SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving
a Proposed Rule Change Regarding the Close-Out and Funds-Only Settlement
Processes Associated with the Sponsoring Member/Sponsored Member Service

February 21, 2020

I. Introduction

On December 27, 2019, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)\(^1\) and Rule 19b-4 thereunder,\(^2\) proposed rule change SR-FICC-2019-007. The proposed rule change was published for comment in the Federal Register on January 10, 2020.\(^3\) The Commission did not receive any comment letters on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

FICC proposes to modify its Government Securities Division (“GSD”) Rulebook (“Rules”)\(^4\) in order to facilitate the submission of repurchase transactions (“repos”) with a

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scheduled final settlement date beyond the next Business Day after the initial settlement date ("term repo activity") through the Sponsoring Member/Sponsored Member Service ("Service") by: (1) providing a mechanism by which a Sponsoring Member may cause the termination and liquidation of a Sponsored Member’s positions arising from trades between the Sponsoring Member and its Sponsored Member that have been novated to FICC; and (2) revising how FICC calculates the funds-only settlement obligations of Sponsored Members and Sponsoring Members with respect to Sponsored Member Trades that have haircuts in order to ensure that the calculation does not result in a return of the haircuts until final settlement. In addition, FICC proposes to make several clarifying and technical changes to the Rules.

A. Background

FICC operates two divisions, GSD and the Mortgage Backed Securities Division ("MBSD"). GSD provides trade comparison, netting, risk management, settlement, and central counterparty services for the U.S. Government securities market. MBSD provides the same services for the U.S. mortgage-backed securities market. GSD and MBSD maintain separate sets of rules, margin models, and clearing funds. The proposed rule change relates solely to GSD.

Under the GSD Rules, certain FICC members are permitted to act as “Sponsoring Members” to sponsor into FICC membership qualified institutional buyers as defined by Rule 144A under the Securities Act of 1933, as amended ("Securities Act"), and certain legal

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5 The Service is primarily governed by Rule 3A, supra note 4.

6 As used herein, the term “haircut” refers to the amount of collateral in excess of the value of the cash due to the Sponsored Member client at the close leg of the Sponsored Member Trade.

7 17 CFR 230.144A.
entities that, although not organized as entities specifically listed in paragraph (a)(1)(i) of Rule 144A under the Securities Act, satisfy the financial requirements necessary to be qualified institutional buyers as specified in that paragraph (“Sponsored Members”).

A Sponsoring Member is permitted to submit to FICC, for comparison, novation, and netting, certain types of eligible securities transactions between itself and its Sponsored Members (“Sponsored Member Trades”). The Sponsoring Member is required to establish an omnibus account at FICC for its Sponsored Members’ positions arising from such Sponsored Member Trades (“Sponsoring Member Omnibus Account”), which is separate from the Sponsoring Member’s regular netting accounts. For operational and administrative purposes, FICC interacts solely with the Sponsoring Member as agent for purposes of the day-to-day satisfaction of its Sponsored Members’ obligations to or from FICC, including their securities and funds-only settlement obligations. Additionally, for operational convenience, FICC calculates a single Net Settlement Obligation and Fail Net Settlement Obligation in each CUSIP for the Sponsoring Member Omnibus Account and associated Deliver Obligations and Receive Obligations. Such calculations do not affect the

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8 15 U.S.C. 77a et seq.
9 Rule 3A (Sponsoring Members and Sponsored Members), supra note 4.
10 Rule 1, definition of “Sponsored Member Trade”; Rule 3A, Sections 6(b) and 7(a), supra note 4. Securities Exchange Act Release No. 85470 (March 29, 2019), 84 FR 13328 (April 4, 2019) (SR-FICC-2018-013) expanded the definition of “Sponsored Member Trade” to include certain types of eligible securities transactions between a Sponsoring Member and a FICC member other than the Sponsoring Member. However, this proposed rule change applies only to Sponsored Member Trades between the Sponsoring Member and its Sponsored Member.
11 Rule 1, definition of “Sponsoring Member Omnibus Account,” supra note 4.
12 Rule 3A, Sections 5, 6, 7, 8, and 9, supra note 4.
13 Rule 3A, Section 8(b), supra note 4. See also Rule 3A, Section 7(a), supra note 4.
Sponsored Member’s obligations, which are calculated in a manner that is generally consistent with how FICC calculates the obligations of its other members.\textsuperscript{14}

