8011-01p
SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-89560; File No. SR-FICC-2020-009]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, to Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Risk Charge in the VaR Charges

August 14, 2020.

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 30, 2020, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2020-009. On August 13, 2020, FICC filed Amendment No. 1 to the proposed rule change, to make clarifications and corrections to the proposed rule change.[3] The proposed rule change, as modified by Amendment No. 1 (hereinafter, the "Proposed Rule Change"), is described in Items I, II and III below, which Items have been prepared primarily by the clearing agency.[4] The

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Amendment No. 1 made clarifications and corrections to the description of the proposed rule change and Exhibits 3 and 5 of the filing, and these clarifications and corrections have been incorporated, as appropriate, into the description of the proposed rule change in Item II below.

4 On July 30, 2020, FICC filed the proposed rule change as an advance notice (SR-FICC-2020-802) with the Commission 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, 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). On August 13, 2020, FICC filed Amendment No. 1 to the advance notice to make similar clarifications and corrections to the advance notice. A copy of the advance notice, as modified by Amendment No. 1 (hereinafter, the "Advance Notice") is available at http://www.dtcc.com/legal/sec-rule-filings.aspx.

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 modifications to the FICC Government Securities Division ("GSD") Rulebook ("GSD Rules") and the FICC Mortgage-Backed Securities Division ("MBSD") Clearing Rules ("MBSD Rules," and together with the GSD Rules, "Rules") to introduce the Margin Liquidity Adjustment ("MLA") charge as an additional component of GSD and MBSD's respective Clearing Funds, as described in greater detail below.[5]

This Proposed Rule Change also consists of modifications to the GSD Rules, the MBSD Rules, the GSD Methodology Document – GSD Initial Market Risk Margin Model ("GSD QRM Methodology Document") and the MBSD Methodology and Model Operations Document – MBSD Quantitative Risk Model ("MBSD QRM Methodology Document," and together with the GSD QRM Methodology Document, the "QRM Methodology Documents") in order to (i) enhance the calculation of the VaR Charges of GSD and MBSD to include a bid-ask spread risk charge, and (ii) make necessary technical changes to the QRM Methodology Documents in order to implement this proposed change.

5 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, and the MBSD Rules, available at www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf.

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

FICC is proposing to enhance the methodology for calculating Required Fund Deposits to the respective Clearing Funds of GSD and MBSD by (1) introducing a new component, the MLA charge, which would be calculated to address the risk presented to FICC when a Member's portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type (referred to as "asset groups"),[6] and (2) enhancing the calculation of the VaR Charges of GSD and MBSD by including a bid-ask spread risk charge, as described in more detail below.[7]

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6 References herein to "Members" refer to GSD Netting Members and MBSD Clearing Members, as such terms are defined in the Rules. References herein to "net unsettled positions" refer to, with respect to GSD, Net Unsettled Positions, as such term is defined in GSD Rule 1 (Definitions) and, with respect to MBSD, refers to the net positions that have not yet settled. Supra note 4.

7 The results of a study of the potential impact of adopting the proposed changes have been provided to the Commission.

FICC is also proposing to make certain technical changes to the QRM Methodology Documents, as described in below, in order to implement the proposed enhancement to the VaR Charges.

(i) Overview of the Required Fund Deposits and the Clearing Funds

As part of its market risk management strategy, FICC manages its credit exposure to Members by determining the appropriate Required Fund Deposits to the GSD and MBSD Clearing Fund and monitoring their sufficiency, as provided for in the Rules.[8] The Required Fund Deposits serve as each Member's margin. The objective of a Member's Required Fund Deposit is to mitigate potential losses to FICC associated with liquidating a Member's portfolio in the event FICC ceases to act for that Member (hereinafter referred to as a "default").[9] The aggregate of all Members' Required Fund Deposits constitutes the respective GSD and MBSD Clearing Funds. FICC would access the GSD and MBSD Clearing Funds should a defaulting Member's own Required Fund Deposit be insufficient to satisfy losses to FICC caused by the liquidation of that Member's portfolio.

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8 See GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD Rule 4 (Clearing Fund Formula and Loss Allocation), supra note 4. FICC's market risk management strategy is designed to comply with Rule 17Ad-22(e)(4) under the Act, where these risks are referred to as "credit risks." 17 CFR 240.17Ad-22(e)(4).

