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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80574; File No. SR-FICC-2017-005]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of Proposed Rule Change to Establish the Centrally Cleared Institutional Triparty Service and Make Other Changes

May 2, 2017

I. Introduction

On March 9, 2017, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2017-005, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on March 30, 2017.³ The Commission received one comment letter on the proposed rule change.⁴ This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4. FICC also filed this proposal as an advance notice pursuant to Section 802(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 and Rule 19b-4(n)(1) under the Act. 15 U.S.C. 5465(e)(1) and 17 CFR 240.19b-4(n)(1). The advance notice was published for comment in the Federal Register on April 7, 2017. See Securities Exchange Act Release No. 80361 (April 3, 2017), 82 FR 17053 (April 7, 2017) (SR-FICC-2017-803). The Commission did not receive any comments on the advance notice.

³ Securities Exchange Act Release No. 80303 (March 24, 2017), 82 FR 15749 (March 30, 2017) (SR-FICC-2017-005) (“Notice”).

⁴ See letter from Thomas Wipf, Chief Financial Officer, Morgan Stanley & Co. LLC, dated April 19, 2017, to Eduardo A. Aleman, Assistant Secretary, Commission, available at <https://www.sec.gov/comments/sr-ficc-2017-005/ficc2017005.htm> (“Morgan Stanley Letter”).

II. Description of the Proposal

Repurchase agreement (“repo”) transactions involve the sale of securities along with an agreement to repurchase the securities on a later date. Bilateral repo transactions involve a cash lender (e.g., a money market mutual fund, pension fund, or other entity with funds available for lending) and a cash borrower (typically a broker-dealer, hedge fund, or other entity seeking to finance securities that can be used to collateralize the loan). In the opening leg of the repo transaction, the cash borrower receives cash in exchange for securities equal in value to the amount of cash received, plus a haircut. In the closing leg of the repo transaction, the cash borrower pays back the cash plus interest in exchange for the securities posted as collateral. In tri-party repo transactions, a clearing bank tri-party agent provides to both the cash lender and the cash borrower certain operational, custodial, collateral valuation, and other services to facilitate the repo transactions. For example, the tri-party agent may facilitate and record the exchange of cash and securities on a book-entry basis for each of the counterparties to the repo transaction, as well as effectuating the collection and transfer of collateral that may be required under the terms of the repo transaction. Cash lenders use tri-party repos as investments that offer liquidity maximization, principal protection, and a small positive return, while cash borrowers rely on them as a major source of short-term funding.⁵

⁵ See Federal Reserve Bank of New York, Tri-Party Repo Infrastructure Reform, https://www.newyorkfed.org/medialibrary/media/banking/nyfrb_triparty_whitepaper.pdf (last visited Apr. 27, 2017).

FICC currently provides central clearing to a segment of the tri-party repo market through its general collateral finance repo service (“GCF Repo[®] Service”).⁶ The GCF Repo Service is available to sell-side entities, such as dealers, that enter into tri-party repo transactions, in GCF Repo Securities, with each other.⁷

FICC’s proposal would broaden the pool of entities that would be eligible to submit tri-party repo transactions for central clearing at FICC. Specifically, FICC proposes to amend its Government Securities Division (“GSD”) Rulebook (“GSD Rules”)⁸ to establish the “Centrally Cleared Institutional Tri-Party Service” or the “CCIT[™] Service.”⁹ The proposed CCIT Service would allow the submission of tri-party repo transactions in GCF Repo Securities between GSD Netting Members¹⁰ that

⁶ The term “GCF Repo” is a registered trademark of FICC. The GCF Repo Service is a service offered by FICC to compare, net, and settle general collateral repos. Notice, 82 FR at 15750.

⁷ GCF Repo Securities are securities issued or guaranteed by the United States, a U.S. government agency or instrumentality, a U.S. government-sponsored corporation (or otherwise approved by FICC’s Board of Directors), and such securities are only eligible for submission to FICC in connection with the comparison, netting and/or settlement of repo transactions involving generic CUSIP numbers (i.e., identifying numbers established for a category of securities, as opposed to a specific security). See Notice, 82 FR at 15750.

⁸ Available at <http://www.dtcc.com/legal/rules-and-procedures>.

