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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-81051; File No. SR-FICC-2017-012]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change to the Mortgage-Backed Securities Division Clearing Rules Regarding Fixed Income Clearing Corporation's (1) Time of Novation, (2) Treatment of Itself as the Settlement Counterparty for Certain Transaction Types, and (3) Proposal to Implement New Processes to Promote Operational Efficiencies for Its Clearing Members

June 29, 2017.

I. Introduction

On May 15, 2017, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2017-012, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder[2] (hereinafter, "Proposed Rule Change"). The Proposed Rule Change was published for comment in the Federal Register on May 24, 2017.[3] The Commission received no comments to the Proposed Rule Change. This order approves the Proposed Rule Change.

II. Description of the Proposed Rule Change

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

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 80716 (May 18, 2017), 82 FR 23852 (May 24, 2017) (SR-FICC-2017-012) ("Notice").

The Proposed Rule Change consists of modifications to FICC's Mortgage-Backed Securities Division ("MBSD") Clearing Rules ("MBSD Rules").[4] Specifically, the Proposed Rule Change would (1) change the time that FICC treats itself as the settlement counterparty for SBO-Destined Trades[5] to the time of trade comparison, which is earlier in the lifecycle of the trade than the current practice; (2) change the time that FICC novates[6] and treats itself as the settlement counterparty for Trade-for-Trade Transactions[7]

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4 FICC is comprised of two divisions, MBSD and the Government Securities Division ("GSD"). MBSD provides, among other things, clearance and settlement for trades in mortgage-backed securities. GSD provides, among other things, clearance and settlement for trades in U.S. government debt issues. MBSD and GSD maintain separate sets of rules, margin models, and clearing funds. The Proposed Rule Change relates solely to the MBSD Rules. Capitalized terms used and not otherwise defined shall have the meaning assigned to such terms in the MBSD Rules or the FICC MBSD EPN Rules, as applicable, available at http://www.dtcc.com/en/legal/rules-and-procedures.

5 The Proposed Rule Change would add the new defined term "SBO" to define the settlement balance orders that constitute the net positions of a Clearing Member as a result of the TBA Netting process. Notice, 82 FR at 23860. The term "SBO-Destined Trade" means a "To-Be-Announced" ("TBA") transaction intended for TBA Netting. MBSD Rule 1, supra note 4. TBA transactions are trades for which the actual identities of and/or the number of pools underlying each trade are unknown at the time of trade execution. See Notice, 82 FR at 23854. "TBA Netting" means the netting service that FICC provides to Clearing Members in connection with TBA transactions. MBSD Rule 1, supra note 4. The MBSD settlement balance order ("SBO") system nets trades within the same mortgage backed security ("MBS") product, coupon rate, maturity, and settlement date. The SBO system provides netting efficiencies, eliminating the need for Clearing Members to settle all but the resulting net buy and sell obligations.

6 Novation terminates the obligations between Clearing Members to deliver, receive, and make payments to each other, and replaces those obligations with identical obligations between the Clearing Members and FICC. MBSD Rule 5 Section 13, supra note 4.

7 The term "Trade-for-Trade Transaction" means a TBA transaction submitted to FICC that is not intended for TBA Netting. MBSD Rule 1, supra note 4. Entities use Trade-for-Trade Transactions either by choice or for trades that are not eligible for netting.

to the time of trade comparison, which is earlier in the lifecycle of the trade than the current practice; (3) regarding Specified Pool Trades,[8] novate and establish FICC as the settlement counterparty at the time of trade comparison; and (4) regarding Stipulated Trades[9] (a new proposed trade type), guarantee, novate, and establish FICC as the settlement counterparty at the time of trade comparison.

The Proposed Rule Change also includes several changes to the MBSD Rules regarding the operational processes for clearing MBSD trades. These changes include (1) eliminating the Notification of Settlement process regarding trades that currently settle bilaterally, as the process would become obsolete once FICC novates and directly settles all SBO-Destined Transactions, Trade-for-Trade Transactions, and Specified Pool Trades, as proposed; (2) establishing the "Do Not Allocate" ("DNA") process, which would allow Clearing Members[10] to offset SBON Trades[11] and Trade-for-Trade Transactions; (3) establishing the "Expanded Pool Netting" process, which would net

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8 The term "Specified Pool Trade" means a trade in which all required pool data, including the pool number to be delivered upon settlement are agreed by the counterparties at the time of trade execution. MBSD Rule 1, supra note 4.

9 A "Stipulated Trade" is a trade in which pools allocated and delivered against the trade must satisfy certain conditions that are agreed upon by the parties at the time of trade execution. See Notice, 82 FR at 23856. Trades carrying stipulations may reflect terms that include, but are not limited to issuance year, issuance month, weighted average coupon, weighted average maturity and/or weighted average loan age, etc.

10 The term "Clearing Member" means any entity admitted into MBSD membership pursuant to MBSD Rule 2A. MBSD Rule 1, supra note 4.

11 The proposed MBSD Rules would use the term "SBON Trades" to signify obligations that result from the TBA Netting process. Such obligations would reflect FICC as the settlement counterparty.

Pool Instructs[12] stemming from SBON Trades and Trade-for-Trade Transactions to arrive at a single net position per counterparty in a particular Pool Number[13] for next-day delivery; (4) eliminating the "give-up" process for Brokered Transactions,[14] as the process would become obsolete once FICC novates and settles all such transactions, as proposed; and (5) amending the components of the Cash Settlement[15] calculation to reflect the changes above.