Sponsoring Members are also responsible for providing FICC with a Sponsoring Member Guaranty, whereby the Sponsoring Member guarantees to FICC the payment and performance by its Sponsored Members of their obligations under the Rules.\textsuperscript{15} Although Sponsored Members are principally liable to FICC for their own settlement obligations under the Rules, the Sponsoring Member Guaranty requires the Sponsoring Member to satisfy those settlement obligations on behalf of a Sponsored Member if the Sponsored Member defaults and fails to perform its settlement obligations.\textsuperscript{16}

Although the Rules currently permit Sponsoring Members to submit term repo activity within the Service,\textsuperscript{17} most of the Sponsored Member Trades submitted to FICC by Sponsoring Members have a scheduled settlement date of the next Business Day after the initial settlement date (i.e., overnight repo). FICC believes that certain provisions of the Rules discourage the submission of term repo activity within the Service, as discussed more fully below.

\section*{B. Termination and Liquidation of Defaulting Sponsored Member Positions}

\textsuperscript{14} Rule 3A, Section 7, \textit{supra} note 4.

\textsuperscript{15} Section 2(c) of Rule 3A states: “Each Netting Member to become a Sponsoring Member shall also sign and deliver to [FICC] a Sponsoring Member Guaranty….,” A “Sponsoring Member Guaranty” is defined in Rule 1 as “a guaranty…that a Sponsoring Member delivers to [FICC] whereby the Sponsoring Member guarantees to [FICC] the payment and performance by its Sponsored Members of their obligations under [the] Rules, including, without limitation, all of the securities and funds-only settlement obligations of its Sponsored Members under [the] Rules.” Rule 1; Rule 3A, Section 2(c), \textit{supra} note 4.

\textsuperscript{16} \textit{Id.}

\textsuperscript{17} Rule 3A, Section 5, \textit{supra} note 4.
The Rules governing the termination and liquidation of a defaulting member provide that if FICC ceases to act for a member (including a Sponsored Member), FICC will close-out the defaulting member’s positions by (i) establishing a Final Net Settlement Position for each Eligible Netting Security with a distinct CUSIP equal to the net of all outstanding Deliver Obligations and Receive Obligations of the member in respect of the security, and (ii) taking market action to liquidate such Final Net Settlement Position.\(^\text{18}\)

The Rules require a Sponsoring Member to advise FICC of circumstances that would require FICC to cease to act for a Sponsored Member.\(^\text{19}\) Under the current Rules, FICC has the exclusive ability to terminate and liquidate a Sponsored Member’s positions, even though the relevant Sponsoring Member is responsible for the Sponsored Member’s payment and performance in respect of such positions.\(^\text{20}\) The current Rules do not allow a Sponsoring Member to terminate or liquidate any Sponsored Member Trades.\(^\text{21}\) FICC states that the inability of Sponsoring Members to terminate and liquidate Sponsored Member Trades is inconsistent with comparable intermediated relationships.\(^\text{22}\) FICC states that in the context of such other intermediated relationships, the intermediary is typically permitted to terminate and liquidate the positions of a client that the intermediary guarantees if an event of default or other similar circumstance occurs under the agreement between the intermediary and the client.\(^\text{23}\) In such scenarios, the intermediary’s ability to terminate and liquidate its client’s

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\(^\text{18}\) Rule 22A, Section 2(b); Rule 3A, Sections 13(c) and 15(b), \textit{supra} note 4.

