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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66550; File No. SR-FICC-2008-01)

March 9, 2012

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Amended Proposed Rule Change to Allow the Mortgage-Backed Securities Division to Provide Guaranteed Settlement and Central Counterparty Services

I. Introduction

On March 12, 2008, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change (SR-FICC-2008-01) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder. On November 21, 2011, FICC amended the proposed rule change. The amended proposed rule change was published for comment in the Federal Register on December 12, 2011.³ On January 10, 2012, the Commission extended the time within which to take action on the proposed rule change to March 9, 2012.⁴ The Commission received one comment on the proposed rule change.⁵ This order approves the proposal.

II. Description

The proposed rule changes consist of modifications to the rules of FICC’s MBSD to allow MBSD to provide guaranteed settlement and central counterparty (“CCP”) services. These

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 65899 (Dec. 6, 2011), 76 FR 77287 (Dec. 12, 2011). A non-substantive correction to the notice of the proposed rule change was published on December 14, 2011. See Securities Exchange Act Release No. 65899A (Dec. 12, 2011), 76 FR 77865 (Dec. 14, 2011).

⁴ Securities Exchange Act Release No. 66124 (Jan. 10, 2012), 77 FR 2103 (Jan. 13, 2012).

⁵ Letter from Christopher Killian, Managing Director, Securities Industry and Financial Markets Association (Dec. 19, 2011).

modifications necessitated the MBSD to draft a new rulebook, which is also part of this rule filing.⁶

A. MBSD Rulebook Changes

As noted above, the current MBSD rulebook will be replaced in its entirety by a new proposed rulebook that incorporates parts of the current MBSD rulebook where appropriate. Set forth below is an overview of the significant substantive and structural changes to the rules.

1. Definitions

The MBSD rules will have a revised Rule 1, “Definitions,” which will include terminology applicable to new MBSD processing and procedures. For example, terms relevant to pool netting have been included (such as “pool deliver obligation” and “pool receive obligation”). Where practical and/or applicable, the MBSD rulebook uses terms from the current GSD rules, in order to harmonize language between the Divisions.

2. Membership

Rule 2, “Members,” Rule 2A, “Initial Membership Requirements,” Rule 3, “Ongoing Membership Requirements,” and Rule 3A, “Cash Settling Bank Members,” govern membership types, member application requirements, and ongoing reporting requirements.

i. *Membership Categories*

The new MBSD rules will provide for two membership types (as set forth in Rule 2): Clearing Members and Cash Settling Bank Members. Those entities qualifying for clearing membership will be guaranteed service members of the MBSD – trades submitted by these

⁶ Certain provisions in the current MBSD rulebook that reflect processes that will continue unchanged after introduction of the CCP services are retained in the proposed MBSD rulebook. In order to promote uniformity between FICC’s two divisions and to increase transparency for common members, the new MBSD rulebook follows the structure of the Government Securities Division rulebook and, where appropriate, the language of equivalent provisions mirror each other.

members will be guaranteed at the point of comparison, and eligible, as applicable, for pool comparison, netting, and settlement. Clearing membership categories include: (i) registered brokers or dealers; (ii) other registered clearing agencies; (iii) registered investment companies; (iv) banks⁷; (v) government securities issuers/government sponsored enterprises; (vi) insurance companies;⁸ and (vii) unregistered investment pools (“UIPs”).⁹ In addition, the MBSD will have the discretion to make its services available to other entity types which it deems appropriate subject to the approval of the Commission. Membership requirements for Cash Settling Bank Members are set forth in Rule 3A, “Cash Settling Bank Members.” These requirements remain unchanged from the current MBSD rulebook and they mirror the requirements of the GSD-equivalent members.

ii. *Initial Membership Requirements*

The initial membership requirement for the MBSD members mirrors the current requirements for the GSD netting membership where there is an existing identical membership type in the GSD rules. The two membership categories where there are no GSD equivalents are registered investment companies and UIPs. In addition to standard requirements regarding financial and operational responsibility applicable to all Clearing Members, registered investment companies must be registered under the Investment Company Act of 1940 and have

⁷ The term “Banks” includes Federal Savings Associations.

⁸ The MBSD does not currently have any insurance company Clearing Members. Financial and other membership requirements for this category may be established in a future rule filing.

⁹ The MBSD currently has two members that do not fit into any of the new listed membership types. These entities remain members of the MBSD under Article III, Rule 1, Section (1)(f) of the MBSD rules and remain subject to the MBSD rulebook and all ongoing membership requirements.

minimum net assets of \$100 million. In addition to standard requirements regarding financial and operational responsibility applicable to all Clearing Members, UIPs must:

- have an investment advisor domiciled in the United States and registered with the Commission under the Investment Advisors Act of 1940; and
- the UIP must have (i) \$250 million in net assets, or (ii) \$100 million in net assets and the UIP's investment advisor must advise an existing UIP Clearing Member that has assets under management of \$1.5 billion.

iii. *Ongoing Membership Requirements*

Required membership levels must be maintained by all members on an ongoing basis as a condition of membership. Current provisions applicable to the GSD netting membership under the GSD rules have been incorporated to the MBSD rules to apply to certain member types. For example, the GSD currently assesses a premium against any member whose Clearing Fund requirement exceeds its specified regulatory capital figure.¹⁰ The MBSD will also apply this premium to members. Also, bank, broker-dealer, and UIP members of the MBSD will be rated. Among other things, financial measures relevant to these types of entities will be assessed. Any member that receives a poor rating may be monitored more closely and/or placed on FICC's internal watch list.

¹⁰ By way of example, under the current GSD rules, if a member has a Clearing Fund requirement of \$11.4 million and excess net capital of \$10 million, its "ratio" is 1.14 (or 114 percent), and the applicable collateral premium would be 114 percent of \$1.4 million (which is equal to the amount by which the member's Clearing Fund requirement exceeds its excess net capital), or \$1,596,000. The current GSD rules provide that FICC has the right to: (i) apply a lesser collateral premium (including no premium) based on specific circumstances (such as a member being subject to an unexpected haircut or capital charge that does not fundamentally change its risk profile), and (ii) return all or a portion of the collateral premium amount if it believes that the member's risk profile does not require the maintenance of that amount. These rights will be carried over to the proposed MBSD rules.