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12 The term "Pool Instruct" is defined in FICC's MBS Pool Netting User Guide to mean "[a]n input used by a [M]ember to submit pool details directly into [FICC's Real-Time Trade Matching System] pool netting for bilateral matching and assignment to a corresponding open TBA position as a prerequisite to pool netting. FICC MBS Pool Netting User Guide, available at http://www.dtcc.com/clearing-services/ficc-mbsd/ficc-mbsd-user-documentation.

13 The term "Pool Number" is defined in FICC's MBS Pool Netting User Guide to mean a "[u]nique number assigned by the industry to identify the pool (in addition to the pool CUSIP [(i.e., the Committee on Uniform Securities Identification Procedures identifying number for a security)], since the pool CUSIP is not always known at the time of issuance)." FICC MBS Pool Netting User Guide, supra note 12.

14 The term "Brokered Transaction" means any "give-up" transaction calling for the delivery of a security for which data has been submitted to FICC by Members, in transactions to which a Broker is a party. MBSD Rule 1, supra note 4. FICC operates its brokered business on a "give-up" basis, which means that MBSD discloses (i.e., "gives-up") the identity of each Dealer (i.e., a Member that is in the business of buying and selling Securities as principal, either directly or through a Broker.) to a Brokered Transaction after a period of time. MBSD Rule 1; Rule 5 Section 7, supra note 4.

15 The term "Cash Settlement" refers to the payment each business day by FICC to a Member or by a Member to FICC pursuant to Rule 11. MBSD Rule 1, supra note 4. Cash Settlement is a daily process of generating a single net credit or debit cash amount at the "Aggregated Account" level (i.e., either a single account linked to an aggregate ID or a set of accounts linked to an aggregate ID for the processing of transactions.) Clearing Members' Cash Settlement obligations are calculated on a net basis at the aggregate ID level. MBSD Rule 1, supra note 4.

Finally, the Proposed Rule Change would modify FICC's Real-Time Trade Matching ("RTTM") system to remove size restrictions on SBO-Destined Trades. Since trade size submission requirements are not reflected in the MBSD Rules, this change would not require changes to the MBSD Rules.

A. MBSD's Current Trade Comparison and Netting Processes

MBSD currently processes four types of trades: (1) SBO-Destined Trades; (2) Trade-for-Trade Transactions; (3) Specified Pool Trades; and (4) Option Contracts. SBO-Destined Trades and Trade-for-Trade Transactions are TBA transactions, which are trades for which the actual identities of and/or the number of pools underlying each trade are unknown at the time of trade execution. Specified Pool Trades are trades for which all pool data is agreed upon by the Clearing Members at the time of trade execution. Option Contracts are not addressed by the Proposed Rule Change.

The first step of MBSD's clearance and settlement process is trade comparison, which consists of the reporting, validating, and matching by FICC of both sides of a transaction to ensure that the details of the trades are in agreement between the parties.[16] Clearing Members enter trade data into the RTTM system, and once the trade is deemed compared, FICC guarantees settlement of the trade, provided that the trade meets the requirements of the MBSD Rules and was entered into in good faith.[17]

FICC novates SBO-Destined Trades upon trade comparison.[18] In contrast, FICC does not novate Trade-for-Trade Transactions at the time of trade comparison. However,

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[16] MBSD Rule 5, supra note 4.

[17] MBSD Rule 5 Section 8, supra note 4.

[18] MBSD Rule 5 Section 13, supra note 4.

FICC guarantees the settlement of Trade-for-Trade Transactions upon trade comparison.[19] FICC treats Stipulated Trades as Trade-for-Trade Transactions because Clearing Members currently do not notify FICC of the stipulations. Similarly, Specified Pool Trades are not novated upon trade comparison. However, FICC guarantees the obligations of Specified Pool Trade counterparties to deliver, receive, and make payment for securities that satisfy the same generic criteria as the securities underlying Specified Pool Trades upon trade comparison.[20]

MBSD employs two netting processes to reduce settlement obligations as well as the number of securities and the amount of cash to be exchanged at settlement: the TBA Netting system; and the Pool Netting system.[21] The TBA Netting system is used to net eligible SBO-Destined Trades.[22] Three business days prior to the established settlement date of the TBA settlement obligations (referred to as "72-Hour Day"),[23] TBA Netting for the applicable class occurs. On 72-Hour Day, all compared SBO-Destined Trades within

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19 Id.

20 MBSD Rule 5 Section 12, supra note 4.

21 MBSD Rules 6, 7 and 8, supra note 4.

22 Although Trade-for-Trade Transactions are not netted through the TBA Netting system, they constitute TBA settlement obligations against which Pool Instructs may be submitted. Specified Pool Trades are also not netted through the TBA Netting system, nor do such trades enter the Pool Netting system. MBSD Rules 6 and 8, supra note 4.