⁹ CCIT is a trademark of The Depository Trust & Clearing Corporation, of which FICC is a subsidiary. FICC defines “Centrally Cleared Institutional Tri-Party Service” and “CCIT Service” as “the service offered by the Corporation to clear institutional tri-party repurchase agreement transactions, as more fully described in Rule 3B.” Proposed GSD Rule 1, Definitions.

¹⁰ The term “Netting Member” is defined as a member of FICC’s Comparison System (i.e., the system of reporting, validating, and matching the long and short sides of securities trades to ensure that the details of such trades are in agreement between the parties) and FICC’s Netting System (i.e., the system for aggregating and matching offsetting obligations resulting from trades). GSD Rules, supra note 8.

participate in the GCF Repo Service and institutional counterparties (other than registered investment companies (“RICs”) under the Investment Company Act of 1940, as amended),¹¹ where the institutional counterparties are the cash lenders in the transactions.

To effectuate the proposed CCIT Service, FICC proposes to create a new limited service membership category in GSD for institutional cash lenders. These new members would be referred to as CCIT members, and the GSD membership provisions that apply to the CCIT members would be addressed in proposed GSD Rule 3B. These new membership provisions include:¹²

- membership eligibility criteria, including minimum financial requirements, operational capabilities, and opinions of counsel;
- joint account ownership, in which one authorized entity would act as agent for two or more CCIT members;
- membership application processes, including document provision and disclosure requirements, operational testing requirements, reporting requirements, FATCA

¹¹ 15 U.S.C. 80a-1 et seq. According to FICC, the legal ability of such registered investment companies to participate in the proposed CCIT Service is uncertain in light of applicable regulatory requirements under the Investment Company Act of 1940 (including, for example, liquid asset requirements and counterparty diversification requirements). Notice 82 FR at 15762.

¹² For additional discussion of the membership provisions set forth in proposed GSD Rule 3B, see also Notice, 82 FR at 15751–58.

compliance certification requirements,¹³ and the procedures for denying membership;

- membership agreement terms describing rights and obligations;
- procedures for the voluntary termination of CCIT membership; and
- ongoing membership requirements, including (i) annual financial and other disclosure requirements; (ii) operational testing requirements and related reporting requirements; (iii) notification of GSD rule non-compliance; (iv) penalties for GSD rule non-compliance; (v) mandatory assurances in the event that FICC has reason to believe a member may fall into GSD rule non-compliance; (vi) requirements to comply with applicable tax, money laundering, and sanctions laws;(vii) audit provisions allowing FICC to access relevant books and records; and (viii) financial/operational monitoring.

In addition to membership provisions, proposed Rule 3B also would set forth the applicable risk management provisions relating to the new limited service membership category, including:¹⁴

- non-mutualized loss allocation obligations of CCIT members, including FICC's perfected security interest in each CCIT member's underlying repo securities;

¹³ FATCA is the Foreign Account Tax Compliance Act, 26 U.S.C. 1471 *et seq.* FATCA compliance means that an "...FFI [foreign financial institution] Member has qualified under such procedures promulgated by the Internal Revenue Service...to establish exemption from withholding under FATCA such that [FICC] would not be required to withhold [anything] under FATCA...." GSD Rules 1, *supra* note 8.

¹⁴ For additional discussion of the risk management provisions set forth in proposed GSD Rule 3B, see also Notice, 82 FR at 15757–58.

- a rules-based committed liquidity facility for CCIT members, in which CCIT members that have outstanding CCIT transactions with a defaulting member would be required to enter into CCIT master repurchase agreement (“MRA”) transactions with FICC for specified periods of time;
- uncommitted liquidity repos between CCIT members and FICC; and
- application of certain other GSD Rules (e.g., comparison, netting, settlement, default, and other applicable provisions) to CCIT members and transactions.

In addition to the proposed changes to the GSD Rules related to the proposed CCIT Service, the proposal also contains other changes to the GSD Rules, unrelated to the CCIT proposal. These non-CCIT related changes generally are intended to update the GSD Rules and provide additional specificity, clarity, and transparency for members that rely on them.¹⁵ These non-CCIT related proposed rule changes include the following:

- clarifying that Comparison-Only Members must conform to FICC’s operational conditions and requirements;¹⁶

¹⁵ For additional description and explanation of the non-CCIT-related changes included in the proposal, see Notice, 82 FR at 15759-60.