The MBSD will take additional risk management measures with respect to UIP members. Specifically, the “value at risk” (“VaR”) confidence level for UIP members will be set at 99.5%, half a percentage higher than the confidence level used for a VaR calculation for non-UIP Clearing Members.¹¹ UIP members also are required to achieve a qualitative assessment rating of at least “medium” as part of the initial membership requirement. Qualitative assessments will be based on such factors as management, capital, strategy and risk profile, valuation procedures, and internal risk management controls. Current UIP members that become rated less than “medium” may be subject to increased Required Fund Deposits and may also become subject to revocation of membership. Finally, the Clearing Fund requirement of UIPs shall be no less than \$1 million.¹²

3. Clearing Fund and Loss Allocation

The conversion of the MBSD to a CCP increases the amount of risk for the clearing agency. The CCP assumes the counterparty credit risk of the other Clearing Members which primarily includes: (1) the market risk associated with liquidating the defaulted Member's portfolio, and (2) the liquidity risk associated with maintaining sufficient liquid resources to finance the defaulted Clearing Member's scheduled settlement obligations. FICC believes that

¹¹ The MBSD rules will provide FICC with the discretion to increase the confidence level for UIP and non-UIP Clearing Members if it determines that it is appropriate to do so with respect to a particular Clearing Member or Clearing Members generally. The MBSD rules will require Clearing Fund requirements to each Clearing Member within each membership type to be applied on a consistent and non-discriminatory basis. See MBSD Proposed Rule 4 (Clearing Fund and Loss Allocation), Section 2(c).

¹² The MBSD rules will provide FICC with the discretion to increase the minimum charge if it determines that it is appropriate to do so with respect to a particular Clearing Member or Clearing Members generally. The MBSD rules will require Clearing Fund requirements to each Clearing Member within each membership type to be applied on a consistent and non-discriminatory basis. See MBSD Proposed Rule 4 (Clearing Fund and Loss Allocation), Section 2(c).

the MBSD has established a robust risk management framework to manage the credit risks from its Clearing Members and the credit and liquidity risks involved with its payment, clearing, and settlement process.

The MBSD relies on many different controls to manage its counterparty risk. These controls include: (i) membership standards, (ii) initial and variation margins, (iii) back and stress testing, (iv) position and risk monitoring, and (v) non-margin collateral. The first set of controls aims to prevent the CCP from conducting business with counterparties that have unacceptably high probabilities of default. As noted above, concurrent with the introduction of CCP services, the MBSD will increase its minimum financial standard for clearing membership eligibility to mirror GSD eligibility standards and enhance its risk monitoring for UIPs.

The second line of defense is the margins collected from counterparties in the form of cash and highly liquid government securities in the Clearing Fund. The dual purpose of the Clearing Fund is to provide readily accessible liquidity to facilitate settlement and reduce loss-related costs which may be incurred in the event of a Clearing Member's insolvency or failure to fulfill its contractual obligations to the MBSD. Margins are intended to cover possible losses between the time of default of a counterparty, at which point the CCP would inherit its positions, and the close-out of these positions through selling or hedging. For this purpose, the MBSD marks Clearing Member portfolios to the market on a daily basis and charges variation margins accordingly, and establishes initial margins to cover a minimum 99th percentile of expected possible losses that could arise over a 3-day settlement period utilizing a VaR-based approach.¹³

In order to further enhance the MBSD's risk framework, the MBSD will add two components - the margin requirement differential and the coverage charge - to the Clearing

¹³ An index-based haircut methodology will be used for securities with insufficient pricing data.

Fund, as well as additional MBSD mark-to-market items related to the new pool netting services. The MBSD also has the ability to collect charges above the systemically generated Clearing Fund charges when it deems it appropriate in order to protect FICC and its Clearing Members. If any loss were incurred in the liquidation of a Clearing Member that was not covered by the Clearing Member's Clearing Fund deposit or amounts available under the cross-guaranty arrangement to which FICC is a party, the MBSD would invoke its loss allocation process.

The MBSD uses regular back and stress testing to monitor the sufficiency of collected margin levels vis-a-vis the risk represented by the 99th percentile of expected possible losses from Clearing Member portfolios and to monitor its tail risk exposure that is beyond the 99th percentile. If a Clearing Member portfolio does not pass a back test, additional margin will be collected via the coverage charge. Stress tests are also used to evaluate margin adequacy. The MBSD's framework reflects stress events from the last 10 years as well as special stress events outside of the past 10 years and takes the form of swap rate shifts and credit spread shocks that reflect market conditions for the instruments that the MBSD clears or holds as collateral. As described more fully below, the MBSD analyzes and reviews on an intraday basis certain components of the Clearing Fund that are recalculated using updated positions and prices if there is increased exposure in a Clearing Member's portfolio intraday. In addition, the MBSD may at its discretion call for additional collateral on an intraday basis if exposures are in excess of predefined thresholds.

Finally, aside from the risk of loss that could be encountered from a Clearing Member failure, a central counterparty could also face liquidity risk, defined as the risk that the central counterparty has insufficient financial resources to cover a default by a Clearing Member to which it has the largest exposure. To that end, the MBSD maintains sufficient resources to meet

its observed liquidity risk. The Clearing Fund would be the primary source to fulfill the liquidity need incurred if MBSD had to complete settlement on behalf of the defaulting Clearing Member. Other conventional funding tools such as loans secured via the MBSD clearing banks and/or tri-party repo transactions would also be used to fulfill the liquidity need, but if those were unavailable or insufficient, the MBSD would invoke the “Capped Contingency Liquidity Facility,” as described below, to provide additional financing in the event of a Clearing Member default.

Tail risk is one of the risks the MBSD has to manage. The MBSD addresses this risk through a continuous process of: (1) reviewing margin methodologies with stakeholders; (2) analyzing and monitoring margin and collateral requirements; (3) actively reviewing and timely acting on market conditions and credit events; (4) reviewing back and stress tests, and (5) identifying, assessing, and managing risks associated with the products and services provided by the MBSD and FICC.

i. *Clearing Fund*

The underlying Clearing Fund methodology is designed primarily to account for market risks associated with a Clearing Member’s unsettled portfolio. The Clearing Fund model is back tested on a monthly basis and periodically validated by outside experts. Additional charges and premiums may be considered to address additional risks (i.e., credit, reputation, and legal) or non-compliance with the MBSD rules. The Clearing Fund is calculated every business day for each MBSD Clearing Member.