23 MBSD performs the TBA Netting process four times per month, corresponding to each of the four primary settlement classes and dates established by the Securities Industry Financial Markets Association ("SIFMA"). SIFMA publishes a calendar that specifies one settlement date per month for four different product classes (known as Classes A, B, C and D) that are used to categorize the various types of TBA securities. These product classes and the associated settlement dates are recognized by the industry, and they provide the foundation for MBSD's TBA Netting process.

the class that have been designated for the TBA Netting process are netted within and across counterparties. Even though FICC has become the legal counterparty for each SBO-Destined Trade upon trade comparison, TBA Netting occurs as though each SBO-Destined Trade is with the Original Contra-Side Member.[24] The net positions created by the TBA Netting process are referred to as the settlement balance order positions ("SBO positions"), which constitute settlement obligations against which Clearing Members will submit Pool Instructs for the Pool Netting process.[25]

Two business days prior to the established settlement date of the TBA settlement obligations (referred to as "48-Hour Day"), Clearing Members that have an obligation to deliver pools ("Pool Sellers") must notify their counterparties ("Pool Buyers") through MBSD's Electronic Pool Notification Service ("EPN Service")[26] of the relevant Pool Instructs (i.e., pools that such Pool Sellers intend to allocate in satisfaction of their SBO positions and/or Trade-for-Trade Transactions).[27] For Trade-for-Trade Transactions, the relevant counterparty is the Original Contra-Side Member. For SBO-Destined Trades,

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[24] The term "Original Contra-Side Member" means a Member with whom a Member has entered into a contract for the purchase or sale of a security. MBSD Rule 1, supra note 4.

[25] MBSD Rule 6, supra note 4.

[26] MBSD's electronic pool notification service (the "EPN Service") provides Clearing Members with the ability to electronically communicate pool information to MBSD, as described in the proposed rule changes. MBSD Rule 1, supra note 4.

[27] Pool allocations occur for all TBA Obligations, whether established on 72-Hour Day through the TBA Netting process or established upon comparison when the Trade-for-Trade Transaction was submitted. Pool allocations are not performed for Specified Pool Trades because the pool that is to be delivered in connection with such trade is specified upon submission.

although FICC is the legal counterparty, Clearing Members are directed to treat a designated SBO Contra-Side Member[28] as their counterparty.[29] Clearing Members are required to submit Pool Instructs on 48-Hour Day to MBSD through its RTTM system for Pool Comparison[30] (which is a prerequisite to Pool Netting).[31] Trade counterparties must bilaterally match their respective pools. At this stage, the Pool Netting System processes the compared pool allocations (provided that neither Clearing Member has cancelled the submitted allocation).[32]

Pool netting takes place one business day prior to the established settlement date of the TBA settlement obligations (referred to as "24-Hour Day"). The Pool Netting system

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28 The term "SBO Contra-Side Member" means the Member with whom a Member is directed by the Corporation to settle an SBO Trade. The term "SBO Trade" means a settlement balance order that offsets an SBO Net Open Position pursuant to the MBSD Rules. A Member which has one or more "Long SBO Trades" in a particular CUSIP number is a net purchaser with respect to that CUSIP number, as the case may be; a Member which has one or more "Short SBO Trades" is a net seller. MBSD Rule 1, supra note 4. An "SBON Contra-Side Member" is an SBO Contra-Side Member that is not an Original Contra-Side Member with respect to such SBO Trade. An "SBOO Contra-Side Member" is an SBO Contra-Side Member that is also an Original Contra-Side Member with respect to such SBO Trade. MBSD Rule, supra note 4.

29 A Clearing Member's "counterparty" for purposes of notifications, netting, and processing is the SBO Contra-Side Member or the Original Contra-Side Member for SBO-Destined Trades and Trade-for-Trade Transactions, respectively. MBSD Rule 6, supra note 4.

30 The term "Pool Comparison" means the service provided to Clearing Members, as applicable, and the operations carried out by FICC in the course of providing such service, in accordance with Rule 7. MBSD Rule 1, supra note 4.

31 As with the EPN Service allocation process described above, Clearing Members submit Pool Instructs against all of their TBA Obligations, regardless of whether the TBA Obligation is established upon trade comparison or stems from the TBA Netting process.

32 MBSD Rule 8, supra note 4.

reduces the number of pool settlements by netting Pool Instructs stemming from SBO Trades and Trade-for-Trade Transactions to arrive at a single net position per counterparty in a particular pool number for next-day delivery.

On each business day, MBSD makes available to each Clearing Member a report with information to enable such Clearing Member to settle its Pool Net Settlement Positions[33] on that business day. At that time, all deliver, receive and related payment obligations between Clearing Members resulting from compared pools that comprise a Pool Net Settlement Position or Positions are terminated and replaced by the Pool Deliver Obligations,[34] Pool Receive Obligations,[35] and related payment obligations to and from FICC. Each Clearing Member then provides appropriate instructions to its clearing bank to deliver to MBSD, and/or to receive from MBSD, Eligible Securities against payment or receipt at the appropriate settlement value.

Clearing Members are required to settle certain obligations directly with their applicable settlement counterparties (i.e., outside of FICC).[36] These obligations include (1) Pool Instructs that are not included in Pool Netting (either because they are ineligible or because they do not meet selection criteria for inclusion); and (2) Specified Pool Trades, which are not eligible for Pool Netting. Upon settling such obligations, Clearing

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33 The term "Pool Net Settlement Position" means either a Pool Net Short Position or a Pool Net Long Position, as the context requires. MBSD Rule 1, supra note 4.

