

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-92799; File No. SR-FICC-2021-801)

August 27, 2021

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Amendment No. 1 and Notice of No Objection to Advance Notice, as Modified by Amendment No. 1, to Add the Sponsored GC Service and Make Other Changes

On May 12, 2021, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-FICC-2021-801 pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act”),<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> under the Securities Exchange Act of 1934 (“Exchange Act”)<sup>3</sup> to amend FICC’s Government Securities Division Rulebook<sup>4</sup> to add a new service that expands FICC’s existing Sponsored Service. The advance notice was published for public comment in the Federal Register on June 3, 2021.<sup>5</sup> On June 8, 2021, FICC filed Amendment No. 1 to the advance notice, to correct an erroneous cross reference in the original filing.<sup>6</sup> The advance notice, as

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> 15 U.S.C. 78a et seq.

<sup>4</sup> FICC’s Government Securities Division (“GSD”) Rulebook (“Rules”) are available at <http://www.dtcc.com/legal/rules-and-procedures>.

<sup>5</sup> Securities Exchange Act Release No. 92019 (May 27, 2021), 86 Fed. Reg. 29834 (June 3, 2021) (SR-FICC-2021-801) (“Notice of Filing”).

<sup>6</sup> Amendment No. 1 made a correction to Exhibit 5 of the filing. On May 12, 2021, FICC also filed a related proposed rule change (SR-FICC-2021-003) with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The

modified by Amendment No. 1, is hereinafter referred to as the “Advance Notice.” On June 11, 2021, the Commission, by the Division of Trading and Markets, pursuant to delegated authority,<sup>7</sup> requested additional information from FICC pursuant to Section 806(e)(1)(D) of the Act.<sup>8</sup> The request for information tolled the Commission’s period of review of the Advance Notice until 60 days from the date of the Commission’s receipt of the information requested from FICC, absent an additional information request.<sup>9</sup> The Commission received the information requested from FICC on July 2, 2021.

The Commission is publishing this notice to solicit comments on Amendment No. 1 from interested persons and, for the reasons discussed below, is hereby providing notice

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proposed rule change was published in the Federal Register on June 1, 2021. Securities Exchange Act Release No. 92014 (May 25, 2021), 86 Fed. Reg. 29334 (June 1, 2021) (SR-FICC-2020-003). On June 8, 2021, FICC filed Amendment No. 1 to the proposed rule change to make the same correction as regarding the Advance Notice. The proposed rule change, as amended by Amendment No. 1, is hereinafter referred to as the “Proposed Rule Change.” In the Proposed Rule Change, FICC seeks approval of proposed changes to its rules necessary to implement the Advance Notice. On June 24, 2021, the Commission published a notice designating a longer period of time for Commission action and a longer period for public comment on the Proposed Rule Change. Securities Exchange Act Release No. 92185 (June 15, 2021), 86 Fed. Reg. 33420 (June 24, 2021) (SR-FICC-2021-003). The Commission has received one comment in support of the Proposed Rule Change, available at <https://www.sec.gov/comments/sr-ficc-2021-003/srficc2021003.htm>. Because the proposals contained in the Advance Notice and the Proposed Rule Change are the same, the Commission considered all public comments received on the proposal as applicable to both filings, regardless of whether the comments were submitted with respect to the Advance Notice or the Proposed Rule Change.

<sup>7</sup> 17 CFR 200.30-3(a)(93).

<sup>8</sup> 12 U.S.C. 5465(e)(1)(D).

<sup>9</sup> See 12 U.S.C. 5465(e)(1)(E)(ii) and (G)(ii); see Memorandum from the Office of Clearance and Settlement, Division of Trading and Markets, titled “Commission’s Request for Additional Information,” available at <https://www.sec.gov/rules/sro/ficc-an/2021/34-92019-memo-ficc.pdf>.

of no objection to the Advance Notice.