9 The Rules identify when FICC may cease to act for a Member and the types of actions FICC may take. For example, FICC may suspend a firm's membership with FICC or prohibit or limit a Member's access to FICC's services in the event that Member defaults on a financial or other obligation to FICC. See GSD Rule 21 (Restrictions on Access to Services), and MBSD Rule 14 (Restrictions on Access to Services), of the Rules, supra note 4.

Pursuant to the Rules, each Member's Required Fund Deposit amount consists of a number of applicable components, each of which is calculated to address specific risks faced by FICC, as identified within the Rules.[10] The VaR Charge comprises the largest portion of a Member's Required Fund Deposit amount. Currently, the GSD QRM Methodology Document states that the total VaR Charge for each portfolio is the sum of the sensitivity VaR of the portfolio plus the haircut charges plus the repo interest volatility charges plus the pool/TBA basis charge. In the MBSD QRM Methodology Document, the current description of the total VaR Charge states that it is the sum of the designated VaR Charge and the haircut charge.

The VaR Charge is calculated using a risk-based margin methodology that is intended to capture the risks related to market price that is associated with the securities in a Member's portfolio. This risk-based margin methodology is designed to project the potential losses that could occur in connection with the liquidation of a defaulting Member's portfolio, assuming a portfolio would take three days to 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 99 percent confidence level for Members.[11]

FICC regularly assesses market and liquidity risks as such risks relate to its margining methodologies to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market. The proposed

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10 Supra note 4.

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

changes to include the MLA charge to its Clearing Fund methodology and to enhance the VaR Charges by including a bid-ask spread risk charge, as described below, are the result of FICC's regular review of the effectiveness of its margining methodology.

(ii) Overview of Liquidation Transaction Costs and Proposed Changes

Each of the proposed changes addresses a similar, but separate, risk that FICC faces increased transaction costs when it liquidates the net unsettled positions of a defaulted Member due to the unique characteristics of that Member's portfolio. The transaction costs to FICC to liquidate a defaulted Member's portfolio include both market impact costs and fixed costs. Market impact costs are the costs due to the marketability of a security, and generally increase when a portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type, as described more below. Fixed costs are the costs that generally do not fluctuate and may be caused by the bid-ask spread of a particular security. The bid-ask spread of a security accounts for the difference between the observed market price that a buyer is willing to pay for that security and the observed market price that a seller is willing to sell that security.

The transaction cost to liquidate a defaulted Member's portfolio is currently captured by the measurement of market risk through the calculation of the VaR Charge.[12] The proposed changes would supplement and enhance the current measurement of this market risk to address situations where the characteristics of the defaulted Member's

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12 The calculation of the VaR Charge is described in GSD Rule 1 (Definitions) and MBSD Rules 1 (Definitions). Supra note 4.

portfolio could cause these costs to be higher than the amount collected for the VaR Charge.

First, as described in more detail below, the MLA charge is designed to address the market impact costs of liquidating a defaulted Member's portfolio that may increase when that portfolio includes large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type. These positions may be more difficult to liquidate because a large number of securities with similar risk profiles could reduce the marketability of those large net unsettled positions, increasing the market impact costs to FICC. As described below, the MLA charge would supplement the VaR Charge.

Second, as described in more detail below, the bid-ask spread risk charge would address the risk that the transaction costs of liquidating a defaulted Member's net unsettled positions may increase due to the fixed costs related to the bid-ask spread. As described below, this proposed change would be incorporated into, and, thereby, enhance the current measure of transaction costs through, the VaR Charge.

(iii) Proposed Margin Liquidity Adjustment Charge

In order to address the risks of increased market impact costs presented by portfolios that contain large net unsettled positions in the same asset group, FICC is proposing to introduce a new component to the GSD and MBSD Clearing Fund formulas, the MLA charge.

As noted above, a Member portfolio with large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type may be more difficult to liquidate in the market in the event the Member defaults because a concentration in that group of securities or in a transaction type could reduce the marketability of those large net unsettled positions. Therefore, such portfolios create a risk that FICC may face increased market impact cost to liquidate that portfolio in the assumed margin period of risk of three business days at market prices.