34 The term "Pool Deliver Obligation" means a Clearing Member's obligation to deliver securities to FICC. MBSD Rule 1, supra note 4.

35 The term "Pool Receive Obligation" means a Clearing Member's obligation to receive securities from FICC. MBSD Rule 1, supra note 4.

36 MBSD Rule 5 Section 12 and MBSD Rule 8 Section 2, supra note 4.

Members must notify FICC by submitting a Notification of Settlement to MBSD for pool settlements relating to all trade types (excluding Option Contracts).[37] Notification of Settlement is required for bilateral settlement because MBSD will not otherwise know that the subject pools have actually settled directly between Clearing Members. Upon both Clearing Members' submission of Notification of Settlement, the relevant obligation is deemed to have settled and is, therefore, no longer subject to MBSD's risk management.

B. Proposed Changes to MBSD's Trade Comparison and Netting Processes

FICC proposes to novate all transactions (except Option Contracts) at the time of trade comparison. Upon trade comparison, the deliver, receive, and related payment obligations between the Clearing Members, with respect to SBO-Destined Trades and Trade-for-Trade Transactions, would terminate and be replaced by identical obligations to and from FICC (i.e., FICC would become the buyer to every seller and the seller to every buyer). A similar process would occur for Specified Pool Trades and Stipulated Trades, except that, for those trades, the existing deliver, receive, and related payment obligations would terminate and be replaced with obligations to deliver, receive and make payment for securities that satisfy the same generic criteria (such as coupon rate, maturity, agency, and product) as the securities underlying the Specified Pool Trades or Stipulated Trades.[38] In addition, FICC proposes to treat itself as the settlement

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[37] MBSD Rule 10, supra note 4.

[38] In other words, FICC would not novate or guarantee the obligations to deliver the particular securities underlying Specified Pool Trades or securities that contain the particular stipulations set forth in Stipulated Trades.

counterparty throughout the lifecycle of the trade for netting, processing, and settlement purposes.[39] These changes are described in detail below.

1. SBO-Destined Trades

As described above, FICC currently novates SBO-Destined Trades at the time of trade comparison; however, FICC does not currently treat itself as the settlement counterparty for netting and processing purposes until after the Pool Netting process is complete and FICC has established Pool Receive Obligations or Pool Deliver Obligations. As a result, Clearing Members are directed to (1) allocate pools through the EPN Service to designated SBO Contra-Side Members and (2) submit Pool Instructs through the RTTM system.[40]

Under the Proposed Rule Change, FICC would treat itself as settlement counterparty for netting and processing purposes from the time of trade comparison. SBO-Destined Trades would proceed to the TBA Netting process as they do currently; however, the SBO positions that result from the TBA Netting process would reflect FICC as the settlement counterparty. Thus, Clearing Members would no longer settle with a designated SBO Contra-Side Member,[41] but with FICC instead.

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39 Upon trade comparison, Clearing Members would receive a notification through the RTTM system establishing FICC as each party's novated and settlement counterparty.

40 MBSD Rule 7, supra note 4.

41 FICC would eliminate its calculation for determining the Settlement Value of "SBON Trades" (i.e., SBO Trades which a Member settles with an SBON Contra-Side Member) and "SBOO Trades" (i.e., SBO Trades which a Member settles with an SBOO Contra-Side member). MBSD Rule 1, supra note 4. The MBSD Rules refer to the calculation as "CUSIP Average Price" or "CAP" for SBON Trades and "Firm CUSIP Average Price" or "FCAP" for SBOO Trades. MBSD Rule 6, supra note 4.

On 48-Hour Day, Clearing Members that are Pool Sellers would notify MBSD (rather than their designated SBO Contra-Side Member) through the EPN Service of the allocated pools. FICC would then submit corresponding notifications to Clearing Members that are Pool Buyers. Clearing Members would continue to submit Pool Instructs to MBSD on 48-Hour Day through FICC's RTTM system. If a Clearing Member does not submit its Pool Instructs by the established deadline, FICC would determine and apply the Pool Instructs for that Clearing Member. Such determination would be based on the allocated pools that the Clearing Member has submitted through the EPN Service. As a result of this proposed change, all pools would be compared, and FICC would no longer require Clearing Members to settle uncompared pools directly with their applicable settlement counterparties (i.e., outside of FICC).

Additionally, FICC proposes to eliminate the trade size restriction for SBO-Destined Trades. Currently, SBO-Destined Trades are only eligible for the TBA Netting process in multiple amounts of one million, with the minimum set at one million. FICC proposes to remove this size restriction from the RTTM system so that Clearing Members would be permitted to submit SBO-Destined Trades in any trade size. Since trade size restrictions are not reflected in the MBSD Rules, this proposed change would not necessitate any changes to the MBSD Rules. For the avoidance of doubt, FICC does not propose to change the trade size restrictions for Trade-for-Trade Transactions or Specified Pool Trades.