\(^\text{19}\) Rule 3A, Section 15(a), \textit{supra} note 4.

\(^\text{20}\) Rule 3A, Section 13(c) and 15(b), \textit{supra} note 4.

\(^\text{21}\) \textit{Id}.

\(^\text{22}\) Notice, \textit{supra} note 3 at 1355.

\(^\text{23}\) \textit{Id}.
positions is not dependent on a third party’s determination that a certain circumstance or event has occurred.\textsuperscript{24} Instead, the intermediary and the client bilaterally agree to the circumstances and events that give rise to an event of default allowing the intermediary to terminate or liquidate the guaranteed positions.\textsuperscript{25}

FICC states that the inability of a Sponsoring Member to terminate and liquidate its defaulting Sponsored Member’s positions discourages term repo activity within the Service.\textsuperscript{26} Specifically, under the current Rules, when a Sponsored Member defaults, FICC currently controls the termination and liquidation of the Sponsored Member’s positions.\textsuperscript{27} As such, during the time it would take FICC to terminate and liquidate the Sponsored Member’s positions, the Sponsoring Member would effectively be forced to extend credit to the defaulting Sponsored Member under the Sponsored Member Guaranty if the positions involved term repo activity. Such a scenario could cause the Sponsoring Member to incur additional capital requirements until such time as FICC terminates and liquidates the Sponsored Member’s positions.\textsuperscript{28} Additionally, since FICC currently controls the termination and liquidation of the Sponsored Member’s positions, FICC sets the applicable price, timing, and types of liquidation or hedging transactions. However, the Sponsoring Member would also likely enter into one or more transactions with third parties to hedge its own performance obligations under the Sponsoring Member Guaranty. Therefore, the Sponsoring Member would be exposed to potential risks associated with pricing and timing

\textsuperscript{24} Id.
\textsuperscript{25} Id.
\textsuperscript{26} Id.
\textsuperscript{27} Rule 3A, Section 13(c) and 15(b), supra note 4.
\textsuperscript{28} Id.
differences between its actions and those taken by FICC in the aftermath of a Sponsored Member default. FICC believes that these circumstances discourage Sponsoring Members from engaging in term repo activity within the Service.\(^{29}\)

In order to encourage and facilitate term repo activity within the Service, FICC proposes to amend the Rules to allow a Sponsoring Member to terminate and liquidate a defaulting Sponsored Member’s positions arising from Sponsored Member Trades.\(^{30}\) Specifically, in the event (i) a Sponsoring Member triggers the termination of a Sponsored Member’s positions, or (ii) FICC ceases to act for the Sponsored Member and the Sponsoring Member does not continue to perform the obligations of the Sponsored Member, both the Sponsored Member’s positions and the Sponsoring Member’s corresponding positions arising from the Sponsored Member Trades would be terminated. The Sponsoring Member would calculate a net liquidation value of such terminated positions (i.e., Final Net Settlement Positions), whose liquidation values would be paid either to or by the Sponsored Member by or to the Sponsoring Member.\(^{31}\) The Final Net Settlement Position would equal the net of all outstanding Deliver Obligations and Receive Obligations of the Sponsored Member or Sponsoring Member with respect to each security with a distinct CUSIP number.

\(^{29}\) Notice, supra note 3 at 1355-56.

\(^{30}\) The proposal would only cover Sponsored Member Trades between a Sponsored Member and its Sponsoring Member. See supra note 9. Additionally, the proposal would not cover scenarios in which FICC has ceased to act for the relevant Sponsoring Member or in the event of a FICC default. Such scenarios would be governed by current Rules 22A and 22B, respectively. Notice, supra note 3 at 1356-57.