## **I. THE ADVANCE NOTICE**

### **A. Background**

#### **1. FICC Services for Repurchase Agreement (“Repo”) Transactions**

Repos involve a pair of securities transactions between two parties. The parties agree to the terms of the trade, including the securities, principal amount, interest rate, haircut, and tenor (i.e., date of maturity). The first transaction (the “Start Leg”) consists of the sale of securities, in which one party (the “cash borrower”) delivers securities, and in exchange, the other party (the “cash lender”) delivers cash. At the Start Leg, the cash borrower typically delivers an amount of securities equal in value to the amount of cash received from the cash lender, plus a haircut. Repo durations range from one day (“overnight”) to a year or more, but are usually less than three months (“term”). The second transaction (the “End Leg”) occurs on a date after that of the Start Leg and consists of the repurchase of securities, in which the obligations to deliver cash and securities are the reverse of the Start Leg. At the End Leg, the cash borrower typically delivers the amount of cash borrowed, plus interest, and the cash lender returns the securities.

FICC serves as CCP and provides clearance and settlement services to facilitate both bilateral and tri-party repo transactions. FICC facilitates bilateral repos<sup>10</sup> in which

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<sup>10</sup> A bilateral repo is one in which the cash lender and cash borrower directly exchange cash and securities. In the bilateral repo market, the parties specify the securities used as collateral. Therefore, a cash lender seeking to obtain a particular security would utilize the bilateral repo market.

all securities delivery obligations are made against full payment (“delivery-versus-payment” or “DVP”) (the “DVP Service”). FICC generally novates and guarantees settlement of a trade upon validation of the trade details, which results in the legally binding and enforceable contract between FICC and the parties to the trade.<sup>11</sup> On a daily basis, FICC aggregates and matches a member’s offsetting obligations resulting from the member’s trades, thereby netting the member’s total daily settlement obligations.<sup>12</sup>

FICC facilitates tri-party repos<sup>13</sup> through its General Collateral Finance (“GCF”) Repo® Service, which enables members to trade general collateral finance repos based on rate, term, and underlying product throughout the day on a blind basis.<sup>14</sup> The Bank of New York Mellon operates the tri-party platform that facilitates trades conducted through the GCF Repo Service. FICC has established standardized, generic CUSIP Numbers exclusively for GCF Repo processing and to specify the acceptable types of underlying

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<sup>11</sup> See Rule 5, supra note 4.

<sup>12</sup> See Rule 11, supra note 4.

<sup>13</sup> A tri-party repo is one in which a clearing bank, acting as tri-party agent, provides to both the cash lender and the cash borrower certain operational, custodial, collateral management, and other services. In tri-party repo trading, both parties maintain accounts at a clearing bank, which facilitates the payment and delivery of cash and securities between the parties’ accounts. In contrast to the bilateral repo market and its use of specific collateral, the tri-party repo market is exclusively for general collateral repos, meaning that the parties agree to use any securities from a pre-approved basket of acceptable securities as collateral. In a general collateral repo, the cash lender is indifferent to the particular securities it receives as collateral, provided that the securities come from the pre-approved basket of acceptable securities.

<sup>14</sup> See Rule 20, supra note 4.

Fedwire book-entry eligible collateral, which include U.S. Treasuries, U.S. government agency securities, and certain mortgage-backed securities.<sup>15</sup>

## **2. Sponsored Membership**

In 2005, FICC established the Sponsored Service, allowing eligible members to sponsor their clients into a limited form of membership.<sup>16</sup> A Sponsoring Member is permitted to submit to FICC, for comparison, novation, and netting, certain eligible securities transactions of its Sponsored Members. FICC requires each Sponsoring Member to establish an omnibus account at FICC (separate from its regular netting account) for Sponsored Member trading activity. Sponsored Members generally have to meet the definition of a qualified institutional buyer (“QIB”), as defined in Rule 144A<sup>17</sup> under the Securities Act of 1933.<sup>18</sup>

For operational and administrative purposes, FICC interacts solely with the Sponsoring Member as agent for purposes of the day-to-day satisfaction of its Sponsored Members’ obligations to and from FICC, including their securities and funds-only settlement obligations.<sup>19</sup> Sponsoring Members are also responsible for providing FICC with a Sponsoring Member Guaranty, whereby the Sponsoring Member guarantees to

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<sup>15</sup> See Rule 1 (definitions of “GCF Repo Transaction” and “Generic CUSIP Number”) and Rule 20, Section 2, supra note 4; Notice of Filing, supra note 5 at 29836.