Clearing Fund requirements will be calculated in accordance with the VaR model. The Clearing Fund components will consist of the VaR charge,¹⁴ the coverage charge, the margin requirement differential charge, and the deterministic components charge (which will include the mark-to-market charges, cash obligation items, and accrued principal and interest). The VaR methodology will utilize the prior 252 days of historical information for cash positions, including prices, spreads, and market variables to simulate the market environments in the forthcoming three days. Projected portfolio losses are then calculated assuming these simulated environments actually will be realized. The coverage charge is an additional charge to bring the Clearing Member's coverage to a targeted confidence level. The margin requirement differential considers intra-day portfolio variations and estimates the potential increased risk intra-day and the risk that the next margin call will not be satisfied. The deterministic risk component combines the mark-to-market of the portfolio, gain or loss for the difference between the original contract value and the internally generated netting price derived from the to-be-announced netting process, principal and interest adjustments on failed positions, and other miscellaneous cash items. The deterministic risk component can result in an increase or decrease to a member's total clearing fund requirement.

In order to further mitigate risk, and as part of FICC's efforts to enhance its intraday monitoring capabilities, FICC has determined to expand its intraday monitoring to recalculate the mark-to-market elements of the deterministic risk component. This component of the risk calculations will be updated at least hourly using intraday pricing and position feeds for FICC

¹⁴ The definition of "VaR Charge" (which is referred to as "VaR Component" in the current rules) is being amended to remove the reference to the application of "minimum amounts" to such VaR Charge. The MBSB is currently applying a minimum 5-basis point charge which will not be applicable when the MBSB CCP becomes a CCP because of the addition of the other components to the overall Clearing Fund calculation. Minimum Clearing Fund deposit amounts per Rule 4 remain applicable.

members and compared against the amounts that were previously collected in the Clearing Fund. If the exposures increase above certain defined thresholds, Risk Management staff will be alerted to consider additional intraday margin calls outside of the formal Clearing Fund collection process. These intraday margin calls would need to be satisfied by the affected members within one hour of FICC's notice. The initial thresholds will be based on changes to a Clearing Member's position size, composition, and price changes on the constituent securities. Qualitative factors including, but not limited to, Watch List status and internal rating will also be considered in the application of intraday mark-to-market.

ii. *Use of Payments and Deposits*

FICC is providing additional disclosure relating to its use of a Clearing Member's deposits and payments to the Clearing Fund for temporary financing needs. The rulebook also clarifies that whenever the Clearing Fund is charged for any reason, other than to satisfy a clearing loss attributable to a Clearing Member solely from that Clearing Member's Clearing Fund deposit, FICC will provide the reasons therefore to each Clearing Member.¹⁵

iii. *Loss Allocation*

FICC is introducing a new loss allocation methodology for the MBSD. If a defaulting Clearing Member's Clearing Fund and any amounts of the defaulting member available under a cross-guaranty agreement are not sufficient to cover losses incurred in the liquidation of the defaulting Clearing Member's positions ("Remaining Losses"), the MBSD's loss allocation methodology will be invoked. Under this proposed loss allocation methodology, Remaining Losses will first be allocated to the retained earnings of FICC attributable to the MBSD, in the amount of up to 25 percent of the retained earnings or such higher amount as may be approved

¹⁵ The Clearing Fund is "charged" when FICC has applied the Clearing Fund for more than 30 days and is allocating the amount as a loss or for other loss allocation purposes.

by the Board of Directors of FICC. If a loss still remains, MBSD Clearing Members are placed into one of two tiers for loss allocation purposes: Tier One members are subject to loss mutualization, whereas Tier Two members are not subject to loss mutualization.¹⁶ FICC will divide the Remaining Losses between the Tier One members and Tier Two members. The division of Remaining Losses is based on the amount each solvent Clearing Member would have lost or gained if it had closed out its original outstanding trades with the defaulting Clearing Member on a bilateral basis.¹⁷ FICC then will determine the relevant share of each Tier One member's bilateral losses (members with a bilateral liquidation profit are ignored) in the total of all Clearing Members' bilateral losses and sum these shares to determine the Tier One Remaining Loss. Similarly, FICC will determine the relative share of each Tier Two member's bilateral loss in the total of all Clearing Members' bilateral losses and sum these shares to determine the Tier Two Remaining Loss.

Tier One Remaining Losses will be allocated to Tier One members first by assessing the Required Fund Deposit of each such Member in the amount of up to \$50,000 equally. If a loss remains, Tier One members will be assessed ratably, in accordance with the respective amounts of their Required Fund Deposits, based on the average daily amount of the Clearing Member's Required Fund Deposit over the prior twelve months. Tier Two Remaining Loss will be allocated to Tier Two Clearing Members based on each Tier Two member's original trading activity with the Defaulting Member that resulted in a loss. Tier Two members will only be

¹⁶ Tier Two members are those that are legally prohibited from participating in loss mutualization. Currently, only Registered Investment Companies qualify as Tier Two members.

¹⁷ Brokered trades are done on a "give-up basis," and brokers are thus not considered parties to fully-matched trades. However, for purposes of loss allocation, broker members will be subject to loss allocation for certain partially-matched trades. Brokers are considered Tier One members, and as such will be subject to loss mutualization.

subject to loss to the extent they originally traded with the Defaulting Member consistent with regulatory requirements applicable to the Tier Two members. FICC shall assess such loss against the Tier Two members ratably based upon their loss as a percentage of the entire amount of the Tier Two Remaining Loss. Tier Two counterparties will be liable for losses related to both direct and brokered trades¹⁸ including partially-matched trades for which the Tier Two member did not submit a statement to FICC denying the existence of the trade.¹⁹

¹⁸ Brokered trades involve a broker intermediary between two dealers. Each dealer and broker must submit the trade details to the MBSD for trade comparison. This means that each dealer submits against the broker and the broker submits against each dealer. A fully matched trade will be achieved when both dealers match against the broker (i.e. all submissions discussed above match). With a fully matched trade, both dealers assume principal status, which results in the broker having no settlement obligations with respect to the trade; the broker cannot be subject to any loss with respect to such trade. A partially matched trade results when only one of the two submissions achieves a bilateral match versus the broker. The dealer who has matched with the broker will have a settlement guarantee and is subject to Clearing Fund requirements with respect to such trade. If the unmatched dealer submits a statement to FICC denying the existence of the trade, the broker becomes responsible for such trade from a risk management perspective and loss allocation. If the unmatched dealer does not submit a statement to FICC denying the existence of the trade, the dealer becomes responsible for the settlement and risk management and the broker is released from these responsibilities.

¹⁹ To illustrate the proposed MBSD Tier One (“T1”) /Tier 2 (“T2”) loss allocation rules, consider an example where the \$20 million Clearing Fund requirement of an insolvent MBSD member X turns out to be insufficient to cover the \$30 million liquidation loss that the MBSD incurred as a result of closing out all of X’s open positions. If X doesn’t have any excess collateral, MBSD would need to allocate a \$10 million remaining loss.