The proposed MLA charge would be calculated to address this increased market impact cost by assessing sufficient margin to mitigate this risk. As described below, the proposed MLA charge would be calculated for different asset groups. Essentially, the calculation is designed to compare the total market value of a net unsettled position in a particular asset group, which FICC would be required to liquidate in the event of a Member default, to the available trading volume of that asset group or equities subgroup in the market.[13] If the market value of the net unsettled position is large, as compared to the available trading volume of that asset group, then there is an increased risk that FICC would face additional market impact costs in liquidating that position in the event of a Member default. Therefore, the proposed calculation would provide FICC with a measurement of the possible increased market impact cost that FICC could face when it liquidates a large net unsettled position in a particular asset group.

To calculate the MLA charge, FICC would categorize securities into separate asset groups. For GSD, asset groups would include the following, each of which have similar risk profiles: (a) U.S. Treasury securities, which would be further categorized by maturity – those maturing in (i) less than one year, (ii) equal to or more than one year and

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13 FICC would determine average daily trading volume by reviewing data that is made publicly available by the Securities Industry and Financial Markets Association ("SIFMA"), at https://www.sifma.org/resources/archive/research/statistics.

less than two years, (iii) equal to or more than two years and less than five years, (iv) equal to or more than five years and less than ten years, and (v) equal to or more than ten years; (b) Treasury-Inflation Protected Securities ("TIPS"), which would be further categorized by maturity – those maturing in (i) less than two years, (ii) equal to or more than two years and less than six years, (iii) equal to or more than six years and less than eleven years, and (iv) equal to or more than eleven years; (c) U.S. agency bonds; and (d) mortgage pools transactions. For MBSD, to-be-announced ("TBA") transactions, Specified Pool Trades and Stipulated Trades would be included in one mortgage-backed securities asset group.

FICC would first calculate a measurement of market impact cost with respect to the net unsettled positions of a Member in each of these asset groups. As described above, the calculation of an MLA charge is designed to measure the potential additional market impact cost to FICC of closing out a large net unsettled position in that particular asset group.

To determine the market impact cost for each net unsettled position in Treasuries maturing less than one year and TIPS for GSD and in the mortgage-backed securities asset group for MBSD, FICC would use the directional market impact cost, which is a function of the net unsettled position's net directional market value.[14] To determine the market impact cost for all other net unsettled positions, FICC would add together two

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14 The net directional market value of an asset group within a portfolio is calculated as the absolute difference between the market value of the long net unsettled positions in that asset group, and the market value of the short net unsettled positions in that asset group. For example, if the market value of the long net unsettled positions is $100,000, and the market value of the short net unsettled positions is $150,000, the net directional market value of the asset group is $50,000.

components: (1) the directional market impact cost, as described above, and (2) the basis cost, which is based on the net unsettled position's gross market value.[15]

The calculation of market impact cost for net unsettled positions in Treasuries maturing less than one year and TIPS for GSD and in the mortgage-backed securities asset group for MBSD would not include basis cost because basis risk is negligible for these types of positions.

For all asset groups, when determining the market impact costs, the net directional market value and the gross market value of the net unsettled positions would be divided by the average daily volumes of the securities in that asset group over a lookback period.[16]

FICC would then compare the calculated market impact cost to a portion of the VaR Charge that is allocated to net unsettled positions in those asset groups.[17] If the ratio of the calculated market impact cost to the 1-day VaR Charge is greater than a threshold,

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15 To determine the gross market value of the net unsettled positions in each asset group, FICC would sum the absolute value of each CUSIP in the asset group.

16 Supra note 12.

17 FICC's margining methodology uses a three-day assumed period of risk. For purposes of this calculation, FICC would use a portion of the VaR Charge that is based on one-day assumed period of risk and calculated by applying a simple square-root of time scaling, referred to in this Proposed Rule Change as "1-day VaR Charge." Any changes that FICC deems appropriate to this assumed period of risk would be subject to FICC's model risk management governance procedures set forth in the Clearing Agency Model Risk Management Framework ("Model Risk Management Framework"). See Securities Exchange Act Release Nos. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File No. SR-FICC-2017-014); 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR-FICC-2018-010); 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File No. SR-FICC-2020-004).

an MLA charge would be applied to that asset group.[18] If the ratio of these two amounts is equal to or less than this threshold, an MLA charge would not be applied to that asset group. The threshold would be based on an estimate of the market impact cost that is incorporated into the calculation of the 1-day VaR charge, such that an MLA charge would apply only when the calculated market impact cost exceeds this threshold.