<sup>16</sup> Securities Exchange Act Release No. 51896 (June 21, 2005), 70 Fed. Reg. 36981 (June 27, 2005) (SR-FICC-2004-22). See Rule 3A, supra note 4.

<sup>17</sup> 17 CFR 230.144A.

<sup>18</sup> 15 U.S.C. 77a et seq.

<sup>19</sup> See Rule 3A, Section 8, supra note 4.

FICC the payment and performance by its Sponsored Members of their obligations under the Rules.<sup>20</sup> Although Sponsored Members are principally liable to FICC for their own settlement obligations under the Rules, the Sponsoring Member Guaranty requires the Sponsoring Member to satisfy those settlement obligations on behalf of a Sponsored Member if the Sponsored Member defaults and fails to perform its settlement obligations.<sup>21</sup>

**B. Proposed Sponsored GC Service**

Currently, the Sponsored Service only facilitates trading in bilateral DVP repos, not tri-party repos. In the Advance Notice, FICC proposes to expand the Sponsored Service to accommodate tri-party repo trading, which it believes would increase term repo activity within the Sponsored Service. FICC states that several market participants have indicated that they currently transact tri-party term repos outside of central clearing because they are not operationally equipped to perform the collateral management and other functions associated with term DVP repos.<sup>22</sup> In particular, money market funds and

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<sup>20</sup> See Rule 1 (definition of “Sponsoring Member Guaranty”) and Rule 3A, Section 2(c), supra note 4.

<sup>21</sup> Id.

<sup>22</sup> See Notice of Filing, supra note 5 at 29836. A key difference between the bilateral and tri-party repo markets deals with the operational aspects of managing term repos. In the tri-party repo market, a clearing bank typically automatically selects securities from the cash borrower’s account to serve as collateral that satisfies the credit and liquidity criteria agreed between the parties. The clearing bank delivers securities against the simultaneous delivery of cash between the parties’ accounts at the clearing bank. The clearing bank manages the regular revaluation of collateral, variation margining, income payments on the collateral, and collateral substitutions. In the bilateral repo market, the parties themselves perform such collateral management and other administrative functions.

other mutual funds generally prefer to use the tri-party repo market because a clearing bank administers collateral management and other functions, as described above.<sup>23</sup>

Therefore, FICC proposes to add the Sponsored GC Service, which would allow (but not require) Sponsoring Members and their Sponsored Members to trade general collateral repos with each other on the tri-party platform of a Sponsored GC Clearing Agent Bank<sup>24</sup> (each, a “Sponsored GC Trade”). Such general collateral repos would involve the same asset classes that are currently available for members using the GCF Repo Service.<sup>25</sup> Consistent with the GCF Repo Service, the Sponsored GC Service would also permit cash borrowers to make collateral substitutions. Sponsored GC Trades would settle in a manner similar to the way Sponsoring Members and Sponsored

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<sup>23</sup> See Notice of Filing, supra note 5 at 29836.

<sup>24</sup> The Bank of New York Mellon operates the tri-party platform that would facilitate trades conducted through the Sponsored GC Service.

<sup>25</sup> FICC would register a new series of Generic CUSIP Numbers for the Sponsored GC Service as follows: (i) U.S. Treasury Securities maturing in ten (10) years or less, (ii) U.S. Treasury Securities maturing in thirty (30) years or less, (iii) Non-Mortgage-Backed U.S. Agency Securities, (iv) Federal National Mortgage Association (“Fannie Mae”) and Federal Home Loan Mortgage Corporation (“Freddie Mac”) Fixed Rate Mortgage-Backed Securities, (v) Fannie Mae and Freddie Mac Adjustable Rate Mortgage-Backed Securities, (vi) Government National Mortgage Association (“Ginnie Mae”) Fixed Rate Mortgage-Backed Securities, (vii) Ginnie Mae Adjustable Rate Mortgage-Backed Securities, (viii) U.S. Treasury Inflation-Protected Securities (“TIPS”) and (ix) U.S. Treasury Separate Trading of Registered Interest and Principal of Securities (“STRIPS”). The purpose of registering a new series of Generic CUSIP Numbers specific to the Sponsored GC Service is to avoid any operational processing errors that could otherwise result if a trade intended for the Sponsored GC Service was inadvertently processed as a GCF Repo transaction or vice versa. Notice of Filing, supra note 5 at 29836.