\(^{31}\) FICC intended that the proposal for the Sponsoring Member to establish the Final Net Settlement Position would align with current Rule 22A, which provides for FICC to establish the Final Net Settlement Position when it ceases to act for a member.
The Sponsoring Member would liquidate the Final Net Settlement Positions by establishing a “Sponsored Member Liquidation Amount” and a “Sponsoring Member Liquidation Amount,” which would be identical to, but in the opposite direction of, each other.\textsuperscript{32} If a Sponsored Member Liquidation Amount is due to FICC, the Sponsoring Member would be obligated to pay such Sponsored Member Liquidation Amount to FICC under the Sponsoring Member Guaranty, and this obligation would automatically be set off against the obligation of FICC to pay the corresponding Sponsoring Member Liquidation Amount to the Sponsoring Member. By virtue of such setoff, the Sponsored Member’s obligation to FICC would be discharged, as would FICC’s obligation to the Sponsoring Member. The Sponsoring Member may, however, have a reimbursement claim against the Sponsored Member in an amount equal to the Sponsored Member Liquidation Amount.\textsuperscript{33}

If a Sponsored Member Liquidation Amount were owed by FICC to the Sponsored Member, the Sponsoring Member would satisfy that obligation by transferring the Sponsored Member Liquidation Amount to the account at the Funds-Only Settling Member Bank at which the Sponsoring Member maintains Funds-Only Settlement Amounts related to its Sponsored Member Omnibus Account. To the extent the Sponsoring Member makes such a transfer, it would discharge FICC’s obligation to transfer the Sponsored Member Liquidation Amount to the Sponsored Member and the Sponsoring Member’s corresponding obligation to

\textsuperscript{32} Therefore, if FICC were to owe the Sponsored Member Liquidation Amount to the Sponsored Member, the Sponsoring Member would owe the Sponsoring Member Liquidation Amount to FICC. By the same token, if the Sponsored Member were to owe the Sponsored Member Liquidation Amount to FICC, FICC would owe the Sponsoring Member the Sponsoring Member Liquidation Amount. In all instances, FICC would owe and be owed the same amount of money. Notice, supra note 3 at 1357.

\textsuperscript{33} Such reimbursement claim would not be governed by the Rules, but instead, would be subject to the terms of the bilateral agreement between the Sponsoring Member and Sponsored Member. Id.
transfer the Sponsoring Member Liquidation Amount to FICC. FICC would not, as a practical matter, be involved in the settlement of the foregoing liquidating transactions (i.e., FICC would not need to take any market action), because the termination of the Sponsored Member’s positions and the corresponding Sponsoring Member’s positions would leave FICC flat.

The proposal also provides that the Sponsoring Member would indemnify FICC for any claim by a Sponsored Member arising out of the Sponsoring Member’s calculation of the net liquidation value. Finally, the proposal includes a provision that a Sponsoring Member may take a security interest in FICC’s obligations to the Sponsored Member. Such security interest would not impose new obligations on FICC, but could allow the Sponsoring Member to direct FICC to submit payments due to the Sponsored Member to the Sponsoring Member, so that the Sponsoring Member can apply such amounts to the Sponsoring Member’s unsatisfied obligations to the Sponsoring Member. The proposal would also provide that FICC’s security interest in the Sponsored Member’s assets would be subordinated to the Sponsoring Member’s security interest. However, as noted above, if a Sponsored Member Liquidation Amount is due to FICC, the Sponsoring Member would be obligated to pay such Sponsored Member Liquidation Amount to FICC under the Sponsoring Member Guaranty, and this obligation would automatically be set off against the obligation of FICC to pay the corresponding Sponsoring Member Liquidation Amount to the Sponsoring Member. As such, the Sponsoring Member’s obligation to FICC would be discharged (as would FICC’s

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34 Under the current Rules, each Sponsored Member grants to FICC a security interest in all assets and property placed by the Sponsored Member in the possession of FICC in order to secure the obligations of the Sponsored Member to FICC. Rule 3A, Section 8(g), supra note 4. This security interest provides FICC with credit support in the event that it must terminate and liquidate the Sponsored Member’s positions and assert a claim against the Sponsored Member. Notice, supra note 3 at 1358.
obligation to the Sponsoring Member), and FICC would not need to look to the Sponsored Member or its assets for performance in respect of the terminated positions.