Assume that X has unsettled trades with three Tier One original counterparties (T1A, T1B and T1C) and three Tier Two original counterparties (T2A, T2B and T2C), all executed directly. Further assume that the bilateral liquidation results of X’s solvent original counterparties are as follows: T1A: \$5 million; T1B: (\$5 million); T1C: (\$15 million); T2A: (\$20 million); T2B: (\$10 million); T2C: \$15 million; Total: (\$30 million). Also assume that there are no secondary defaults and no off-the-market trades.

Based on these assumptions, the bilateral Tier One liquidation losses amount to \$20 million (\$5 million attributable to T1B and \$15 million attributable to T1C), while the bilateral Tier Two liquidation losses amount to \$30 million (\$20 million attributable to T2A and \$10 million attributable to T2B). This means that out of a total of \$50 million bilateral liquidation losses, 40% or \$20 million can be attributed to Tier One counterparties and 60% or \$30 million to Tier Two counterparties. As a result, the Tier One remaining loss would be \$4 million (i.e.,

4. Trade Processing

Under the proposed MBSD rules, each Clearing Member will be required to submit to the MBSD for processing transactions with other Clearing Members in all securities that are netting-eligible according to MBSD rules and procedures.²⁰ Eligible transactions will be submitted to FICC's Real-Time Trade Manager ("RTTM") system for matching purposes.²¹ FICC will

40% of the MBSD's \$10 million overall remaining loss) and the Tier Two remaining loss would be \$6 million (i.e., 60% of the MBSD's \$10 million overall remaining loss). Given that T2A's and T2B's bilateral losses represent 2/3 and 1/3 respectively of the Tier Two Remaining Loss, T2A's loss allocation will be \$4 million and T2B's loss allocation will be \$2 million.

The \$4 million Tier One Remaining Loss would first be assessed equally to each Tier One member's clearing fund, up to an amount of \$50,000 per Tier One member. If a loss still remains, the amount is allocated among Tier One members, pro-rata based on each Tier One member's average daily level of clearing fund over the prior twelve months (or shorter period if a member did not maintain a clearing fund deposit over the full twelve month period).

The loss allocation results are not impacted by whether the defaulting Clearing Member is a Tier One or a Tier Two member.

²⁰ Currently, the MBSD recognizes two types of trades: (i) "to be announced" ("TBA") trades and (ii) specified pool trades ("SPTs"). A TBA is a contract for the purchase or sale of agency mortgage-backed securities to be delivered at an agreed-upon future date; however, the actual pool identities and/or the number of pools that will be delivered to fulfill the trade obligation or terms of the contract are unknown at the time of the trade. TBA trades may proceed through the Settlement Balance Order engine for netting or may settle on a trade-for-trade basis ("TFTD"). In an SPT contract, required pool data, including the pool number to be delivered on settlement date, is specified at the time of execution.

Clearing Members may use FICC's Interactive Submission Method, Multiple Batch Submission Method, or Single Batch Submission Method to submit trade data to the MBSD.

²¹ Trade data submitted to the MBSD must include such identifying information as the MBSD may require and must be submitted in the form and manner and in accordance with the time schedules prescribed by the MBSD rules or otherwise set forth by FICC from time to time. The symbol corresponding to the name of a Clearing Member that is printed, stamped, or written on any form, document, or other item issued by the Clearing Member pursuant to Rule 5 Section 2 shall be deemed to have been adopted by the Clearing Member as its signature and shall be valid and binding upon the Clearing Member in all respects as though it had manually affixed its signature to such form document or other item.

provide a trade guarantee for all existing types of trades upon comparison of trade details submitted by members.²²

Additionally, the MBSD will introduce “pool comparison” and “pool netting” and interpose itself as settlement counterparty to certain settlement obligations. Specifically, after the netting of TBA transactions, settlement obligations will be issued between Clearing Members and Clearing Members will allocate pools for settlement through the MBSD’s Electronic Pool Notification (“EPN”) Service.²³ Clearing Members then will submit pool details for those netted TBA settlement obligations through the RTTM system for pool comparison and for consideration for pool netting.²⁴ Upon FICC’s issuance of pool netting results to Clearing Members, those pools that are netted will be novated; i.e., settlement obligations between the Clearing Members will be replaced with settlement obligations between each Clearing Member and FICC. For all other transactions, settlement will occur outside of FICC between the original

²² Comparison is deemed to occur at the point at which the MBSD makes available to both of the counterparties an output indicating that the trade data has been compared. FICC generates the output indicating that a trade is compared contemporaneous with successful comparison of the trade data in FICC’s RTTM system.

²³ Because Clearing Members will be required to allocate pools via EPN and RTTM in order for pool allocations to proceed to pool comparison and netting, all MBSD Clearing Members will be required to be EPN members.

²⁴ Not every compared pool will be included in the pool netting system. FICC will determine which guaranteed trades would receive maximum benefit from pool netting by considering such factors as trading velocity and projected netting factor. SPTs are not eligible for pool netting under this proposal.

Pool allocation information (“Pool Instructs”) may be submitted up to the point that pool netting is executed. Pool Instructs must bilaterally compare (i.e., mandatory comparison pool data submitted by the seller must match the mandatory comparison pool data submitted by the buyer) in order for the Pool Instructs to be eligible for consideration for pool netting. Pool Instructs must also be assigned by the MBSD to a valid, open TBA position, meaning that the trade terms submitted on the Pool Instructs must match the trade terms of a TBA CUSIP that has a sufficient open position. Only compared and assigned Pool Instructs will be evaluated for inclusion in pool netting.

settlement counterparties and must be reported to FICC through a Notification of Settlement (“NOS”).²⁵ Obligations that fail to settle will not be re-netted, as they are in the GSD.²⁶

5. Settlement

i. *Settlement with FICC as Counterparty*

As stated above, obligations generated by the pool netting system will settle versus FICC. Clearing Members will be required to designate a clearing bank for purposes of delivering securities to, and receiving securities from, the MBSD in satisfaction of settlement obligations. All deliveries and receipts of securities in satisfaction of pool deliver obligations and pool receive obligations will be required to be made against simultaneous payment. These securities settlement procedures mirror the current GSD securities settlement rule.

ii. *Settlement Outside of FICC*

Clearing Members will be required to settle trades ineligible for pool netting and allocated pools that are not processed through the pool netting system bilaterally with applicable settlement counterparties outside of FICC. As noted above, these trades remain guaranteed for settlement by FICC but are not novated. The settlement obligations between the Clearing Members are not replaced with settlement obligations between each Clearing Member and FICC. Clearing Members must submit to FICC NOSs on the applicable clearance date for each transaction. When the MBSD receives an NOS from each counterparty to a transaction, the MBSD will report clearance of the applicable transaction back to each Clearing Member. At this

²⁵ These obligations include: (i) SPTs, which are ineligible for pool netting; (ii) transactions for which Clearing Members do not submit allocation information for pool netting; and (iii) transactions with incomplete pool information on file.