Members currently settle tri-party repos with each other outside of central clearing.

#### Sponsored GC Service Structure

Sponsored GC Trades would only be between a Sponsored Member and its Sponsoring Member. FICC would novate only the End Legs of Sponsored GC Trades. Consistent with the current settlement process of such tri-party repos outside of central clearing, the Start Legs of Sponsored GC Trades would continue to settle on a trade-for-trade basis on the tri-party platform of a Sponsored GC Clearing Agent Bank.<sup>26</sup>

Accrued repo interest on Sponsored GC Trades would be paid and collected by FICC on a daily basis. Additionally, if the market value of the securities collateral decreases from its market value at the Start Leg, the cash borrower would be required deliver to FICC additional securities (and/or cash) such that the market value of the total securities collateral remains at least equal to its market value at the Start Leg. Conversely, if the market value of the securities collateral increases from its value at the Start Leg, the cash lender would be required to deliver to FICC securities (and/or cash) such that the market value of the remaining securities collateral remains at least equal to its market value at the Start Leg. Such additional securities (and/or cash) must be

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<sup>26</sup> FICC does not believe it would be efficient or appropriate to novate the Start Legs of Sponsored GC Trades, as that novation would unnecessarily complicate an already efficient process by requiring the parties to make significant operational and business changes to include FICC in the transaction chain. Since Sponsored GC Trades would only be between a Sponsored Member and its Sponsoring Member on a known (i.e., not blind) basis, all Start Leg obligations would settle between a single set of counterparties, negating any efficiency or reduced settlement risk that FICC's novation would provide. See Notice of Filing, supra note 5 at 29836-37.



delivered within the timeframe set forth in a proposed new schedule of Sponsored GC Trade timeframes set forth in the Rules.

In order to facilitate settlement of securities and cash obligations, FICC would direct each party to a Sponsored GC Trade to make any payment or delivery due to FICC in respect of a Sponsored GC Trade (except for certain funds-only settlement obligations, as discussed below) directly to the relevant pre-novation counterparty. As a result, each transfer of securities and daily repo interest would be made directly between the Sponsored Member and its Sponsoring Member via the tri-party repo platform of a Sponsored GC Clearing Agent Bank.<sup>27</sup>

#### Market Risk Management

FICC would manage its market risk with respect to Sponsored GC Trades similar to the manner in which FICC manages existing trades within the Sponsored Service. To mitigate market risk, FICC would calculate the Value at Risk (“VaR”) margin component (“VaR Charge”)<sup>28</sup> for each Sponsored Member based on its activity in the Sponsored

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<sup>27</sup> FICC similarly does not believe it would be appropriate for FICC to be in the transaction chain for each payment and delivery under a Sponsored GC Trade because inserting FICC in the middle of the payments and deliveries would require substantial changes in operational processes for both Sponsored Members and Sponsoring Members. FICC does not believe such operational changes are necessary since there can only be two pre-novation counterparties involved in the settlement of a Sponsored GC Trade (i.e., the Sponsoring Member and its Sponsored Member client). See id.

<sup>28</sup> Each member’s margin consists of a number of applicable components. The VaR Charge is typically the largest component of a member’s margin requirement. The VaR Charge is designed to capture the potential market price risk associated with the securities in a member’s portfolio. The VaR Charge is designed to provide an estimate of FICC’s projected liquidation losses with respect to a defaulted member’s portfolio at a 99 percent confidence level. See Rule 1 (definition of “VaR Charge”), supra note 4; Securities Exchange Act Release No. 83362 (June 1, 2018), 83 Fed. Reg. 26514 (June 7, 2018) (SR-FICC-2018-001).