¹⁶ GSD members may be either Comparison-Only Members or Netting Members. Comparison-Only Members are members of the GSD Comparison System, which is the GSD system for reporting, validating, and in some cases, matching of securities trades. Netting Members are members of both the GSD Comparison System and the GSD Netting System, which is the GSD system for aggregating and matching offsetting obligations resulting from securities trades. Pursuant to GSD Rule 2A, FICC may require an entity to be a Comparison-Only Member for a period of time (during which FICC assess the entity’s operational soundness) before the entity becomes eligible to apply for netting membership.

- clarifying the point of time in which a member is required to notify FICC that the member is no longer in compliance with a relevant membership qualification and standard;
- providing that a member's written notice of its membership termination is not effective until accepted by FICC;
- requiring all GCF Repo transactions to be fully collateralized by 9:00 a.m. New York Time;
- prohibiting a member that receives collateral in the GCF Repo process from withdrawing the securities or cash collateral received;
- specifying the steps that members must take in the event of FICC's default so that FICC may determine the net amount owed by or to each member;
- reflecting FICC's current practice of annual study and evaluation of FICC's internal accounting control system; and
- correcting several grammatical and out-of-date cross-references.

In addition to the proposed changes listed above, the proposed rule change also includes a proposal for a non-CCIT related rule change that would provide FICC with access to the books and records of a RIC Netting Member's controlling management. The change is intended to enable FICC to determine whether the RIC has sufficient financial resources and monitor compliance with FICC's financial requirements on an ongoing basis.

III. Summary of Comments Received

The Commission received one comment letter from Morgan Stanley in support of the proposal. In the comment letter, Morgan Stanley notes the general benefits of central clearing, including enhanced risk management, efficiency in securities financing transactions, enhancing market access, and increased creditworthiness.¹⁷ Morgan Stanley also notes the specific benefits of the CCIT proposal, including (i) generating access for clients to high quality liquid assets (e.g., U.S. Government securities); (ii) providing capacity to cash lenders; (iii) retaining bilateral agreements; (iv) building operational efficiencies; (v) reducing settlement risk; (vi) providing opportunities for margin and capital efficiency and balance sheet netting; and (vii) increasing market stability, liquidity, and price transparency by enhancing the tri-party repo market.¹⁸

IV. Discussion of Commission Findings

Section 19(b)(2)(C) of the Act¹⁹ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considering the proposed rule change and the comment received, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to FICC. In particular, the Commission believes the proposal is consistent

¹⁷ See Morgan Stanley Letter at 1-2.

¹⁸ See Morgan Stanley Letter at 2-3.

¹⁹ 15 U.S.C. 78s(b)(2)(C).

with Sections 17A(b)(3)(F), (G), and (H) of the Act,²⁰ as well as Rules 17Ad-22(e)(1), (4), and (18) thereunder.²¹

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

Section 17A(b)(3)(F) of the Act requires, in part, that the GSD Rules be designed to (i) promote the prompt and accurate clearance and settlement of securities transactions; (ii) remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions; and (iii) in general, to protect investors and the public interest.²²

First, the Commission believes that the proposed changes that are unrelated to the proposed CCIT Service are consistent with promoting prompt and accurate clearance and settlement. As described above, FICC proposes a number of rule changes that are unrelated to the proposed CCIT service. Specifically, FICC proposes changes to Section 3(a) of GSD Rule 2A (Initial Membership Requirements), Sections 7, 10 and 13 of GSD Rule 3 (Ongoing Membership Requirements), Section 5 of GSD Rule 4 (Clearing Fund and Loss Allocation), Section 3 of GSD Rule 20 (Special Provisions for GCF Repo Transactions) and the *Schedule of GCF Timeframes*, Subsection (a) of GSD Rule 22B (Corporation Default), and GSD Rule 35 (Financial Reports). These changes are intended to provide specificity, clarity, and additional transparency to the GSD Rules, which would help provide members with a better understanding of the Rules, decrease the likelihood of errors in the performance of members' responsibilities to FICC, and,

²⁰ 15 U.S.C. 78q-1(b)(3)(F), (G), and (H).

