposes of the Act because they would allow FICC to make adjustments to the VaR Floor percentage within a proposed range when FICC's review of the VaR Floor percentage indicates that the VaR Floor percentage is not sufficient to cover FICC's credit exposure to each Clearing Member with a high degree of confidence. The proposed rule changes would provide FICC with the discretion (subject to its governance) to limit its exposure to Clearing Members by ensuring that each Clearing Member has an appropriate minimum VaR Charge in the event that the VaR model yields too low a VaR Charge for such portfolios. Maintaining an appropriate minimum VaR Charge for each Clearing Member would be necessary in furtherance of the Act because it would allow FICC to maintain sufficient financial resources to cover its credit exposure to each Clearing Member. FICC also believes that any burden on competition that derives from the proposed rule change would be appropriate in furtherance of the purposes of the Act because FICC's discretion would be limited by its governance and also the proposed range for the VaR Floor

³⁹ 15.U.S.C. 78q-1(b)(3)(I).

percentage. Making any proposed adjustments to the VaR Floor percentage subject to a required governance process would be appropriate in furtherance of the Act because it would ensure that the final decision as to whether the adjustment ought to be made falls on a clear and transparent decision-making process. Making any proposed adjustments to the VaR Floor percentage subject to the proposed range would be appropriate in furtherance of the Act because as described above, the proposed range would effectively set a floor on the VaR Charge at a level that has historically impacted only a small number of Clearing Members while at the same time ensuring that FICC can make adjustments to the VaR Floor percentage to minimize FICC's credit exposure to Clearing Members. Therefore, FICC does not believe that the proposed changes described in Item II(A)1(i) above would impose any burden on competition that is not necessary or appropriate in furtherance of the Act.⁴⁰

FICC does not believe that the proposed changes described in Item II(A)1(ii) above to provide Clearing Members with 10 Business Days' notice prior to the implementation of any adjustment to the VaR Floor percentage would impact competition. FICC believes that the proposed change to provide notification of adjustments to the VaR Floor percentage would enhance Clearing Members' information regarding their margin requirements; FICC believes that the proposed 10 Business Days' notice would provide Clearing Members with adequate opportunity to adjust their portfolios if they wish to do so and adequate time to prepare for the increase in their VaR Charge.

⁴⁰ Id.

FICC does not believe the proposed changes described in Item II(A)1(iii) above to state that the VaR Floor percentage would be subject to monthly performance monitoring would impact competition. The proposed rule changes regarding at least monthly model performance review would not alter Clearing Members' rights and obligations. Rather, they would enable FICC to identify any issues with the VaR Floor percentage on a more frequent basis than the current annual model validation. Moreover, the proposed change regarding at least monthly model performance reviews would be consistent with the Framework.

FICC does not believe that the proposed rule changes described in Item II(A)1(iv) above to make technical changes to the MBSD Rules to restate the calculation of the VaR Floor to provide more detail than the current provision and to use defined terms would impact competition. The proposed technical changes would ensure that the MBSD Rules remain clear by replacing the current language with language that sets out in words the calculation of the VaR Floor amount. By doing so, Clearing Members can better understand how the VaR Floor is calculated and understand whether they would be subject to it. FICC believes that the technical changes would not affect Clearing Members' rights and obligations. As such, FICC believes that these proposed rule changes would not have any impact on competition.

FICC does not believe that the proposed technical changes described in Item II(A)1(iv) to the QRM Methodology to reflect at least annual model validation of the VaR Floor percentage would have any impact on competition. This change would reflect current practice and would not alter Clearing Members' rights or obligations. Therefore,

FICC does not believe that these proposed changes to clarify the language in the QRM Methodology would have any impact on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

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

III. Date of Effectiveness of the Proposed Rule Change, and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the 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. Please include File Number SR-FICC-2019-003 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-2019-003. 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 proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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-2019-003 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴¹

Jill M. Peterson
Assistant Secretary

⁴¹ 17 CFR 200.30-3(a)(12).

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