When applicable, an MLA charge for each asset group would be calculated as a proportion of the product of (1) the amount by which the ratio of the calculated market impact cost to the applicable 1-day VaR charge exceeds the threshold, and (2) the 1-day VaR charge allocated to that asset group.

For each Member portfolio, FICC would add the MLA charges for net unsettled positions in each asset group to determine a total MLA charge for a Member.

The ratio of the calculated market impact cost to the 1-day VaR Charge would also determine if FICC would apply a downward adjustment, based on a scaling factor, to the total MLA charge, and the size of any adjustment. For net unsettled positions that have a higher ratio of calculated market impact cost to the 1-day VaR Charge, FICC would apply a larger adjustment to the MLA charge by assuming that it would liquidate that position on a different timeframe than the assumed margin period of risk of three business days. For example, FICC may be able to mitigate potential losses associated with liquidating a Member's portfolio by liquidating a net unsettled position with a larger VaR Charge over a longer timeframe. Therefore, when applicable, FICC would apply a

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18 FICC would review the method for calculating the thresholds from time to time and any changes that FICC deems appropriate would be subject to FICC's model risk management governance procedures set forth in the Model Risk Management Framework. See id.

multiplier to the calculated MLA charge. When the ratio of calculated market impact cost to the 1-day VaR Charge is lower, the multiplier would be one, and no adjustment would be applied; as the ratio gets higher the multiplier decreases and the MLA charge is adjusted downward.

The final MLA charge would be calculated daily and, when the charge is applicable, as described above, would be included as a component of Members' Required Fund Deposit.

MLA Excess Amount for GSD Sponsored Members

For GSD, the calculation of the MLA charge for a Sponsored Member that clears through single account sponsored by a Sponsoring Member would be the same as described above. For a GSD Sponsored Member that clears through multiple accounts sponsored by multiple Sponsoring Members, in addition to calculating an MLA charge for each account (as described above), FICC would also calculate an MLA charge for the consolidated portfolio.

If the MLA charge of the consolidated portfolio is higher than the sum of all MLA charges for each account of the Sponsored Member, the Sponsored Member would be charged the amount of such difference, to be referred to as the "MLA Excess Amount," in addition to the applicable MLA charge. If the MLA charge of the consolidated portfolio is not higher than the sum of all MLA charges for each account of the Sponsored Member, then the Sponsored Member will only be charged an MLA charge for each sponsored account, as applicable.

The MLA Excess Amount is designed to capture the additional market impact cost that could be incurred when a Sponsored Member defaults, and each of the

Sponsoring Members liquidates net unsettled positions associated with that defaulted Sponsored Member. If large net unsettled positions in the same asset group are being liquidated by multiple Sponsoring Members, the market impact cost to liquidate those positions could increase. The MLA Excess Amount would address this additional market impact cost by capturing any difference between the calculations of the MLA charge for each sponsored account and for the consolidated portfolio.

Proposed Changes to GSD and MBSD Rules

The proposal described above would be implemented into the GSD Rules and MBSD Rules. Specifically, FICC would amend GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions) to include a description of the MLA charge.

The proposed change to GSD Rule 1 (Definitions) would first identify each of the asset groups and would then separately describe the two calculations of market impact cost by these asset groups by identifying the components of these calculations. The proposed definition would state that GSD would compare the calculated market impact cost to a portion of that Member's VaR Charge, to determine if an MLA charge would be applied to an asset group. The proposed definition would then state that GSD would add each of the applicable MLA charges calculated for each asset group together. Finally, the proposed definition would state that GSD may apply a downward adjusting scaling factor to result in a final MLA charge. The proposed change to GSD Rule 1 (Definitions) would also include a definition of the "MLA Excess Amount." The proposed definition would state that it would be an additional charge applicable to Sponsored Members that clear through multiple accounts sponsored by multiple Sponsoring Members and would describe how the additional charge would be determined.

The proposed change to MBSD Rule 1 (Definitions) would define the MBS asset group, for purposes of calculating this charge, and would then describe the calculation of market impact cost for that asst group by identifying the components of this calculation. The proposed definition would state that MBSD would compare the calculated market impact cost to a portion of the Member's VaR Charge, to determine if an MLA charge would be applied to a net unsettled position. Finally, the proposed definition would state that MBSD may apply a downward adjusting scaling factor to result in a final MLA charge.