²⁶ The MBSD retains the discretion to re-net fails or to conduct pair-offs if it believes that such actions are necessary to protect itself or its Clearing Members due to market conditions or events.

point, the MBSD will stop collecting margin on the transaction and will no longer be responsible for principal and interest payments.

iii. *Cash Settlement*

Several items have been added to the calculation of each Clearing Member's cash settlement obligation, including: (a) a "net pool transaction adjustment payment" (to reflect the difference between the pool net price²⁷ and a settlement price established at the TBA level); (b) principal and interest payment amounts related to fails; and (c) a "clearance difference amount"²⁸ (to take into account the delivery to FICC of mispriced securities by a Clearing Member).

6. Capped Contingency Liquidity Facility

FICC is adding a provision to the MBSD rulebook that introduces a "Capped Contingency Liquidity Facility," which is a procedure designed to ensure that the MBSD has sufficient liquidity resources to cover the largest failure of a family of accounts. This facility will only be invoked if FICC declares a default or a "cease to act" against a Clearing Member and FICC does not have the ability to obtain sufficient liquidity through its Clearing Fund cash deposits and its established repurchase agreement arrangements ("CCLF Event"). FICC believes that the Capped Contingency Liquidity Facility provides Clearing Members with finality of settlement and allows firms to prepare for and manage their potential financing requirements in the event of a Clearing Member's default. Once a CCLF Event has been declared, FICC will contact Clearing Members that are due to deliver obligations to FICC that are owed to a defaulting Clearing Member. FICC will either cancel the Clearing Member's obligations or

²⁷ "Pool Net Price" is defined as the uniform price for a pool (expressed in dollars per unit of par value), not including accrued interest, established by FICC on each business day, based on current market information for each eligible security.

²⁸ "Clearance Difference Amount" is defined as the absolute value of the dollar difference between the settlement value of a pool deliver obligation or a pool receive obligation and the actual value at which such pool deliver obligation or pool receive obligation was settled.

instruct the Clearing Member to hold the obligations (or a portion thereof) and await instructions as to when to make these deliveries. With respect to the obligations subject to financing (“Financing Amount”) up to the Clearing Member’s defined liquidity contribution cap (“Defined Capped Liquidity Amount”),²⁹ FICC as counterparty, will enter into repurchase agreements with the Clearing Member equal to the Financing Amount pursuant to the terms of the deemed 1996 SIFMA Master Repurchase Agreement (without referenced annexes). If a liquidity need still exists (“Remaining Financing Amount”), FICC will inform Clearing Members that are below the Defined Capped Liquidity Amount and also inform Clearing Members that do

²⁹ The “Defined Capped Liquidity Amount” is the maximum amount that a Clearing Member shall be required to fund during a CCLF Event. The Defined Capped Liquidity Amount will be established as follows:

(a) For those Clearing Members that are eligible for and that have established borrowing privileges at the Federal Reserve Discount Window or for those Clearing Members who have an affiliate that is eligible for and has established borrowing privileges at the Federal Reserve Discount Window, FICC will conduct a study every six months, or such other time period as FICC shall determine from time to time as specified in Important Notices to Clearing Members, to determine each Clearing Member's largest liquidity requirement for the applicable time period based on a Clearing Member’s sell positions versus other Clearing Members at the family level on a bilateral net basis within a TBA CUSIP. Based on the overall study, FICC will define an adjustable percentage (the initial percentage will be set at 60%), as determined by FICC from time to time, and multiply that percentage amount against the maximum amount to establish each Clearing Member’s Defined Capped Liquidity Amount; and

(b) For those Clearing Members that are ineligible for or have not established borrowing privileges at the Federal Reserve Discount Window and for those Clearing Members that do not have an affiliate that is eligible for or has established borrowing privileges at the Federal Reserve Discount Window, FICC will conduct a study every month or such other time period as FICC shall determine from time to time as specified in Important Notices to Clearing Members, to determine each Clearing Member's largest liquidity requirement for the applicable time period based on a Clearing Member’s sell positions versus other Clearing Members at the family level on a bilateral net basis within a TBA CUSIP. The Clearing Member's largest liquidity requirement for the past month, adjusted in each case of a CCLF Event to be no greater than the actual pool delivery obligation to the defaulting Clearing Member, will represent the Clearing Member's Defined Capped Liquidity Amount. Clearing Members in this category will have a defined non-adjustable percentage amount set to 100%. Clearing Members in this category will not be required to finance any Remaining Financing Amount.

(c)

not have a delivery obligation to the defaulting Clearing Member.³⁰ After these Clearing Members have been notified, FICC will distribute the remaining financing need to such Clearing Members on a pro rata basis and enter into repurchase agreements pursuant to the terms of the deemed 1996 SIFMA Master Repurchase Agreement (without referenced annexes). These transactions would remain open until FICC completes the liquidation of the underlying obligations and a haircut based on market conditions will be applied to the transactions.

Once FICC completes the liquidation of the underlying obligation, FICC will instruct the Clearing Member to deliver the securities back to FICC. FICC will then close the repurchase transaction and deliver the securities to complete settlement on the contractual settlement date of the liquidating trade. Because FICC would be receiving and delivering securities on the same day, FICC would not have a liquidity need resulting from the transaction of a defaulting Clearing Member.

7. Corporation Default

FICC is adding provisions to the MBSD rulebook to make explicit the close-out netting of obligations running between FICC and its Clearing Members in the event that FICC becomes insolvent or defaults in its obligations to its Clearing Members. FICC represents that its Clearing Members have stated that the proposed rule changes will provide clarity in their application of balance sheet netting to their positions with FICC under U.S. GAAP in accordance with the criteria specified in the Financial Accounting Standards Board's Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts (FIN 39). The firms have stated further that the provisions would allow them to comply with Basel Accord Standards relating to netting.

