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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-91092; File No. SR-FICC-2020-017]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Modify the Calculation of the MBSD VaR Floor to Incorporate a Minimum Margin Amount

February 9, 2021.

I. Introduction

On November 20, 2020, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] proposed rule change SR-FICC-2020-017 to introduce a new "Minimum Margin Amount" to complement the existing VaR Floor calculation.[3] The proposed rule change was published for comment in the Federal Register on December 10, 2020.[4] The Commission has received comment letters on the proposed rule change.[5] On December 23, 2020,

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

2 17 CFR 240.19b-4.

3 On November 27, 2020, FICC also filed the proposal contained in the proposed rule change as advance notice SR-FICC-2020-804 with the Commission pursuant to Section 806(e)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act"), 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) of the Act, 17 CFR 240.19b-4(n)(1)(i). Notice of filing of the advance notice and extension of the review period was published for comment in the Federal Register on January 6, 2021. Securities Exchange Act Release No. 90834 (December 31, 2020), 86 Fed. Reg. 584 (January 6, 2021) (SR-FICC-2020-804). The proposal contained in the proposed rule change and the advance notice shall not take effect until all regulatory actions required with respect to the proposal are completed.

4 Securities Exchange Act Release No. 90568 (December 4, 2020), 85 FR 79541 (December 10, 2020) (SR-FICC-2020-017) ("Notice").

5 See Letter from Christopher Killian, Managing Director, Securities Industry and Financial Markets Association, dated January 29, 2021, to Vanessa Countryman, Secretary, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8154310-226759.pdf; Letter from Christopher A. Iacovella,

pursuant to Section 19(b)(2) of the Act,[6] the Commission designated a longer period within which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove the proposed rule change and the Commission designated a longer period for comment on the proposed rule change.[7] This order institutes proceedings, pursuant to Section 19(b)(2)(B) of the Act,[8] to determine whether to approve or disapprove the proposed rule change.

Chief Executive Officer, American Securities Association, dated January 28, 2021, to Vanessa Countryman, Secretary, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-804/srficc2020804-8302307-228379.pdf; Letter from James Tabacchi, Chairman, Independent Dealer and Trader Association and Mike Fratantoni, Chief Economist, Senior Vice President, Mortgage Bankers Association, dated January 26, 2021, to Allison Herren Lee, Acting Chair, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8290678-228219.pdf; Letter from Kelli McMorrow, Head of Government Affairs, American Securities Association, dated December 18, 2020, to Vanessa Countryman, Secretary, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8173139-227003.pdf; Letter from Pete Mills, Senior Vice President, Mortgage Bankers Association, dated December 17, 2020, to Jay Clayton, Chairman, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8155338-226778.pdf; Letter from Christopher Killian, Managing Director, Securities Industry and Financial Markets Association, dated December 16, 2020, to Vanessa Countryman, Secretary, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8154310-226759.pdf; Letter from Curtis Richins, President & CEO, Mortgage Capital Trading, Inc., dated December 15, 2020, to Vanessa Countryman, Secretary, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8156568-226839.pdf; and Letter from James Tabacchi, Chairman, Independent Dealer and Trader Association, dated December 10, 2020, to Vanessa Countryman, Secretary, Commission, available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017-8127766-226454.pdf. See comments on the proposed rule change (SR-FICC-2020-017), available at https://www.sec.gov/comments/sr-ficc-2020-017/srficc2020017.htm. Because the proposal contained in the proposed rule change was also filed as an advance notice, supra note 3, the Commission is considering all public comments received on the proposal regardless of whether the comments were submitted to the advance notice or the proposed rule change.

6 15 U.S.C. 78s(b)(2).

7 Securities Exchange Act Release No. 90794 (December 23, 2020), 85 Fed. Reg. 86591 (December 30, 2020) (SR-FICC-2020-017).

8 15 U.S.C. 78s(b)(2)(B).

II. Summary of the Proposed Rule Change

A. Background

FICC, through its Mortgage-Backed Securities Division ("MBSD"), serves as a central counterparty ("CCP") and provider of clearance and settlement services for the non-private label mortgage-backed securities markets. A key tool that FICC uses to manage its respective credit exposures to its members is collecting margin from each member. The aggregated amounts of all members' margin constitutes the Clearing Fund, which FICC would access should a defaulted member's own margin be insufficient to satisfy losses to the CCP caused by the liquidation of that member's portfolio.

Each member's margin consists of a number of applicable components, including a value-at-risk ("VaR") Charge designed to capture the potential market price risk associated with the securities in a member's portfolio. The VaR Charge is typically the largest of the margin components.

To determine the VaR Charge, FICC generally uses a risk-based calculation designed to quantify the risks related to the volatility of market prices associated with the securities in a member's portfolio. However, FICC also uses a haircut-based calculation to determine a VaR Floor, which replaces the risk-based calculation to become a member's VaR Charge in the event that the VaR Floor is greater than the amount determined by the risk-based calculation, operating as a minimum VaR Charge. FICC uses the VaR Floor to mitigate the risk that the risk-based calculation does not result in margin amounts that accurately reflect FICC's applicable credit exposure, which may occur in certain member portfolios containing long and short positions in different asset classes that share a high degree of historical price correlation.