Service, including its activity in the proposed Sponsored GC Service. The VaR Charge for the Sponsoring Member's omnibus account for Sponsored Member trading activity would continue to be gross-margined as the sum of the individual VaR Charges for each Sponsored Member client.<sup>29</sup>

Additionally, FICC would assign a symbol to each Sponsored Member to facilitate FICC's ability to surveil the Sponsored Member's activity across its Sponsored GC Trades as well as its other Sponsored Member Trades within the existing Sponsored Service (both with the same Sponsoring Member and across Sponsoring Members, if applicable). In addition, FICC would apply certain heightened requirements that apply to certain Sponsoring Members within the Sponsored GC Service as well.<sup>30</sup> For example, FICC may impose heightened financial requirements on these Sponsoring Members based on their anticipated activity and other factors,<sup>31</sup> and FICC may limit such a Sponsoring Member's activity if the sum of the VaR Charges of its omnibus and netting accounts exceeds its net capital.<sup>32</sup>

In addition, FICC would manage the mark-to-market risk associated with unaccrued repo interest on a Sponsored GC Trade through a proposed new interest rate

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<sup>29</sup> See Rule 3A, Section 10, supra note 4.

<sup>30</sup> Specifically, these restrictions apply to Category 2 Sponsoring Members, which are other members that meet certain financial requirements as compared to Category 1 Sponsoring Members, which are bank netting members that are well-capitalized with \$5 billion in equity capital. See Rule 3A, Section 2(a), supra note 4.

<sup>31</sup> See Rule 3A, Section 2(b), supra note 4.

<sup>32</sup> See Rule 3A, Section 2(h), supra note 4.

mark component of funds-only settlement.<sup>33</sup> FICC would also apply an Interest Adjustment Payment to Sponsored GC Trades to account for overnight use of funds by the Sponsoring Member or Sponsored Member, as applicable, based on such party's receipt from FICC of a Forward Mark Adjustment Payment (reflecting a GC Interest Rate Mark) on the previous business day.<sup>34</sup>

### Liquidity Risk Management

Currently, trades between a Sponsoring Member and its Sponsored Member do not independently create liquidity risk for FICC. Under its Rules, if a Sponsoring Member defaults, FICC may close out (that is, cash settle) the Sponsored Member trades of the defaulting Sponsoring Member.<sup>35</sup> Similarly, if a Sponsored Member defaults, FICC may offset its settlement obligations to the Sponsoring Member against the Sponsoring Member's obligations under the Sponsoring Member Guaranty to perform on

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<sup>33</sup> This GC Interest Rate Mark would be calculated in the same manner as the GCF Interest Rate Mark is for GCF Repo transactions. For a detailed description of the calculation, see Notice of Filing, supra note 5 at 29837.

<sup>34</sup> No other components of funds-only settlement would be necessary to apply to Sponsored GC Trades because, as described above, (i) all Sponsored GC Trades would novate after the settlement of the Start Legs of such trades (i.e., not during the Forward-Starting Period), (ii) mark-to-market changes in the value of the securities transferred under Sponsored GC Trades would be managed by the Sponsored GC Clearing Agent Bank on FICC's behalf (consistent with the manner in which GCF Repo transactions are currently processed), and (iii) the accrued repo interest on Sponsored GC Trades would be passed on a daily basis, as described above.

<sup>35</sup> See Rule 3A, Section 14(c), supra note 4. See also Rule 22A, Section 2, supra note 4.

behalf of its defaulting Sponsored Member.<sup>36</sup> Thus, in both default scenarios, FICC bears no liquidity risk.

As a result, to the extent a Sponsoring Member either (1) runs a matched book of Sponsored Member trades (i.e., enters into offsetting trades with its own Sponsored Members), or (2) simply enters into trades with its Sponsored Member (i.e., without entering into offsetting transactions), such activities do not increase FICC's liquidity risk. FICC bears liquidity risk only when a Sponsoring Member enters into an offsetting trade in which a third-party member is the pre-novation counterparty. In that scenario, FICC is required to settle the obligations of a defaulting Sponsoring Member.

Since Sponsored GC Trades would not involve third-party members, such trades would impact FICC's liquidity risk in a similar manner to trades between a Sponsoring Member and its Sponsored Member in the current Sponsored Service. As a result, FICC proposes to manage the liquidity risk associated with Sponsored GC Trades in the same manner that it currently manages such risk for other trades between a Sponsoring Member and its Sponsored Member.