FICC believes that the proposal to provide Sponsoring Members with the ability to terminate and liquidate a defaulting Sponsored Member’s positions would remove the potential risks to Sponsoring Members described above stemming from the exclusive ability of FICC to terminate and liquidate the Sponsored Member’s positions under the current Rules. With this new ability, in the context of a Sponsored Member default involving term repo activity, the Sponsoring Member would control the termination and liquidation of the Sponsored Member’s positions. In contrast to the current Rules, the Sponsoring Member would not be compelled to shoulder risks and extend credit to its defaulting Sponsored Member during the time it would otherwise take FICC to terminate and liquidate the Sponsored Member’s positions. Therefore, FICC believes that the proposal would encourage and facilitate term repo activity within the Service.35

C. Haircuts on Sponsored Member Trades

In some Sponsored Member Trades, a Sponsoring Member may choose to post to its Sponsored Member client a haircut. Similarly in some circumstances, a Sponsoring Member may choose to collect a haircut from its Sponsored Member client to mitigate the Sponsoring Member’s exposure under the Sponsoring Member Guaranty. In both scenarios, the intent of the parties is for the haircut recipient to retain the haircut for the duration of the Sponsored Member Trade, which, in the context of term repo activity, would be the scheduled final settlement date beyond the next Business Day after the initial settlement date. FICC states that Sponsoring Members and Sponsored Members might have accounting considerations

35 Notice, supra note 3 at 1356.
that would favor facilitating the posting of haircuts through FICC’s systems.\(^{36}\) However, under the current Rules regarding FICC’s funds-only settlement process, a Sponsored Member or Sponsoring Member that received a haircut at the Start Leg of a Sponsored Member Trade would be required to transfer an amount of cash equal to the haircut (plus or minus any interim mark-to-market movements) on the next Business Day after the Start Leg has settled.\(^{37}\) Specifically, FICC’s standard funds-only settlement process involves marking to market twice each Business Day all positions associated with term repo activity, including any Sponsored Member Trade with a Close Leg that is scheduled to occur two or more Business Days after the settlement of the Start Leg.\(^ {38}\) FICC calculates a “Collateral Mark” equal to the absolute value of the difference between (i) a Sponsored Member Trade’s Contract Value (i.e., the dollar value at which it is due to finally settle), and (ii) its Market Value (i.e., FICC’s system price of the securities underlying the transaction). This Collateral Mark is incorporated into the calculation of certain of the Funds-Only Settlement Amounts payable.\(^ {39}\) When the Market Value exceeds the Contract Value, the Collateral Mark is negative for, and thus payable by, the party with a Net Short Position (i.e., the party required to deliver securities at final settlement). Therefore, the purpose of the haircut would be frustrated because if the haircut is returned before final settlement of a Sponsored Member Trade, the party that was supposed to retain the haircut for the duration of that trade would cease to be over-collateralized, thus defeating the contractual intent of the parties.

\(^{36}\) Notice, supra note 3 at 1358.

\(^{37}\) Rule 13, supra note 4.

\(^{38}\) Id.