FICC would also amend GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD Rule 4 (Clearing Fund and Loss Allocation) to include the MLA charge as a component of the Clearing Fund formula.

(iv) Proposed Bid-Ask Spread Risk Charge

FICC has identified potential risk that its margining methodologies do not account for the transaction costs related to bid-ask spread in the market that could be incurred when liquidating a portfolio. Bid-ask spreads account for the difference between the observed market price that a buyer is willing to pay for a security and the observed market price that a seller is willing to sell that security. Therefore, FICC is proposing to amend the VaR models of GSD and MBSD to include a bid-ask spread risk charge in the VaR Charges of GSD and MBSD to address this risk.

In order to calculate this charge, GSD would segment Members' portfolios into separate bid-ask spread risk classes by product type and maturity. The bid-ask spread risk classes would be separated into the following types: (a) mortgage pools ("MBS"); (b) TIPS; (c) U.S. agency bonds; and (d) U.S. Treasury securities, which would be further segmented into separate classes based on maturities as follows: (i) less than five years, (ii) equal to or more than five years and less than ten years, and (iii) equal to or more than ten years. FICC would further segment the U.S. Treasury securities into separate classes based on maturities.

Only the MBS asset group is applicable to MBSD Member portfolios. FICC would exclude Option Contracts in to-be-announced ("TBA") transactions from the bid-ask spread risk charge because, in the event of a Member default, FICC would liquidate any Option Contracts in TBAs in a Member's portfolio at the intrinsic value of the Option Contract and, therefore, does not face a transaction cost related to the bid-ask spread.

Each product type and maturity risk class would be assigned a specific bid-ask spread haircut rate in the form of a basis point charge that would be applied to the gross market value in that particular risk class. The applicable bid-ask spread risk charge would be the product of the gross market value in a particular risk class in the Member's portfolio and the applicable basis point charge. The bid-ask spread risk charge would be calculated at the portfolio level, such that FICC would aggregate the bid-ask spread risk charges of the applicable risk classes for the Member's portfolio.

FICC proposes to review the haircut rates annually based on either the analysis of liquidation transaction costs related to the bid-ask spread that is conducted in connection with its annual simulation of a Member default or market data that is sourced from a third-party data vendor. Based on the analyses from recent years' simulation exercises, FICC does not anticipate that these haircut rates would change significantly year over year. FICC may also adjust the haircut rates following its annual model validation review, to the extent the results of that review indicate the current haircut rates are not adequate to address the risk presented by transaction costs from a bid-ask spread.[19]

The proposed initial haircuts are based on the analysis from the most recent annual default simulation and market data sourced from a third-party data vendor, and are listed in the table below:

Class	Asset Class	Maturity	Haircut (bps)
MBS	MBS	All	0.8
TIPS	TIPS	All	2.1
Agency	Agency bonds	All	3.8
Treasury 5-	Treasury	< 5 years	0.6
Treasury 5-10	Treasury	5-10 years	0.7
Treasury 10+	Treasury	>10 years	0.7

Proposed Changes to GSD and MBSD Rules

The proposal described above would be implemented into the GSD Rules and MBSD Rules. Specifically, FICC would include a description of the bid-ask spread risk charge in the current definitions of the VaR Charge in GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions). The proposed change would state that the calculations the VaR Charge shall include an additional bid-ask spread risk charge measured by multiplying the gross market value of each net unsettled position by a basis point charge.

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19 All proposed changes to the haircuts would be subject to FICC's model risk management governance procedures set forth in the Model Risk Management Framework. See id.

The proposed change would also state that the basis point charge would be based on six risk classes and would identify those risk classes.

Proposed Changes to QRM Methodology Documents

To implement this proposal, FICC is proposing to amend the QRM Methodology Documents to describe the bid-ask spread risk charge. Specifically, FICC would describe (i) that the bid-ask spread risk charge is designed to mitigate the risk related to transaction costs in liquidating a portfolio in the event of a Member default; (ii) how the bid-ask spread risk charge would be calculated; and (ii) the impact analysis that was conducted in each of the QRM Methodology Documents. The GSD QRM Methodology Document would describe the proposed six classes (listed in the table above). The MBSD QRM Methodology Document would state that the only class for MBSD portfolios is the MBS asset class, and that the Option Contracts in TBAs would be excluded from the proposed charge. Finally, FICC would update the descriptions of the total VaR Charge in the QRM Methodology Documents to include the bid-ask spread risk charge as a component of this charge.