**C. Proposed Changes to Allocations within the Capped Contingency Liquidity Facility ("CCLF")**

**1. CCLF Background**

On April 25, 2017, the Commission approved FICC's adoption of the Clearing Agency Liquidity Risk Management Framework ("Framework"), which broadly describes FICC's liquidity risk management strategy and objective to maintain sufficient liquid resources in order to meet the potential amount of funding required to settle

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<sup>36</sup> See Rule 3A, Section 11, supra note 4.

outstanding transactions of a defaulting member (including affiliates) in a timely manner.<sup>37</sup> The Framework identifies, among other things, each of the qualifying liquid resources available to FICC, including the CCLF.<sup>38</sup> The CCLF is a rules-based, committed liquidity resource, designed to enable FICC to meet its cash settlement obligations in the event of a default of the member (including the member's family of affiliated members) to which FICC has the largest exposure in extreme but plausible market conditions.<sup>39</sup> FICC would activate the CCLF if, upon a member default, FICC determines that its non-CCLF liquidity resources would not generate sufficient cash to satisfy FICC's payment obligations to its non-defaulting members. In simple terms, a CCLF repo is equivalent to a non-defaulting member financing FICC's payment obligation under the original trade, thereby providing FICC with time to liquidate the securities underlying the original trade. More specifically, upon activating the CCLF, members would be called upon to enter into repo transactions (as cash lenders) with FICC (as cash borrower) up to a pre-determined capped dollar amount, thereby providing FICC with sufficient liquidity to meet its payment obligations. For a non-defaulting member to whom FICC has a payment obligation disrupted by a member default, a CCLF

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<sup>37</sup> See Securities Exchange Act Release No. 80489 (April 19, 2017), 82 Fed. Reg. 19120 (April 25, 2017) (SR-FICC-2017-008).

<sup>38</sup> See id.

<sup>39</sup> FICC designed the CCLF to meet the regulatory requirement for a covered clearing agency to measure, monitor, and manage its liquidity risk by maintaining sufficient liquid resources to effect same-day settlement of payment obligations in the event of a default of the participant family that would generate the largest aggregate payment obligation for the clearing agency in extreme but plausible market conditions. 17 CFR 240.17Ad-22(e)(7)(i); see Securities Exchange Act Release No. 82090 (November 15, 2017), 82 Fed. Reg. 55427, 55430 (November 21, 2017) (SR-FICC-2017-002); Rule 22A, Section 2a, supra note 4.

repo would extinguish and replace the original trade that gave rise to FICC's payment obligation.

FICC determines the total size of the CCLF based on FICC's potential cash settlement obligations that would result from the default of the member (including affiliates) presenting the largest liquidity need to FICC over a specified look-back period, plus an additional liquidity buffer. Under the proposal in the Advance Notice, FICC would not change the method by which it determines the total size of the CCLF.

FICC uses a tiered approach to allocate the total size of the CCLF among its members to arrive at the amount of each member's CCLF obligation. FICC allocates \$15 billion of the total size of the CCLF among all members.<sup>40</sup> FICC allocates the remainder of the total size of the CCLF among members that generate liquidity needs above the \$15 billion threshold based on the frequency that such members generate daily liquidity needs over \$15 billion across supplemental liquidity tiers in \$5 billion increments. Specifically, FICC calculates a dollar amount for the CCLF obligation applicable to each supplemental liquidity tier. FICC allocates the CCLF obligation for each supplemental liquidity tier to

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<sup>40</sup> FICC has determined that \$15 billion is an appropriate amount for allocation to all members because the average member's liquidity need from 2015-2016 was approximately \$7 billion, with a majority of members (approximately 85 percent) having liquidity needs less than \$15 billion. See Securities Exchange Act Release No. 82090 (November 15, 2017), 82 Fed. Reg. 55427, 55430 (November 21, 2017) (SR-FICC-2017-002).

members on a pro-rata basis corresponding to the number of times each member generates liquidity needs within each supplemental liquidity tier.<sup>41</sup>

## **2. Current CCLF Allocation Methodology for the Sponsored Service**

Currently, FICC does not impose a CCLF obligation on a Sponsoring Member to the extent the Sponsoring Member runs a matched book of Sponsored Member trades. This is because to determine a Sponsoring Member's CCLF obligation, FICC nets all of the positions recorded in the Sponsoring Member's omnibus account (regardless of whether they relate to the same Sponsored Member) and separately nets all of the positions in the Sponsoring Member's netting account.<sup>42</sup> As a result, to the extent a Sponsoring Member enters into perfectly offsetting Sponsored Member trades (i.e., the matched book scenario), the settlement obligations of those trades net out in the omnibus account and the netting account, with no resulting CCLF obligation for the Sponsoring Member.