2. Trade-for-Trade Transactions

Currently, as described above, FICC does not novate Trade-for-Trade Transactions or treat itself as settlement counterparty for purposes of netting, processing, and settlement until, in each case, the Pool Netting process is complete and each Clearing

Member receives their Pool Receive Obligation or Pool Deliver Obligations, as applicable, from FICC.[42] As a result, Clearing Members are required to allocate pools to their original counterparties through the EPN Service, and submit Pool Instructs through the RTTM system. Once Pool Netting is complete, the deliver, receive, and related payment obligations between Clearing Members that were created by compared pools that comprise a Pool Net Settlement Position are terminated and replaced by Pool Deliver Obligations, Pool Receive Obligations, and related payment obligations to and from FICC.[43]

Under the Proposed Rule Change, FICC would novate Trade-for-Trade Transactions at trade comparison and treat itself as settlement counterparty, at that time, for purposes of processing and settlement. Similar to the process with SBO-Destined Trades, Clearing Members with an obligation to deliver pools would notify MBSD (rather than their original counterparty) through the EPN Service, and FICC would submit corresponding notifications to Clearing Members that are Pool Buyers. Clearing Members would continue to be required to submit Pool Instructs. In the event that Pool Instructs are not submitted by the established deadline, FICC would determine Pool Instructs for that Clearing Member. Such determinations would be based on the allocated pools that the Clearing Member has submitted through the EPN Service.

3. Specified Pool Trades

Currently, as described above, FICC does not novate Specified Pool Trades during any point of the trade lifecycle (though, upon trade comparison of Specified Pool

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[42] MBSD Rule 8 Section 4, supra note 4.

[43] MBSD Rule 8 Section 6, supra note 4.

Trades, FICC guarantees the obligation to deliver, receive, and pay for securities that satisfy the same generic criteria as the underlying securities).[44] Specified Pool Trades are currently ineligible for the TBA Netting process and the Pool Netting process. Specified Pool Trades are currently settled between the original counterparties directly (i.e., outside of FICC).

Under the Proposed Rule Change, FICC would novate Specified Pool Trades upon trade comparison. Such novation would be limited to the obligations to deliver, receive, and make payment for securities satisfying the same generic criteria as the securities underlying the Specified Pool Trades. As a result, upon trade comparison, the existing deliver, receive, and related payment obligations between Clearing Members under Specified Pool Trades would be terminated and replaced with obligations to or from FICC to deliver, receive, and make payment for securities satisfying the same generic criteria as the securities underlying the Specified Pool Trades. FICC would not novate the obligation to deliver the securities for the particular specified pool.

Additionally, FICC proposes to settle Specified Pool Trades directly with the Clearing Member party thereto (rather than require that counterparties to such trades settle directly with one another). No other changes are being proposed with respect to the processing of Specified Pool Trades. Such trades would continue to be ineligible for the TBA Netting and Pool Netting systems.

4. Stipulated Trades

Currently, as described above, FICC does not treat Stipulated Trades as a separate type of trading activity because Clearing Members submit Stipulated Trades to FICC as

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[44] MBSD Rule 5, supra note 4.

Trade-for-Trade Transactions, without notifying FICC of the stipulations. Under the Proposed Rule Change, FICC would add Stipulated Trades as a new trade type that would be eligible for processing by MBSD. FICC would guarantee and novate Stipulated Trades at trade comparison, provided that such trades meet the requirements of the MBSD Rules and are entered into in good faith. Such guarantee and novation would be limited to the obligations to deliver, receive, and make payment for securities satisfying the same generic criteria as the securities underlying the Stipulated Trade, but not the obligation to deliver securities that contain the particular stipulations contained in the Stipulated Trades. At trade comparison, the deliver, receive, and related payment obligations between Clearing Members would be terminated and replaced with obligations to or from FICC to deliver, receive, and make payment for securities satisfying the same generic criteria as the securities underlying the Stipulated Trades.

Because of the narrow nature of FICC's guarantee and novation, in the event of a Clearing Member's default, FICC would only be required to deliver, receive, or make payment for securities that have the same generic terms, such as coupon rate, maturity, agency, and product, as the securities underlying the Stipulated Transaction.

Clearing Members would be required to allocate Stipulated Trades to FICC through the EPN Service. Such allocation would result in the creation of pool obligations, which would settle with FICC based on the settlement date agreed to as part of the terms of the trade. Similar to Specified Pool Trades, Stipulated Trades would not be eligible for the TBA Netting process and the Pool Netting process.

5. Notification of Settlement Process

As described above, the Notification of Settlement process currently requires Clearing Members to notify FICC of obligations that have settled directly between Clearing Members and their applicable settlement counterparties.[45] Once both parties to a transaction submit a Notification of Settlement to MBSD through the RTTM system, the obligations are no longer subject to MBSD's margin calculation process.[46] Because, under the Proposed Rule Change, FICC would novate and directly settle all SBO-Destined Transactions, Trade-for-Trade Transactions, and Specified Pool Trades, the Notification of Settlement process would become obsolete. Therefore, FICC proposes to delete Notification of Settlement from the MBSD Rules.

6. Do Not Allocate ("DNA") Process

Under the Proposed Rule Change, FICC would establish a process to enable Clearing Members to offset Trade-for-Trade Transactions[47] and SBON Trades. This process would be referred to as the "Do Not Allocate" or "DNA" process. The purpose of this process is to exclude SBON Trades and Trade-for-Trade Transactions from the pool allocation process[48] and securities settlement.

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45 MBSD Rule 10, supra note 4.

46 MBSD Rule 4, supra note 4.

47 Specified Pool Trades and Stipulated Trades would not be eligible for the proposed DNA process because such trades are not eligible for the Pool Netting process. MBSD Rule 8, supra note 4.