(v) Proposed Technical Changes

Finally, FICC would amend the QRM Methodology Documents to re-number the sections and tables, and update certain section titles, as necessary, to add a new section that describes the proposed bid-ask spread risk charge.

(vi) Implementation Timeframe

FICC would implement the proposed changes no later than 10 Business Days after the later of the approval of the Proposed Rule Change and no objection to the related advance notice[20] by the Commission. FICC would announce the effective date of the proposed changes by Important Notice posted to its website.

2. Statutory Basis

FICC believes that the proposed changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, FICC believes the proposed changes are consistent with Section 17A(b)(3)(F) of the Act,[21] and Rules 17Ad-22(e)(4)(i) and (e)(6)(i), each promulgated under the Act,[22] for the reasons described below.

Section 17A(b)(3)(F) of the Act requires that the rules of FICC be designed to, among other things, assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.[23] FICC believes the proposed change to implement the MLA charge is designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible because it is designed to address the market impact costs to FICC of liquidating a Member's portfolio in the event of that Member's default. Specifically, the proposed MLA charge would allow FICC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type that are not captured by the VaR Charge. Additionally, as described

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20 Supra note 3.

21 15 U.S.C. 78q-1(b)(3)(F).

22 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

23 15 U.S.C. 78q-1(b)(3)(F).

above, the proposed MLA Excess Amount is designed to capture any additional market impact cost that could be incurred when each of the Sponsoring Members liquidates large net unsettled positions in securities of the same asset group that are all associated with one defaulted Sponsored Member.

The Clearing Fund is a key tool that FICC uses to mitigate potential losses to FICC associated with liquidating a Member's portfolio in the event of Member default. Therefore, the proposed change to include the MLA charge among the Clearing Fund components, when applicable, would enable FICC to better address the increased market impact costs of liquidating net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type, such that, in the event of Member default, FICC's operations would not be disrupted and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the Proposed Rule Change to implement the MLA charge is designed to assure the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible, consistent with Section 17A(b)(3)(F) of the Act.[24]

Additionally, FICC believes that the proposed change to amend the VaR model of each of GSD and MBSD to include bid-ask spread risk charge within Members' final VaR Charge would be designed to assure the safeguarding of securities and funds that are in the custody or control of FICC or for which it is responsible because the proposed change would enable FICC to better limit its exposure to increased transaction costs due to the bid-ask spread in the market when liquidating the a defaulted Member's portfolio. FICC believes that including the above-described bid-ask spread risk charge within the

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24 Id.

VaR Charges would better ensure that FICC calculates and collects sufficient margin and, thereby, better enable FICC to limit its exposure to these transaction costs. By enabling FICC to limit its exposure to Members in this way, the proposed change is designed to better ensure that, in the event of a Member Default, FICC would have adequate margin from the defaulting Member and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the proposed change to include the bid-ask spread risk charge within the calculation of the final VaR Charges of GSD and MBSD would be designed to assure the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible and therefore consistent with Section 17A(b)(3)(F) of the Act.[25]

FICC believes that the proposed technical changes described above are designed to assure the safeguarding of securities and funds which are in the custody and control of the clearing agency or for which it is responsible, consistent with Section 17A(b)(3)(F) the Act.[26] FICC believes the proposed technical changes would also enhance the clarity of the QRM Methodology Documents for FICC. Having clear and accurate methodology documents, which describe how the bid-ask spread risk charge would be calculated and that such bid-ask spread risk charge is included within the calculation of the final VaR Charges of GSD and MBSD, would help to ensure that FICC continues to accurately calculate and assess margin and in turn, collect sufficient margin from its Members and better enable FICC to limit its exposures to the risks related to increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a

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25 Id.