\(^{39}\) Id.
FICC proposes to amend the Rules to ensure that haircuts in the scenario described above are not returned until final settlement. Specifically, FICC would amend Section 9(a) of Rule 3A to provide that, if the parties to a Sponsored Member Trade agree for such Sponsored Member Trade to have a haircut, then any Funds-Only Settlement Amount applicable to such Sponsored Member Trade that includes a Collateral Mark would be calculated without regard for the Collateral Mark. Such Collateral Mark would be replaced by either a “Haircut Deficit” or “Haircut Surplus.” A Haircut Deficit would exist if the amount by which the Market Value as of the settlement date of the Start Leg exceeded the Contract Value of the Close Leg (the “Initial Haircut”) is greater than the amount by which the Market Value as of the time of measurement exceeds the Contract Value of the Close Leg (the “Current Haircut”). Any Haircut Deficit would be payable by the party with a Net Long Position. A “Haircut Surplus” would exist if the Current Haircut exceeds the Initial Haircut, and any Haircut Surplus would be payable by the party with a Net Short Position. FICC would also amend Section 9(a) of Rule 3A to make clear that any Initial Haircut would be as agreed between the parties to the Sponsored Member Trade, and that FICC would not be under any obligation to verify the parties’ agreement with respect to any Initial Haircut, and its calculation of the Initial Haircut would be conclusive and binding on the parties.

FICC believes that the proposed changes described above would enable a Sponsoring Member and its Sponsored Member who intend for one of those two parties to remain over-collateralized for the duration of a Sponsored Member Trade to transfer a haircut between each other and allow such haircut to remain with the intended party until final settlement of
the Sponsored Member Trade. As such, the proposal would encourage and facilitate term repo activity within the Service.

D. **Clarifications and Technical Changes**

FICC proposes to make several clarifications and technical changes to Rule 3A. First, FICC would add a parenthetical to Section 8(c) to clarify that the operational netting provisions of Section 8(b) do not substantively modify a Sponsored Member’s obligations to FICC. Section 8(b) provides that, for operational convenience, FICC calculates a single Net Settlement Position and Fail Net Settlement Position in each CUSIP for the Sponsoring Member’s Sponsoring Member Omnibus Account. Section 8(c), in turn, provides that each Sponsored Member shall satisfy its allocable portion of the Deliver Obligations and Receive Obligations established for the Sponsoring Member Omnibus Account. Neither Section 8(b) nor Section 8(c) modifies the obligations of any Sponsored Member; rather, those provisions are simply designed for operational convenience. Each Sponsored Member still remains responsible for its Deliver Obligations Receive Obligations to and from FICC, which are calculated in accordance with Rule 3A, Section 7. The Sponsored Member’s allocable portion of the Deliver Obligations and Receive Obligations of the Sponsoring Member Omnibus Account will always equal its Deliver Obligations and Receive Obligations to and from FICC, as calculated under Rule 3A, Section 7. Therefore, in order to eliminate doubt regarding the extent of the Sponsored Member’s obligations upon a termination and

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40 Notice, *supra* note 3 at 1359.
41 Rule 3A, Section 8(b), *supra* note 4.
42 Rule 3A, Section 8(c), *supra* note 4.
44 Id.
liquidation of a Sponsored Member’s positions under the proposed rule change, FICC proposes to add a parenthetical to Section 8(c) to clarify that a Sponsored Member’s allocable portion of the obligations established for the Sponsoring Member Omnibus Account are the obligations of the Sponsored Member, as calculated in Rule 3A, Section 7.

Second, FICC would add language at the end of Sections 8(c) and 9(b) to clarify that, if a Sponsoring Member satisfies the net Deliver Obligations and Receive Obligations or the net Funds-Only Settlement Amount obligations of its Sponsoring Member Omnibus Account (including through the proposed setoff described above) before the Sponsoring Member receives corresponding performance from the Sponsored Member, such satisfaction would constitute performance by the Sponsoring Member under the Sponsoring Member Guaranty with respect to the relevant Sponsored Member’s allocable portion of the Sponsoring Member Omnibus Account Deliver Obligations and Receive Obligations or Funds-Only Settlement Amount obligations. If a termination and liquidation were to occur, the Sponsoring Member would be required to perform on behalf of the Sponsored Member under the Sponsoring Member Guaranty. The added language at the end of Sections 8(c) and 9(b) is designed to ensure that, when the Sponsoring Member effects such performance, it would be entitled to reimbursement from the Sponsored Member.