48 As noted above, the pool allocation process requires Clearing Members to allocate pools on 48-Hour Day through the EPN Service. Under the Proposed Rule Change, Clearing Members would not be required to allocate pools for obligations that have been offset through the DNA process.

The DNA process would be available to Clearing Members at the start of the business day on 48-Hour Day through 4:30 p.m.[49] on 24-Hour Day. During this time, Clearing Members with two or more open TBA Obligations[50] with the same Par Amount,[51] CUSIP Number, and SIFMA designated settlement date would be permitted to offset such obligations. In order to initiate the offset, Clearing Members would be required to submit a request ("DNA Request") to MBSD through the RTTM system. Upon FICC's validation of this request, the obligations would be reduced, and the Clearing Member would not be required to allocate pools against such obligations. As a result, a Clearing Member's overall number of open obligations would be reduced.

Clearing Members would be permitted to cancel a DNA Request; however, such cancellation must be submitted through the RTTM system prior to the time that the designated offsetting TBA Obligations have settled. Upon FICC's timely receipt of a cancellation request, the trades that were previously marked for the DNA process would reopen and the Clearing Member would be expected to notify MBSD through the EPN

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49 All times referenced herein are Eastern Time.

50 The term "TBA Obligations" means SBO-Destined obligations and, with respect to Trade-for-Trade Transactions, settlement obligations generated by the Trade Comparison system. MBSD Rule 1, supra note 4.

51 The term "Par Amount" means for Trade-for-Trade and SBO Transactions, Option Contracts and Pool Deliver and Pool Receive Obligations, the current face value of a Security to be delivered on the Contractual Settlement Date. With respect to Specified Pool Trades, "Par Amount" shall mean the original face value of a Security to be delivered on the Contractual Settlement Date. MBSD Rule 1, supra note 4.

Service of the pools that such Clearing Member intends to allocate to the open obligations.[52]

The proposed DNA process would generate Cash Settlement credits and debits from the price differential of the resulting offsetting obligations. The proposed Cash Settlement obligations are described more fully below in Item 9.

7. Expanded Pool Netting Process

As described above, the Pool Netting system reduces the number of pool settlements by netting Pool Instructs stemming from SBON Trades and Trade-for-Trade Transactions to arrive at a single net position per counterparty in a particular pool number for next-day delivery. Prior to the Pool Netting process, Pool Sellers must notify their Pool Buyers through MBSD's EPN Service of the pools to be allocated in satisfaction of a TBA Obligation. In accordance with the SIFMA Guidelines,[53] such notifications must occur before 3:00 p.m. on 48-Hour Day.[54] Notifications that take place after this time are considered late, and the delivery of such pools to the related Pool Buyers will be delayed for one additional business day.

In order to capture notifications submitted after 3:00 p.m. on 48-Hour Day through 4:30 p.m. on 24-Hour Day, FICC proposes to establish an additional netting cycle, referred to as "Expanded Pool Netting." Similar to the initial Pool Netting process,

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[52] A detailed example of the DNA process is described in the Notice. Notice, 82 FR at 23857.

[53] The term "SIFMA Guidelines" means the guidelines for good delivery of Mortgage-Backed Securities as promulgated from time to time by SIFMA. MBSD Rule 1, supra note 4.

[54] All times referenced herein are Eastern Time.

Expanded Pool Netting would result in a reduction in the number of Pool Delivery Obligations. As with the existing Pool Netting process, the proposed Expanded Pool Netting process would (1) calculate Pool Net Settlement Positions in a manner that is consistent with Section 3 of MBSD Rule 8, and (2) allocate Pool Deliver Obligations and Pool Receive Obligations in a manner that is consistent with Section 4 of MBSD Rule 8.

The Expanded Pool Netting process would occur four times per month in accordance with the SIFMA designated settlement dates. Pool Net Settlement Positions and the resultant Pool Deliver Obligations and Pool Receive Obligations would only be provided to Clearing Members during such times. The proposed Expanded Pool Netting process would generate Cash Settlement credits and debits, described more fully below in Item 9.

8. Give-Up Process for Brokered Transactions

Currently, as described above, FICC operates its brokered business on a "give-up" basis, which means that MBSD discloses (i.e., "gives-up") the identity of each Dealer to a Brokered Transaction after a period of time.[55] Under the Proposed Rule Change, FICC would eliminate the need to disclose Dealers' identities because FICC would novate all Brokered Transactions and treat itself as the settlement counterparty upon trade comparison. Thus, the report that FICC issues after trade comparison of a Brokered Transaction would refer to FICC as settlement counterparty.

9. Cash Settlement Calculations

As described above, Cash Settlement is a daily process of generating a single net credit or debit cash amount at the Aggregated Account level and settling those cash

[55] MBSD Rule 5 Section 7, supra note 4.

amounts between Clearing Members and MBSD.[56] FICC's proposal to become the settlement counterparty upon trade comparison and the proposed DNA process would require several changes to the Cash Settlement calculation described below.[57]

- SBO Market Differential. Under the Proposed Rule Change, FICC would eliminate the SBO Market Differential[58] because it reflects the price difference for SBO positions settled among Clearing Members. This amount would no longer be required because Clearing Members would settle all SBO-Destined Trades directly with FICC.
- TBA Transaction Adjustment Payment. Under the Proposed Rule Change, FICC would add the TBA Transaction Adjustment Payment to reflect the cash differential that would result when calculating the net proceeds of the contractual quantity of an SBO-Destined Trade when comparing such trade's Settlement Price[59] and the System Price.[60] The proposed TBA Transaction

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56 MBSD Rule 11, supra note 4.