26 Id.

portfolio. By better enabling FICC to limit its exposure to Member's in this way, the proposed change is designed to better ensure that, in the event of a Member default, FICC would have adequate margin from the defaulting Member and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the proposed technical changes to the QRM Methodology Documents would be designed to assure the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible and therefore consistent with Section 17A(b)(3)(F) of the Act.[27]

Rule 17Ad-22(e)(4)(i) under the Act requires, in part, that FICC 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 arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.[28]

As described above, FICC believes that both of the proposed changes would enable it to better identify, measure, monitor, and, through the collection of Members' Required Fund Deposits, manage its credit exposures to Members by maintaining sufficient resources to cover those credit exposures fully with a high degree of confidence.

Specifically, FICC believes that the proposed MLA charge would effectively mitigate the risks related to large net unsettled positions of securities in the same asset

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[27] Id.

[28] 17 CFR 240.17Ad-22(e)(4)(i).

group within a portfolio and would address the potential increased risks FICC may face related to its ability to liquidate such positions in the event of a Member default. The proposed MLA Excess Amount would supplement this proposed charge to capture any additional market impact cost related to Sponsored Members that clear through multiple accounts with multiple Sponsoring Members.

Therefore, FICC believes that the proposal would enhance FICC's ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. As such, FICC believes the proposed changes are consistent with Rule 17Ad-22(e)(4)(i) under the Act.[29]

Additionally, FICC believes that the proposed bid-ask spread risk charge would enhance FICC's ability to identify, measure, monitor and manage its credit exposures to Members and those exposures arising from its payment, clearing, and settlement processes because the proposed changes would better ensure that FICC maintains sufficient financial resources to cover its credit exposure to each Member with a high degree of confidence. FICC believes that the proposed change would enable FICC to more effectively identify, measure, monitor and manage its exposures to risks related to market price, and enable it to better limit its exposure to potential losses from Member defaults by providing a more effective measure of the risks related to market price. As described above, due to the bid-ask spread in the market, there is an observable transaction cost to liquidate a portfolio. The proposed bid-ask spread risk charge is designed to manage the risk related to this transaction cost in the event a Member's

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29 Id.

portfolio is liquidated. As such, FICC believes that the proposed change would better address the potential risks that FICC may face that are related to its ability liquidate a Member's net unsettled positions in the event of that firm's default, and thereby enhance FICC's ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In this way, FICC believes this proposed change is also consistent with Rule 17Ad-22(e)(4)(i) under the Act.[30]

Rule 17Ad-22(e)(6)(i) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to cover 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.[31]

The Required Fund Deposits are made up of risk-based components (as margin) that are calculated and assessed daily to limit FICC's credit exposures to Members, including the VaR Charges. FICC's proposed change to introduce an MLA charge is designed to more effectively address the risks presented by large net unsettled positions in the same asset group. FICC believes the addition of the MLA charge would enable FICC to assess a more appropriate level of margin that accounts for these risks. This proposed change is designed to assist FICC in maintaining a risk-based margin system that considers, and produces margin levels commensurate with, the risks and particular

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30 Id.

31 17 CFR 240.17Ad-22(e)(6)(i).

attributes of portfolios that contain large net unsettled positions in the same asset group and may be more difficult to liquidate in the event of a Member default. The proposed MLA Excess Amount would further this goal by measuring any additional risks that could be presented by a Sponsored Member that clears through multiple accounts at multiple Sponsoring Members. Therefore, FICC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(i) under the Act.[32]

Furthermore, FICC believes that including the bid-ask spread risk charge within the calculation of the final VaR Charges of GSD and MBSD would provide FICC with a better assessment of its risks related to market price. This proposed change would enable FICC to assess a more appropriate level of margin that accounts for this risk at the portfolio level. As such, each Member portfolio would be subject to a risk-based margining system that, at minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market, consistent with Rule 17Ad-22(e)(6)(i) under the Act.[33]

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

FICC believes that the proposed changes could have an impact on competition. Specifically, FICC believes the proposed changes could burden competition because they would result in larger Required Fund Deposit amounts for Members when the additional charges are applicable and result in a Required Fund Deposit that is greater than the amount calculated pursuant to the current formula.

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32 Id.

33 Id.

When the proposal results in a larger Required Fund Deposit, the proposed change could burden competition for Members that have lower operating margins or higher costs of capital compared to other Members. However, the increase in Required Fund Deposit would be in direct relation to the specific risks presented by each Member's net unsettled positions, and each Member's Required Fund Deposit would continue to be calculated with the same parameters and at the same confidence level for each Member. Therefore, Members that present similar net unsettled positions, regardless of the type of Member, would have similar impacts on their Required Fund Deposit amounts. As such FICC believes that any burden on competition imposed by the proposed changes would not be significant and, further, would be both necessary and appropriate in furtherance of FICC's efforts to mitigate risks and meet the requirements of the Act, as described in this filing and further below.