Third, in connection with the proposed changes to Rule 3A, Section 9 regarding haircuts, FICC would make certain re-lettering and grammatical changes for clarity and readability. Finally, FICC would revise proposed Rule 3A, Section 9(c) to clarify that the Sponsored Member is responsible for satisfying the allocable portion of the Funds-Only Settlement Amount calculated for the Sponsoring Member Omnibus Account.

III. Discussion and Commission Findings
Section 19(b)(2)(C) of the Act\(^45\) directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considering the proposed rule change, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to FICC. In particular, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,\(^46\) and Rule 17Ad-22(e)(21) promulgated under the Act,\(^47\) for the reasons described below.

A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, in part, that the Rules of a clearing agency, such as FICC, be “designed to promote the prompt and accurate clearance and settlement of securities transactions....”\(^48\)

As stated above in Section II.B., under the current Rules, FICC has the exclusive ability to terminate and liquidate a defaulting Sponsored Member’s positions; the current Rules do not allow a Sponsoring Member to terminate and liquidate any Sponsored Member Trades. The inability on the part of Sponsoring Members to terminate and liquidate its defaulting Sponsored Member’s positions discourages term repo activity within the Service because during the time it would take FICC to terminate and liquidate the Sponsored Member’s positions, the Sponsoring Member would effectively be forced to extend credit to the defaulting Sponsored Member under the Sponsored Member Guaranty. In such a


\(^{47}\) 17 CFR 240.17Ad-22(e)(21).

scenario, the Sponsoring Member could incur additional capital requirements until FICC completes the termination and liquidation of the Sponsored Member’s positions.

Additionally, since under the current Rules, FICC sets the applicable price, timing, and types of liquidation or hedging transactions, the Sponsoring Member would be exposed to potential risks associated with pricing and timing differences between its own hedging transactions and those taken by FICC in the aftermath of a Sponsored Member default. To avoid exposing Sponsoring Members to the foregoing risks, FICC proposes to amend the Rules to provide a mechanism whereby Sponsoring Members would control the termination and liquidation of their defaulting Sponsored Members’ positions. By providing Sponsoring Members with greater ability to manage their risks associated with Sponsored Member Trades, the proposal would encourage Sponsoring Members to submit more term repo Sponsored Member Trades to FICC within the Service. Increasing the number of trades centrally-cleared by FICC would promote the prompt and accurate clearance and settlement of securities transactions because securities transactions that might otherwise be conducted bilaterally would benefit from FICC’s risk management and guarantee of settlement. Accordingly, the Commission finds that FICC’s proposal to provide a mechanism for Sponsoring Members to terminate and liquidate their defaulting Sponsored Members’ positions should promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.49

As stated above in Section II.C., Sponsored Member Trades may involve a haircut from either the Sponsoring Member or the Sponsored Member. In the context of term repo activity, the intent of both the Sponsoring Member and the Sponsored Member is for the haircut recipient to retain the haircut until the scheduled final settlement date. However, the

49 Id.
current Rules require the haircut to be returned before final settlement of the Sponsored Member Trade, which creates inefficiencies that discourage term repo activity within the Service. FICC proposes to amend the Rules to ensure that such haircuts are not returned until final settlement. As a result, the proposal would encourage and facilitate more term repo activity within the Service. Increasing the number of trades centrally-cleared by FICC would promote the prompt and accurate clearance and settlement of securities transactions because securities transactions that might otherwise be conducted bilaterally would benefit from FICC’s risk management and guarantee of settlement. Accordingly, the Commission finds that FICC’s proposal to ensure that such haircuts with respect to Sponsored Member Trades are not returned until final settlement should promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.\footnote{Id.}