B. Minimum Margin Amount

FICC is proposing to introduce a new calculation called the "Minimum Margin Amount" to complement the existing VaR Floor calculation. Under the proposal, FICC would revise the existing definition of the VaR Floor to be the greater of (1) the current VaR Floor calculation, and (2) the Minimum Margin Amount. The Minimum Margin Amount would enhance FICC's margin collection during periods of market volatility, particularly when TBA[9] price changes significantly exceed those implied by the VaR model risk factors, such as rates and option-adjusted spread. FICC observed this situation occur during March and April 2020, with the result that margin amounts collected were not sufficient to mitigate FICC's credit exposure to its members' portfolios.[10] The Minimum Margin Amount would be calculated based on historical price movements of the securities in the member's portfolio. Specifically, FICC would use a dynamic haircut method based on observed TBA price moves that would provide a more reliable estimate for the portfolios' risk level when current market conditions deviate from historical observations.

The Minimum Margin Amount would be a minimum volatility calculation for specified net unsettled positions, calculated[11] using the historical market price changes of such benchmark TBA securities determined by FICC. The Minimum Margin Amount

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9 The vast majority of agency MBS trading occurs in a forward market, on a "to-be-announced" or "TBA" basis. In a TBA trade, the seller of MBS agrees on a sale price, but does not specify which particular securities will be delivered to the buyer on settlement day. Instead, only a few basic characteristics of the securities are agreed upon, such as the MBS program, maturity, coupon rate, and the face value of the bonds to be delivered.

10 Although FICC expects its margin methodology to cover projected liquidation losses at a 99 percent confidence level, MBSD's monthly backtesting coverage of the VaR Charge was 86.6 percent in March 2020 and 94.2 percent in April 2020.

11 See generally Notice, supra note 4, 85 Fed. Reg. at 79543–44 for a more detailed description of the calculation.

would cover such range of historical market price moves and parameters using a look-back period of no less than one year and no more than three years.

C. Summary of the Effect of the Changes Proposed in the Proposed Rule Change

FICC performed an impact study on members' portfolios for the period beginning February 3, 2020 through June 30, 2020. On average, at the member level, FICC found that the Minimum Margin Amount would have increased the VaR Charge by $27 million during the period of the impact study.[12] The largest percent increase in VaR Charge for any member would have been 146%, or $22 million.[13] The largest dollar increase for any member would have been $333 million, or 37% increase in the VaR Charge.[14] The top 10 members based on the size of their VaR Charges would have contributed 69.3% of the aggregate VaR Charges had the Minimum Margin Amount been in place.[15] The same members would have contributed to 54% of the increase resulting from the Minimum Margin Amount.[16]

Backtesting studies indicate that average daily Backtesting Charges[17] would have decreased by approximately $450 million or 53% during the impact study period and the overall margin backtesting coverage (based on 12 month trailing backtesting) would have

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12 Notice, supra note 4, 85 Fed. Reg. at 79545.

13 Id.

14 Id.

15 Id.

16 Id.

17 The Backtesting Charge is an existing charge FICC adds to a member's VaR Charge when a member has 12-month trailing backtesting coverage below the 99 percent backtesting coverage target. The Backtesting Charge is generally equal to the member's third largest deficiency that occurred during the previous 12 months.

improved from approximately 97.3% to 98.5% through June 30, 2020 if the Minimum Margin Amount calculation had been in place.[18]

III. Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[19] to determine whether the proposed rule change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the proposed rule change, and provide the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,[20] the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with Section 17A of the Act,[21] and the rules thereunder, including the following provisions:

- Section 17A(b)(3)(F) of the Act,[22] which requires, among other things, that the rules of a clearing agency must be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or

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18 Notice, supra note 4, 85 Fed. Reg. at 79545.

19 15 U.S.C. 78s(b)(2)(B).

20 Id.

21 15 U.S.C. 78q-1.

22 15 U.S.C. 78q-1(b)(3)(F).

for which it is responsible and to protect investors and the public interest;

- Section 17A(b)(3)(I) of the Act,[23] which requires that the rules of a clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act;
- Rule 17Ad-22(e)(4)(i) under the Act,[24] which requires a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence;
- Rule 17Ad-22(e)(6)(i) and (v) under the Act, which require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum (1) considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market, and (2) uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products; and
- Rule 17Ad-22(e)(23)(ii) under the Act,[25] which requires a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to provide sufficient information to enable

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

24 17 CFR 240.17Ad-22(e)(4)(i).

25 17 CFR 240.17Ad-22(e)(23)(ii).

participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,[26] Section 17A(b)(3)(I) of the Act,[27] Rule 17Ad-22(e)(4)(i) under the Act,[28] Rule 17Ad-22(e)(6)(i) and (v),[29] Rule 17Ad-22(e)(23)(ii) under the Act,[30] or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4(g) under the Act,[31] any request for an opportunity to make an oral presentation.[32]

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [insert

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26 15 U.S.C. 78q-1(b)(3)(F).

27 15 U.S.C. 78q-1(b)(3)(I).

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

29 17 CFR 240.17Ad-22(e)(6)(i) and (v).

30 17 CFR 240.17Ad-23(e)(23)(ii).

31 17 CFR 240.19b-4(g).

32 Section 19(b)(2) of the Act grants to the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

date 7 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 15 days from publication in the Federal Register].

The Commission asks that commenters address the sufficiency of FICC's statements in support of the proposed rule change, which are set forth in the Notice,[33] in addition to any other comments they may wish to submit about the proposed rule change.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FICC-2020-017 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FICC-2020-017. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

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33 See Notice, supra note 3.

website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FICC and on DTCC's website (http://dtcc.com/legal/sec-rule-filings.aspx). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2020-017 and should be submitted on or before [insert date 7 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 15 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[34]

J. Matthew DeLesDernier,
Assistant Secretary.

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[34] 17 CFR 200.30-3(a)(31).