²¹ 17 CFR 240.17Ad-22(e)(1), (4), and (18)

²² 15 U.S.C. 78q-1(b)(3)(F).

thereby, help ensure that FICC's clearing and settlement system works more efficiently. Therefore, the Commission believes that these proposed rule changes would promote the prompt and accurate clearance and settlement of securities transactions by FICC, consistent with Section 17A(b)(3)(F) of the Act.²³

Second, the Commission believes that the proposed rule changes related to the proposed CCIT service are consistent with removing impediments to and perfecting the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. As described above, the proposed CCIT Service would establish a new membership category at FICC (i.e., the CCIT membership). By removing current obstacles to FICC's membership through the creation of a new, limited-service GSD membership category for institutional cash lenders, the proposal would expand the availability of GSD's infrastructure to institutional cash lenders and, in turn, enable a greater number of tri-party repo transactions to be eligible for the benefits of FICC's centralized clearing. Accordingly, the Commission believes that the proposed rule change would help remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.²⁴

Third, the Commission believes that the proposed rule changes related to the proposed CCIT service are consistent with the protection of investors and in the public interest. As described above, FICC proposes to establish the CCIT service, which would establish the centralized clearing of proposed CCIT securities transactions that are

²³ Id.

²⁴ Id.

otherwise transacted bilaterally. By expanding access to centralized clearing (and thus, FICC’s netting, novation, and settlement guarantee), the proposal would lower the risk of diminished liquidity in the tri-party repo market caused by a large scale exit of participants from the market in a stress scenario. The proposal would also protect against fire sale risk through FICC’s ability to centralize and control the liquidation of a greater portion of a failed counterparty’s portfolio. Accordingly, by applying the efficiencies and risk mitigating aspects of centralized clearing to the proposed CCIT transactions, the proposal would help decrease the settlement and operational risks that are otherwise present in the current bilateral transactions of such securities.

In addition, as described above, the CCIT proposal includes provisions that would establish the CCIT MRA and a perfected security interest in each CCIT member’s underlying repo securities. Each of these tools would help provide FICC with sufficient liquidity resources to settle the obligations of a CCIT member’s defaulted Netting Member pre-novation counterparty. In doing so, the proposed CCIT Service provides for prudent risk management of CCIT transactions and CCIT members.

For these reasons, the Commission believes that the proposed rule changes related to the proposed CCIT Service help protect investors, particularly those in the CCIT market, and are in the public interest, consistent with Section 17A(b)(3)(F) of the Act.²⁵

B. Consistency with Section 17A(b)(3)(G) and (H) of the Act

Section 17A(b)(3)(G) of the Act requires that the GSD Rules “provide that...[FICC’s] participants shall be appropriately disciplined for violation of any provision of the rules of the clearing agency by expulsion, suspension, limitation of

²⁵ Id.

activities, functions, and operations, fine, censure, or any other fitting sanction.”²⁶

Section 17A(b)(3)(H) of the Act requires, in part, that the GSD Rules “provide a fair procedure with respect to the disciplining of participants, the denial of participation to any person seeking participation therein, and the prohibition or limitation by the clearing agency of any person with respect to access to services offered by the clearing agency.”²⁷

As described above, the proposed CCIT membership would subject CCIT members, and applicants that wish to become CCIT members, to comparable admission requirements²⁸ and the same disciplinary requirements (and related due process procedures) as those applicable to Netting Members, and applicants that wish to become Netting Members. In establishing the proposed CCIT membership under similar admission and disciplinary requirements as FICC’s existing requirements, the Commission believes that the proposed CCIT membership would establish an appropriate framework for the admission and disciplining of CCIT members, consistent with the requirements of Sections 17A(b)(3)(G) and 17A(b)(3)(H) of the Act.²⁹

C. Consistency with Rules 17Ad-22(e)(1), (4), and (18) under the Act

The Commission believes that the proposed rule change is consistent with Rule 17Ad-22(e)(1) under the Act.³⁰ Rule 17Ad-22(e)(1) requires, in part, that FICC

²⁶ 15 U.S.C. 78q-1(b)(3)(G).