57 Detailed examples of the proposed changes to the Cash Settlement calculations are provided in the Notice. Notice, 82 FR at 23858-59.

58 The term "SBO Market Differential" means the amount computed pursuant to the MBSD Rules, reflecting the difference between Firm CUSIP Average Prices (i.e., the average purchase or sale contract price of a Member's SBO-Destined Trades with a particular Original Contra-Side Member in a particular CUSIP number) or between the CUSIP Average Price (i.e., the average contract price of all SBO-Destined Trades in the CUSIP number that have been netted) and the Firm CUSIP Average Price, as the case may be. MBSD Rule 1, supra note 4.

59 The term "Settlement Price" means: (a) in the case of a Trade-for-Trade Transaction, Specified Pool Trade, or SBO-Destined Trade, the contractual settlement price agreed to by the parties; (b) in the case of an SBON Trade, the CUSIP Average Price; (c) in the case of an SBOO Trade, the Firm CUSIP Average Price; and (d) in the case of a Pool Deliver or Pool Receive Obligation, the Pool Net Price. MBSD Rule 1, supra note 4.

Adjustment Payment would be an amount equal to the difference between the SBO-Destined Trade's Settlement Price and the System Price, multiplied by the contractual quantity of such trade, and then divided by 100. To differentiate between the buyer and seller of the transaction, an indicator of -1 for the buy trade and +1 for the sell trade is multiplied by the contractual quantity of such trade.

- Expanded Pool Net Transaction Adjustment Payment. Under the Proposed Rule Change, FICC would add the Expanded Pool Net Transaction Adjustment Payment to be applied when a Clearing Member misses the deadline established by FICC for the Pool Netting process. Unlike the daily Pool Netting process, the Expanded Pool Netting process would only run four times per month in accordance with the SIFMA designated settlement dates. As a result, an Expanded Pool Net Transaction Adjustment Payment would only occur four times per month. The Expanded Pool Net Transaction Adjustment Payment would reflect an amount equal to the difference between the System Price and the SBON Trade's Settlement Price or Trade-for-Trade Transaction's Settlement Price, as applicable, multiplied by the total current face value of the pools used to satisfy such obligation, and then divided by 100. To differentiate between a buy and sell transaction, an indicator of +1

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[60] The term "System Price" means the price for any trade or any Pool Deliver Obligations or Pool Receive Obligation not including accrued interest, established by FICC on each Business Day, based on current market information, for each security. MBSD Rule 1, supra note 4.

for a buy trade and -1 for a sell trade would be multiplied by the total current face value of the pools used to satisfy the obligation.

- Do Not Allocate Transaction Adjustment Payment. Under the Proposed Rule Change, FICC would add the Do Not Allocate Transaction Adjustment Payment to reflect the cash differential among TBA Obligations that have been offset through the DNA process. The proposed Do Not Allocate Transaction Adjustment Payment would be an amount equal to the difference between the Settlement Price of the buy and sell TBA Obligation transactions multiplied by the contractual quantity. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade is multiplied by the contractual quantity of such trade.
- TBA Reprice Transaction Adjustment Payment. Under the Proposed Rule Change, FICC would add the TBA Reprice Transaction Adjustment Payment to reflect the cash differential between the price of a TBA Obligation that was not allocated by a Clearing Member before the deadline established by FICC and the price of the replacement TBA Obligation that was calculated at the System Price. The TBA Reprice Transaction Adjustment Payment would be an amount equal to the difference between the TBA Obligation's Settlement Price and the System Price, multiplied by the unallocated contractual quantity, and then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a sell trade and +1 for a buy trade is multiplied by the unallocated pool's contractual quantity.

- Variance Transaction Adjustment Payment. Under the Proposed Rule Change, FICC would add the Variance Transaction Adjustment Payment to capture the variance (i.e., difference)[61] between a TBA Obligation and the current face value of the pools allocated in satisfaction of such obligation. Specifically, this payment would reflect the cash differential calculated between the SBON Trade's Settlement Price or the Trade-for-Trade Transaction's Settlement Price, as applicable, and the System Price using the variance of the Pool Netting process or the Expanded Pool Netting process, as applicable, based on the current face value of the pools used in satisfaction of the trade. The Variance Transaction Adjustment Payment would be an amount equal to the difference between the SBON Trade's Settlement Price or the Trade-for-Trade Transaction's Settlement Price, as applicable, and the System Price, multiplied by the difference between the TBA Obligation and the allocated pools used in satisfaction of such trade, and then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade would be multiplied by the total variance amount.
- Factor Update Adjustment Payment. Under the Proposed Rule Change, FICC would add the Factor Update Adjustment Payment, to be applied when

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61 Pursuant to the SIFMA Guidelines, TBA trades are allowed to have a variance equal to plus or minus 0.01 percent of the dollar amount of the transaction agreed to by the parties. As a result of this guideline, FICC would capture the variance of TBA Obligations and the current face value of the pools allocated in satisfaction of such obligations.

updated pool factor information is released after the clearing bank's settlement of a pool. This update would create a cash differential that would require a debit to the seller and a credit to the buyer.