As stated above in Section II.D., FICC proposes several clarifications and technical changes to Rule 3A. FICC states that these changes are designed to enhance clarity and transparency regarding the Service.\footnote{Notice, supra note 3 at 1360.} Having transparent and clear Rule provisions regarding the Service should enable members to better understand the operation of the Service, and should also provide members with increased predictability and certainty regarding their rights and obligations. Such increased predictability and certainty regarding their rights and obligations may encourage Sponsoring Members to submit a greater number of securities transactions to be centrally-cleared by FICC. Increasing the number of trades centrally-cleared by FICC would promote the prompt and accurate clearance and settlement of securities transactions because securities transactions that might otherwise be conducted bilaterally would benefit from FICC’s risk management and guarantee of settlement.
Accordingly, the Commission finds that FICC’s proposed clarifications and technical changes should promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.\textsuperscript{52}

B. **Consistency with Rule 17Ad-22(e)(21) under the Act**

Rule 17Ad-22(e)(21) under the Act requires that each covered clearing agency, such as FICC, “establish, implement, maintain and enforce written policies and procedures reasonably designed to...be efficient and effective in meeting the requirements of its participants and the markets it serves....”\textsuperscript{53}

As stated above in Section II.B., the current Rules do not allow a Sponsoring Member to terminate and liquidate any Sponsored Member Trades. The inability on the part of Sponsoring Members to terminate and liquidate its defaulting Sponsored Member’s positions discourages term repo activity within the Service because during the time it would take FICC to terminate and liquidate the Sponsored Member’s positions, the Sponsoring Member would effectively be forced to extend credit to the defaulting Sponsored Member under the Sponsored Member Guaranty. In such a scenario, the Sponsoring Member could incur additional capital requirements until FICC completes the termination and liquidation of the Sponsored Member’s positions. Additionally, since under the current Rules, FICC sets the applicable price, timing, and types of liquidation or hedging transactions, the Sponsoring Member would be exposed to potential risks associated with pricing and timing differences between its own hedging transactions and those taken by FICC in the aftermath of a Sponsored Member default. To avoid exposing Sponsoring Members to the foregoing risks, FICC proposes to amend the Rules to provide a mechanism whereby Sponsoring Members

\begin{footnotesize}
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\item[\textsuperscript{52}] 15 U.S.C. 78q-1(b)(3)(F).
\item[\textsuperscript{53}] 17 CFR 240.17Ad-22(e)(21).
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would control the termination and liquidation of their defaulting Sponsored Members’ positions. By providing Sponsoring Members with greater ability to manage their risks associated with Sponsored Member Trades, the proposal would enhance FICC’s Rules in a manner that meets the needs of Sponsoring Members and Sponsored Members.

Additionally, as stated above in Section II.C., the current Rules require haircuts with respect to term repo Sponsored Member Trades to be returned before final settlement, which discourages term repo activity within the Service. FICC proposes to amend the Rules to ensure that such haircuts are not returned until final settlement. As a result, the proposal would encourage and facilitate term repo activity within the Service by ensuring that haircuts with respect to Sponsored Member Trades are not returned until final settlement in a manner consistent with the intent of the Sponsoring Member and Sponsored Member. For the reasons described in this Section III.B., the Commission finds FICC’s proposals to (i) provide a mechanism for Sponsoring Members to terminate and liquidate their defaulting Sponsored Members’ positions, and (ii) ensure that haircuts with respect to term repo Sponsored Member Trades are not returned until final settlement would constitute policies and procedures reasonably designed to be efficient and effective in meeting the requirements of FICC’s members and the relevant markets FICC serves, consistent with Rule 17Ad-22(e)(21) under the Act.54

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and, in particular, with the requirements of Section 17A of the Act55 and the rules and regulations promulgated thereunder.

54 Id.
IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act\(^\text{56}\) that proposed rule change SR-FICC-2019-007, be, and hereby is, APPROVED.\(^\text{57}\)

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.\(^\text{58}\)

Jill M. Peterson,

Assistant Secretary.


\(^\text{57}\) In approving the proposed rule change, the Commission considered the proposals’ impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

\(^\text{58}\) 17 CFR 200.30-3(a)(12).