FICC believes the above described burden on competition that may be created by the proposed MLA charge and the bid-ask spread risk charge would be necessary in furtherance of the Act, specifically Section 17A(b)(3)(F) of the Act.[34] As stated above, the proposed MLA charge is designed to address the market impact costs to FICC of liquidating a Member's portfolio in the event of that Member's default. Specifically, the proposed MLA charge would allow FICC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating net unsettled positions that are not captured by the VaR Charge. Additionally, as described above, the proposed MLA Excess Amount is designed to capture any additional market impact cost that could be incurred when each of the Sponsoring Members liquidates large net

34 15 U.S.C. 78q-1(b)(3)(F).

unsettled positions in securities of the same asset group that are all associated with one defaulted Sponsored Member. Likewise, the proposed bid-ask spread risk charge is designed to help limit FICC's exposures to the increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a Member's portfolio in the event of a Member default. Therefore, FICC believes this proposed change is consistent with the requirements of Section 17A(b)(3)(F) of the Act, which requires that the Rules be designed to assure the safeguarding of securities and funds that are in FICC's custody or control or which it is responsible.[35]

FICC believes these proposed changes would also support FICC's compliance with Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act, which require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to (x) effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence; and (y) cover 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.[36]

As described above, FICC believes the introduction of the MLA charge would allow FICC to employ a risk-based methodology that would address the increased market impact costs that FICC could face when liquidating net unsettled positions in a particular

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35 Id.

36 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

group of securities with a similar risk profile or in a particular transaction type. The proposed MLA Excess Amount would supplement this proposed charge to capture any additional market impact cost related to Sponsored Members that clear through multiple accounts with multiple Sponsoring Members. Similarly, the proposed change to include the bid-ask spread risk charge within the calculation of the VaR Charge would allow FICC to employ a risk-based methodology that would better measure the transaction costs that could be incurred in liquidating a defaulted Member's portfolio. Therefore, the proposed changes would better limit FICC's credit exposures to Members, consistent with the requirements of Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act.[37]

FICC believes that the above described burden on competition that could be created by the proposed changes would be appropriate in furtherance of the Act because such changes have been appropriately designed to assure the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible, as described in detail above. The proposed MLA charge and the proposed bid-ask spread risk charge would also enable FICC to produce margin levels more commensurate with the risks and particular attributes of each Member's portfolio.

The proposed MLA charge and the MLA Excess Amount would do this by measuring the increased market impact costs that FICC may face when liquidating a defaulted Member's portfolio that includes net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type. With respect to the proposed bid-ask spread risk charge, a haircut (in the form of a basis point charge that

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37 Id.

would be applied to the gross market value) would be applied to separate risk classes in the portfolio. As described above, for purposes of calculating this charge, the portfolio would be segmented into separate risk classes, by asset group and maturity, and a haircut would be applied to the gross market value of each group. Therefore, because the proposed changes are designed to provide FICC with an appropriate measure of the risks (*i.e.*, risks related to both market impact costs and transaction costs) presented by Members' portfolios, FICC believes the proposal is appropriately designed to meet its risk management goals and its regulatory obligations.

FICC believes that it has designed the proposed changes in an appropriate way in order to meet compliance with its obligations under the Act. Specifically, the proposals would improve the risk-based margining methodology that FICC employs to set margin requirements and better limit FICC's credit exposures to its Members. Therefore, as described above, FICC believes the proposed changes are necessary and appropriate in furtherance of FICC's obligations under the Act, specifically Section 17A(b)(3)(F) of the Act[38] and Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act.[39]

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

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

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38 15 U.S.C. 78q-1(b)(3)(F).

39 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

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.

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 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-2020-009 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-2020-009. 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-2020-009 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.[40]

J. Matthew DeLesDernier,

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[40] 17 CFR 200.30-3(a)(12).

Assistant Secretary.

[FR Doc. 2020-18199 Filed: 8/19/2020 8:45 am; Publication Date: 8/20/2020]