³⁰ Applicable to those Clearing Members that are eligible for and that have established borrowing privileges at the Federal Reserve Discount Window or to those Clearing Members who have an affiliate that is eligible for and has established borrowing privileges at the Federal Reserve Discount Window.

Specifically, firms are able to calculate their capital requirements on the basis of their net credit exposure where they have legally enforceable netting arrangements with their counterparties, which includes a close-out netting provision in the event of the default of the counterparty (in this case, the division of the clearing corporation acting as a central counterparty).

8. Fails Charge

To encourage market participants to resolve fails promptly, FICC is applying a fails charge recommended by the Treasury Market Practices Group (“TMPG”) that expands the applicability of the fails charge to settlement of pools versus FICC involving failing agency MBS issued or guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae.³¹ A fails charge will not apply to TBA and pool level “round robins.”³² FICC believes that the fails charge will reduce the incidence of delivery failures and supporting liquidity in these markets.

The proposed charge will be equal to the greater of (a) 0 percent and (b) 2 percent per annum minus the federal funds target rate. The charge accrues each calendar day a fail is outstanding. The MBSD will not impose a fails charge if delivery occurs on either of the two business days following the contractual settlement date. The MBSD will not employ a minimum

³¹ TMPG is a group of market participants active in the Treasury securities market and sponsored by the Federal Reserve Bank of New York. The Commission has approved similar rule proposals at the GSD. See Securities Exchange Act Release No. 59802 (Apr. 20, 2009), 74 FR 19248 (Apr. 28, 2009) and Securities Exchange Act Release No. 65910 (Dec. 8, 2011), 76 FR 77861 (Dec. 14, 2011) (expanding applicability of the fails charge to Agency debt securities transactions).

³² “Round robins” are a circular series of transactions between multiple parties where there is no ultimate long and short position to be settled. For example, if A sells to B and B sells to C and C sells to A, this group of transactions constitutes a round robin. In a round robin, there is no settlement of securities, but there is satisfaction of money across all interested parties. There can be a fail in a round robin transaction when a deliver obligation arises because the trade submission of certain members of the round robin do not match. The MBSD will not apply the fails charge to a round robin if each affected Clearing Member in the round robin provides the MBSD with the required information to resolve the trade.

fail charge amount, but, instead, will apply the fails charge to any pool for which delivery has not occurred within the two business day grace period.³³ Each business day, the MBSD will provide reports reflecting fail charge amounts to Clearing Members and will generate a consolidated monthly report at month end. Failing parties with a net debit (i.e., the fails charge amounts such party owes exceed the fails charge amounts it is owed) will be required to pay such net amount in respect of those pools that have settled the previous month and that are reflected in the previous month's consolidated month end report by the Class "B" payable date (as established by SIFMA guidelines) of the month following settlement in conjunction with other cash movements. The fails charge funds received by the MBSD then will be used to pay Clearing Members with fail net credits.

The MBSD will implement a rate change procedure so that if fails accrue at one rate and the rate changes, the fail will keep the original accrual and new fails calculations will be subject to the new rate. When there is a substitution of the underlying pool, the fails charge will be calculated pursuant to the above formula, using (in the formula) the federal funds target rate for each day of the substitution period beginning on the contractual settlement date.

In the event that the MBSD is the failing party because (i) the MBSD received Agency MBS issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae too late to make redelivery or for any other reason or (ii) MBSD received a substitution of a pool deliver obligation of agency MBS issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae too

³³ FICC is not establishing a minimum charge because the MBSD, as counterparty in multiple transactions, may owe a net credit to one counterparty that is financed by multiple small net debits owed to it by multiple counterparties. The lack of a threshold minimum charge deviates from the TMPG recommendation of a \$500 threshold. FICC notified Clearing Members of this deviation in an Important Notice (MBS 119.11) and received no objection.

late for same day redelivery of securities or for any other reason, the fails charge will be distributed pro-rata to the Clearing Members based upon usage of the MBSD's services.

The MBSD will not guarantee fails charge proceeds in the event of a default (i.e., if a defaulting Clearing Member does not pay its fail charge, Clearing Members due to receive fails charge proceeds will have those proceeds reduced pro-rata by the defaulting Clearing Member's unpaid amount). Failure by a Clearing Member to meet its obligations in connection with a fails charge may be a violation of the MBSD rules that is subject to disciplinary actions consistent with the MBSD rule book. FICC's Board of Directors (or appropriate Committee thereof) will retain the right to revoke application of the charges if industry events or practices warrant such revocation. The fails charges will apply to applicable transactions entered into on or after the date of this order, as well as to transactions that were entered into, but remain unsettled as of the date of this order. For transactions entered into prior to, and unsettled as of, the date of this order, the fails charge will begin accruing on the later of the date of this order or the contractual settlement date. The following are examples of fails scenarios and the applicable fails charge in each scenario:

Example 1: A delivery is contracted to occur on settlement date (S), a Tuesday, but does not occur until the second business day following contractual settlement, Thursday (S+2). The Clearing Member would not be subject to a fails charge because delivery occurs within the two business days following the contractual settlement date.

Example 2: A delivery is contracted to occur on settlement date (S), a Tuesday, but does not occur until the third business day following contractual settlement, Friday (S+3). The Clearing Member would be subject to a three-day fails charge.

Example 3: A delivery is contracted to occur on settlement date (S), a Wednesday, but does not occur until the third business day following contractual settlement, Monday (S+3). The Clearing Member would be subject to a five-day fails charge, as the charge accrues on each calendar day in the fail period.

Example 4: A delivery is contracted to occur on settlement date (S), May 10th, but does not occur until the month following the contractual settlement date; it settles on June 8th. The Clearing Member will not be subject to collection of the fails charge in June (the month following the contractual settlement date) because delivery did not occur in May. The participant will be subject to the collection of the fails charge in July (on the Class "B" payable date) because delivery occurred in June. The charge will be recalculated for 29 days.

9. Suspension of Rules in Emergency Circumstances

The MBSD rule regarding suspension of its rules in emergency situations is being revised to specify that: (i) the rule applies to emergency circumstances; (ii) an emergency shall exist in the judgement of the FICC Board or a FICC Officer, which causes the Board or the FICC Officer, as applicable, to believe that an extension, waiver, or suspension of the MBSD rules is necessary for FICC to continue to facilitate the prompt and accurate clearance and settlement of securities transactions; (iii) FICC shall notify the Commission of such extension, waiver, or suspension of the MBSD rules within 2 hours of such determination;³⁴ (iv) the written report of such extension shall include the nature of the emergency, along with the other requirements listed in the current rules; (v) such written report shall be submitted to the Commission no later

³⁴ But no later than one hour before the close of the Federal Reserve Banks' Fedwire Funds Service if such determination relates to the extension of time for settlement and is made on a settlement day.

than three calendar days after the implementation of the extension, waiver, or suspension of the MBSD rules; and (vi) any suspension shall not last for more than thirty calendar days from the date of the event or events giving rise to the suspension unless the MBSD submits a proposed rule change to the Commission seeking approval of a further extension.