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act[62] directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considering the Proposed Rule Change, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to FICC. In particular, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act[63] and Rule 17Ad-22(e)(21)[64] under the Act.

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.[65] As discussed above, the Proposed Rule Change would result in FICC novating and treating itself as the settlement counterparty from the time of trade comparison with respect to SBO-Destined Trades, Trade-for-Trade Transactions, Specified Pool Trades, and Stipulated Trades. By novating such trades to FICC and treating FICC as the settlement counterparty to such trades the Proposed Rule Change

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62 15 U.S.C. 78s(b)(2)(C).

63 15 U.S.C. 78q-1(b)(3)(F).

64 17 CFR 240.17Ad-22(e)(21).

65 15 U.S.C. 78q-1(b)(3)(F).

would make FICC the only counterparty to whom the Clearing Members are obligated, as compared to the current process where Clearing Members may have multiple counterparties with whom they need to settle multiple obligations outside of FICC. Additionally, the Proposed Rule Change would also accelerate the point in time at which FICC becomes that ultimate counterparty (i.e., at the time of trade comparison), resulting in such trades being governed by the MBSD Rules from that time. Collectively, the proposed changes are designed to simplify, streamline, and centralize trade processing under the MBSD Rules, which would help promote the prompt and accurate clearance and settlement of these types of securities transactions. Therefore, the Commission believes that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act.[66]

As discussed above, the Proposed Rule Change would make a number of operational changes with respect to MBSD trade processing. Specifically, the Proposed Rule Change would provide that (1) the submission of Pool Instructs by Clearing Members would become optional because FICC would be permitted to submit on behalf Clearing Members; (2) Clearing Members would no longer to be required to fulfill Notification of Settlement obligations because all of the above-referenced transactions would settle with FICC; (3) Clearing Members would have the ability to exclude TBA Obligations from the pool allocation process, netting, and securities settlement through the DNA process; (4) Clearing Members would have the ability to net their pools via the Expanded Pool Netting process in the event that such Clearing Members miss the established deadline for the initial Pool Netting process; (5) Dealer Netting Members

[66] 15 U.S.C. 78q-1(b)(3)(F).

would remain anonymous with the elimination of the "give-up" process for Brokered Transactions; (6) Clearing Members would be allowed to submit SBO-Destined Trades in all trade sizes; and (7) Clearing Members would be allowed to submit Stipulated Trades as a new trade type. These proposed changes are designed to eliminate operational steps in the current trade processing cycle and enable Clearing Members to take advantage of MBSD's trade processing efficiencies at an earlier point, which would help promote the prompt and accurate clearance and settlement of these types of securities transactions. Therefore, Commission believes that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act.[67]

Rule 17Ad-22(e)(21) under the Act requires, in part, that FICC establish, implement, maintain, and enforce written policies and procedures reasonably designed to be efficient and effective in meeting the requirements of its participants and the markets it serves, and regularly review the efficiency and effectiveness of its (i) clearing and settlement arrangements; (ii) operating structure; and (iii) scope of products cleared or settled.[68] As discussed above, the Proposed Rule Change would enable FICC to novate MBS trades at an earlier point the trade lifecycle (i.e., upon trade comparison). Additionally, as described above, the Proposed Rule Change would add Stipulated Trades as a new trade type that could be cleared and settled at MBSD, and it would remove the size restrictions with respect to SBO-Destined Trades.

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67 Id.

68 See 17 CFR 240.17Ad-22(e)(21).

With these changes, which were developed in consideration of the feedback received from MBSD Clearing Members,[69] FICC could provide a more efficient and effective operational processes in connection with the clearance and settlement of MBS trades, expand the scope of products cleared and settled by MBSD, and enable Clearing Members to submit such trades in any size. Therefore, the Commission believes that the Proposed Rule Change is designed to help FICC be more efficient and effective in meeting the requirements of its participants and the markets it serves, and in providing clearing and settlement arrangements, operating structure, and scope of products cleared or settled, which is consistent with Rule 17Ad-22(e)(21).

V. Conclusion

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act[70] and the rules and regulations promulgated thereunder.

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69 FICC describes in Item 7 of its Form 19b-4 responses the extent to which the proposed changes were informed by feedback from its Clearing Members and various working groups over numerous years. Available at http://www.dtcc.com/legal/sec-rule-filings. Specifically, FICC states that in 2015, 92 Clearing Member representatives participated in forums held in June, and 157 representatives participated in forums in September and October. Id. FICC states that in 2016, 139 representatives participated in forums held in March, 241 representatives participated in forums held in August, and 121 participated in forums held in December. Id. Additionally, FICC states that it held a number of conference calls with individual Clearing Members to address questions and concerns on the subject. Id. Moreover, FICC explains that the Proposed Rule Change was even the subject of a prior rule filing with the Commission to fund the proposed changes. Id. See also Exchange Act Release No. 74033 (January 12, 2015), 80 FR 2452 (January 16, 2015) (SR-FICC-2014-12).

70 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act[71] that proposed rule change SR-FICC-2017-012 be, and hereby is, APPROVED.[72]

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[73]

Jill M. Peterson,

Assistant Secretary.

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[71] 15 U.S.C. 78s(b)(2).

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

[73] 17 CFR 200.30-3(a)(12).

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