²⁷ 15 U.S.C. 78q-1(b)(3)(H).

²⁸ There would be certain differences between the admission requirements applicable to CCIT members under proposed GSD Rule 3B and those applicable to Netting Members under GSD Rule 2A. See Notice, 82 FR at 15761.

²⁹ 15 U.S.C. 78q-1(b)(3)(G) and (H).

³⁰ 17 CFR 240.17Ad-22(e)(1).

“establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [p]rovide for a well-founded, clear, transparent and enforceable legal basis for each aspect of its activities.”³¹ As described above, FICC proposes a number of changes that are unrelated to the proposed CCIT Service and designed to make the GSD Rules more clear, consistent, and current for members that rely on them. The Commission believes that these non-CCIT related changes could make FICC’s policies and procedures in the GSD Rules more clear, consistent, and transparent for members that rely on them, and therefore believes that the proposed changes would help support FICC’s rules being clear and transparent, consistent with Rule 17Ad-22(e)(1), cited above.

The Commission believes that the proposed rule change is consistent with Rule 17Ad-22(e)(4)(iii) under the Act.³² Rule 17Ad-22(e)(4)(iii) requires, in part, that FICC “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]ffectively identify, measure, monitor, and manage its credit exposures to participants and those arising from [FICC’s] payment, clearing, and settlement processes, including by . . . maintaining . . . financial resources at the minimum to enable [FICC] to cover a wide range of stress scenarios . . .”³³ As discussed above, the CCIT Service includes risk management tools, such as the perfected security interest and the CCIT MRA liquidity resource. The Commission believes that these risk management tools would help facilitate FICC’s management of credit, market, and liquidity risk that

³¹ Id.

³² 17 CFR 240.17Ad-22(e)(4)(iii).

³³ Id.

would arise from becoming a central counterparty to the new repo positions coming in via the proposed CCIT Service. Accordingly, the Commission believes that the proposed changes to its policies and procedures in the GSD Rules are designed to help effectively manage FICC's exposure, including its credit exposure to participants, arising from its payment, clearing, and settlement processes for the proposed CCIT transactions by providing for financial resources to help cover a wide range of foreseeable stress scenarios, consistent with Rule 17Ad-22(e)(4)(iii), cited above.

The Commission also believes that the proposal is consistent with Rule 17Ad-22(e)(18) under the Act.³⁴ Rule 17Ad-22(e)(18) requires, in part, that FICC “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]stablish objective, risk-based, and publicly disclosed criteria for participation, which . . . require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis.”³⁵

In connection with the establishment of the proposed CCIT Service, FICC would include provisions in the GSD rules to incorporate membership standards, requiring, for example, ongoing financial responsibility and operational capacity requirements, as well as the requirements that would be applicable to Netting Members with respect to their participation in the proposed CCIT Service. The Commission believes that, by incorporating such requirements, FICC would establish in its policies and procedures

³⁴ 17 CFR 240.17Ad-22(e)(18).

³⁵ Id.

objective, risk-based, and publicly disclosed criteria for participation in the CCIT Service, consistent with Rule 17Ad-22(e)(18).

Similarly, in connection with the proposed non-CCIT related change to provide FICC with access to the books and records of a RIC Netting Member's controlling management, FICC would be authorized to review the financial information of the RIC. Because this would enable FICC to determine whether the RIC has sufficient financial resources and monitor compliance with FICC's financial requirements on an ongoing basis, the Commission believes this requirement is consistent with Rule 17Ad-22(e)(18).

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act, in particular the requirements of Section 17A of the Act³⁶ and the rules and regulations promulgated thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that proposed rule change SR-FICC-2017-005 be and hereby is APPROVED as of the date of this order or the date of a notice by the Commission authorizing FICC to implement FICC's advance notice proposal (SR-FICC-2017-803) that is consistent with this proposed rule change, whichever is later.³⁷

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁸

³⁶ 15 U.S.C. 78q-1.

³⁷ In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³⁸ 17 CFR 200.30-3(a)(12).

Eduardo A. Aleman,

Assistant Secretary.

[FR Doc. 2017-09193 Filed: 5/5/2017 8:45 am; Publication Date: 5/8/2017]