10. Ceasing to Act, Wind-Down Members, and Insolvency

The MBSD's rules regarding restrictions on access to services, ceasing to act, winding-down Clearing Members, and Clearing Member mirror the current GSD rules, conformed to apply to the specifics of MBSD processing as applicable. For example, upon the MBSD ceasing to act for a Clearing Member, Clearing Members will be required to submit immediate NOS so that the MBSD has all necessary settlement information with respect to a defaulting Clearing Member to affect a close-out of such Clearing Member. In addition, the MBSD will have the right, with respect to specified pool trades, to substitute alternate pools as necessary.³⁵

11. DTCC Audit Committee

While FICC MBSD does not have a rule and it is not adding a rule to require an audit committee, FICC is governed by the DTCC Audit Committee and such Committee could not be dismantled without a proposed rule change filed with the Commission.

12. Summary of Other Rule Changes

i. *Current MBSD Rules Not Reflected in Proposed Rulebook*

The following current MBSD rules are not included in the new rulebook:

- With respect to Article III (Participants), in the current MBSD rules: Rule 1, "Requirements Applicable to Participants and Limited Purpose Participants"; Section

³⁵ In the event of a close-out of a defaulting Clearing Member, broker members will be responsible for partially-matched trades for which FICC has received a statement denying the existence of the trade.

- 5, “Supplemental Agreement of Participants and Limited Purpose Participants”; and Section 14 “Special Provisions Applicable to Partnerships” are not included in the proposed MBSD rules because each of these rules is no longer necessary because proposed Rule 2A harmonizes the MBSD rules with the GSD rules on this subject. Rule 1, “Requirements Applicable to Participants and Limited Purpose Participants” Section 15 “Special Provisions Applicable to Non-Domestic Participants” is not included in the proposed MBSD rules because as with the GSD, the MBSD will be using the Netting Agreement for foreign members and not the master agreement format. Proposed Rule 2A, “Initial Membership Requirements,” Section 5, “Member Agreement” covers the provisions of the membership agreement generally and thereby serves to harmonize the proposed MBSD rules with the GSD rules with respect to this subject.
- Rule 3, “Corporation Declines to Act for a Participant or Limited Purpose Participant” Section 2 “Other Grounds for Ceasing to Act for a Participant or Limited Purpose” of the current MBSD rules is not included in the proposed MBSD rules because it is being replaced by proposed MBSD Rule 14 “Restrictions on Access to Services” and Rule 16 “Insolvency of a Member” which cover the same matters and harmonize these provisions with those in the GSD rules.
 - In an effort to harmonize with the GSD rules, Rule 3, “Corporation Declines to Act for a Participant or Limited Purpose Participant” Section 3 is not reflected in the proposed MBSD Rules. FICC does not believe it is necessary to state the current MBSD concept in the proposed MBSD rules because it would apply regardless of whether it is stated in the rules. Rule 3, “Corporation Declines to Act for a Participant

- or Limited Purpose Participant” Sections 5(a) “Disposition of Open Commitments” is not included in the proposed MBSD rules because FICC does not accept Letters of Credit as a permissible form of Clearing Fund collateral as a routine matter; however, FICC reserves the right to accept this type of collateral, if needed. In addition, the current MBSD rule addresses the liquidation of other types of collateral posted by the defaulting Clearing Member. Under the proposed MBSD rule, close-out processes, in general, are covered by Rule 17, which has been drafted to be harmonized with the equivalent GSD Rule to the extent possible. Section 5(c) of the current MBSD Rule 3 in Article III is not reflected in proposed rulebook because it addresses non-defaulting Clearing Members engaging in the close-out of the defaulting Clearing Member’s positions, which will be undertaken by the MBSD as CCP under the proposed rules.
- Under the section titled “Schedule of Charges Broker Account Group” in the appendix to the proposed MBSD rules, FICC no longer provides hardcopy output from microfiche. As a result, the reference to this charge is being removed.

ii. *New MBSD Rules*

The following rules are being added to the MBSD rulebook in connection with this filing and have not been addressed separately above:

- Rule 3, Section 6 “General Continuance Standard” of the proposed MBSD rules includes additional language which states that FICC may require that increased or modified Required Fund Deposits be deposited by the Clearing Member on the same Business Day on which the FICC requests additional assurances from such Clearing Member. FICC has always interpreted the current rules to permit such action; this additional language makes this point explicit.

- Rule 5, “Trade Comparison” Section 1 “General” and Section 3 “Trade Submission Communication Methods” includes disclosure relating to the means by which data may be entered and submitted to FICC. Section 10 “Modification of Trade Data” of this rule allows FICC to unilaterally modify trade data submitted by Clearing Members if FICC becomes aware of any changes to the transaction that invalidates the original terms upon which it was submitted or compared and Rule 12 “Obligations” of Section 10 discusses the point at which trade data becomes a settlement obligation.
- With respect to the computation of cash balances under Rule 11, “Cash Settlement,” FICC has included a new process with respect to fail tracking. Fail tracking is an automated process that takes place when the actual settlement date of a transaction is beyond the contract date. An adjustment is made when one or more beneficiary dates (i.e., certain securities have a record date that does not represent the end of the accrual period and instead the beneficiary date is the actual date the accrual period ends) fall between the contract date and the settlement date. The adjustment results in the payment of funds from the message originator to the message receiver through the Federal Reserve’s National Settlement Service. This eliminates a cumbersome manual process for tracking and clearing adjustments from securities transaction counterparties and it impacts all Fed-eligible mortgage-backed securities, including Freddie Mac, Fannie Mae, and Ginnie Mae.
- With respect to Rule 26, “Financial Reports and Internal Accounting Control Reports”, Section 1 “Financial Reports” has been revised to state that FICC will: (i) prepare its financial statements in accordance with Generally Accepted Accounting

Principles; (ii) make unaudited financial statements for the fourth quarter available to its Clearing Members within 60 days following the close of FICC's calendar year; and (iii) provide a certain level of minimum disclosures in its quarterly financial statements. This rule has also been revised to include Section 2 "Internal Accounting Control Reports," which requires FICC to make internal accounting control reports available to its Clearing Members.

- The proposed MBSD rules also introduce pool netting fees. Below is a description of each fee:
 1. Matched Pool Instruct ("PID") (per side): When a pool instruct is matched resulting from either an instruct or an affirmation (with or without pending status), a matched fee is charged to both sides.
 2. Customer Delivery Request ("CDR") Pool Instruct Fee: When a pool instruct in a matched status is included in the net (vs. FICC) a CDR fee is charged at the instruct PID level to the Clearing Member that submitted the CDR.
 3. Cancel of Matched Pool Instruct: This fee is assessed to the Clearing Member submitting a unilateral cancel on a matched pool instruct.
 4. Pool Obligation: This fee is charged to the net long and short Clearing Member when a Pool Obligation ("POID") is created versus FICC.
 5. Post Net Subs: This fee is charged to the Clearing Member that submits a substitution (the net seller) on a POID vs. FICC.
 6. Clearance of Pool vs. FICC: This is a fee associated with clearing a POID versus FICC.

7. Financing Charges (Financing costs are the costs of carrying positions overnight): For each Clearing Member, a pass-through charge calculated on a percentage of the total of all such costs incurred by FICC, allocated by Agency product.

iii. *Revised MBSD Rules to Harmonize with GSD Rules*

The provisions listed below are revised to harmonize them with similar provisions in the current GSD rules and in some cases updated as appropriate to reflect the mortgage-backed securities market:

- Rule 3 Section 12 (Excess Capital Premium)
- Rule 5 Section 10 (Modification of Trade Data by the Corporation)
- Rule 14 (Restrictions on Access to Services)
- Rule 15 (Wind-Down of a Member)
- Rule 16 (Insolvency of a Member)
- Rule 17 (Procedures For When the Corporation Ceases to Act) (revised for the mortgage-backed securities market)
- Rule 17A (Corporation Default)
- Rule 18 (Charges for Services Rendered)
- Rule 19 (Bills Rendered)
- Rule 26 (Financial Reports and Internal Accounting Control Reports) (revised as explained above)
- Rule 27 (Rule Changes)
- Rule 28 (Hearing Procedures)
- Rule 29 (Governing Law and Captions)
- Rule 30 (Limitations of Liability)
- Rule 31 (General Provisions)
- Rule 32 (Cross-Guaranty Agreements)
- Rule 33 (Suspension of Rules in Emergency Circumstances) (revised as explained above)
- Rule 34 (Action by the Corporation)
- Rule 35 (Notices)

- Rule 20 (Admission to Premises of the Corporation, Powers of Attorney, etc.)
- Rule 21 (Forms)
- Rule 22 (Release of Clearing Data)
- Rule 23 (Lists to be Maintained) (revised for the mortgage backed-securities market)
- Rule 24 (Signatures)
- Rule 25 (Insurance)
- Rule 36 (Interpretation of Terms)
- Rule 37 (Interpretation of Rules)
- Rule 38 (Disciplinary Proceedings)
- Rule 39 (DTCC Shareholders Agreement)

III. Comments

The Commission received one comment to the proposed rule change, from SIFMA.³⁶ The commenter supported the proposed rule change, stating that the proposed rule change would both reduce risk and increase efficiency in the mortgage-backed security market. The commenter believes that the proposed rule change would reduce risk because it would decrease the number of settlements through the pool netting process and as a result likely would reduce the number of fails in the market. Furthermore, the commenter believes the proposed rule change would provide for a less risky process for the liquidation of positions of a defaulting member.³⁷ The commenter believes that the proposed rule change would increase efficiency

³⁶ See supra note 5.

³⁷ The Commission notes that FICC, consulting with market participants and regulators and using emergency powers under its rulebook, has temporarily provided certain central counterparty services in two instances to alleviate liquidity pressure on the market: (i) to facilitate the orderly liquidation of Lehman Brothers' positions and (ii) to facilitate the orderly liquidation of MF Global positions. In both instances, FICC significantly reduced the number of deliveries required by netting deliver and receive obligations among members.

because as the total number of settlements is reduced through pool netting, market participants likely would have to deal with fewer settlement-related issues, such as pool notifications, resolution disputes, and fails, for which they currently dedicate significant time and resources.

IV. Discussion

The Commission has carefully considered the proposed rule change and the comment thereto and the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder.

The Commission agrees with the commenter that the proposed rule change likely will reduce risk and promote efficiency in the mortgage-backed security market by reducing the number of settlements that are performed and as a result reducing the number of settlement-related risks and costs that confront counterparties. The Commission also believes that the FICC guarantee and the provision of CCP services will reduce risks of bilateral counterparty default. The Commission believes that these changes are consistent with the Exchange Act, including Section 17A, because they should help facilitate the prompt and accurate clearance and settlement of securities transactions and help assure the safeguarding of securities and funds under FICC's control or for which FICC is responsible. In particular, the Commission believes that these changes to the MBSD's rules should result in a more efficient system of settlement for the mortgage-backed security market.

The Commission also notes that the MBSD marks Clearing Member portfolios to the market on a daily basis and charges variation margins accordingly, and establishes initial margins designed to cover a minimum 99th percentile of expected possible losses that could arise over a 3-day settlement period utilizing a VaR-based approach. In addition, in order to further enhance the MBSD's risk framework, the MBSD will add two components - the margin requirement differential and the coverage charge - to the Clearing Fund, as well as additional

MBSD mark-to-market items related to the new pool netting services. Furthermore, the MBSD uses regular back and stress testing to monitor the sufficiency of collected margin levels vis-a-vis the risk represented by the 99th percentile of expected possible losses from Clearing Member portfolios and to monitor its tail risk exposure that is beyond the 99th percentile. The Commission believes these steps should, consistent with Section 17A(b)(3)(A) of the Exchange Act,³⁸ facilitate the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds under FICC's custody or control or for which FICC is responsible.

V. Conclusion

On the basis of the foregoing, the Commission finds that the amended proposed rule change is consistent with the requirements of the Exchange Act and in particular Section 17A of the Exchange Act and the rules and regulations thereunder.³⁹

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change (File No. SR-FICC-2008-01) be, and hereby is, approved.⁴⁰

By the Commission.

Kevin M. O'Neill
Deputy Secretary

Dated: March 9, 2012

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³⁸ 15 U.S.C. 78q-1(b)(3)(A).

³⁹ 15 U.S.C. 78q-1.

⁴⁰ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).