However, if a Sponsoring Member enters into a Sponsored Member trade without entering into an offsetting transaction, the Sponsoring Member is subject to CCLF

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<sup>41</sup> For example, a member that generates daily liquidity needs in the \$15-\$20 billion supplemental liquidity tier would incur a pro-rata share for the \$15-\$20 billion supplemental liquidity tier only. Another member that generates daily liquidity needs in the \$20-\$25 billion supplemental liquidity tier would incur a pro-rata share for both the \$15-\$20 and \$20-\$25 billion supplemental liquidity tiers. A third member that generates daily liquidity needs in the \$65-\$70 billion supplemental liquidity tier would incur a pro-rata share for every supplemental liquidity tier. Each member's pro-rata share is based on the frequency with which the member generates daily liquidity needs in each supplemental liquidity tier. See Securities Exchange Act Release No. 80234 (March 14, 2017), 82 Fed. Reg. 14401, 14404-05 (March 20, 2017) (SR-FICC-2017-002).

<sup>42</sup> See Rule 3A, Section 8(b) and Rule 22A, Section 2a(b), supra note 4.

obligations for the position of its Sponsored Member recorded in its omnibus account as well as its own position arising from the Sponsored Member trade recorded in its netting account. Although the positions in the Sponsoring Member's omnibus account and netting account offset each other, FICC does not currently net such positions for CCLF purposes because CCLF allocations are determined at the participant account level.<sup>43</sup> FICC believes the foregoing scenario should not contribute to the Sponsoring Member's CCLF obligation because, as described above in Section I.B, such offsetting obligations do not present liquidity risk to FICC.

### **3. Proposed CCLF Allocation Methodology for the Sponsored Service**

As described above, trades between a Sponsoring Member and its Sponsored Member do not independently create liquidity risk for FICC, and, therefore, FICC believes that such trades should not affect the Sponsoring Member's CCLF obligation. To ensure that a Sponsoring Member's CCLF obligation is calculated to reflect the lack of liquidity risk to FICC associated with Sponsored Member trades, FICC proposes to take into account, for CCLF calculation purposes, any offsetting settlement obligations

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<sup>43</sup> This limitation on offset is consistent with FICC's approach of not offsetting the positions of two accounts of the same member for CCLF purposes. However, FICC notes an important difference between Sponsored Member trades and other FICC repo activity. See Notice of Filing, supra note 5 at 29842. Specifically, as mentioned above in Section I.A.2., the Sponsored Service requires a Sponsoring Member to maintain an omnibus account that is separate from its netting account. In contrast, for all other repo activity, members have the option to collapse all of their activity into a single participant account in order to achieve a similar netting benefit. Sponsoring Members do not have that option with respect to their Sponsored Member trades. Therefore, FICC believes this proposed change is necessary to ensure that a Sponsoring Member's CCLF obligations are calculated in a manner that more closely aligns with the liquidity risk associated with Sponsored Member trades. Id.



between a Sponsoring Member's netting account and its omnibus account. This proposed change would ensure that all Sponsored Member trades, whether perfectly offset by other Sponsored Member trades (i.e., the matched book scenario) or not, would be recognized for CCLF purposes as not affecting FICC's liquidity risk. This proposed change would also apply to trades in the new Sponsored GC Service.<sup>44</sup>

Although, as noted above, the proposal in the Advance Notice would not affect the method by which FICC determines the total CCLF amount, FICC's proposal to net offsetting trades between a Sponsoring Member and its Sponsored Member for CCLF calculation purposes would affect the allocation of CCLF obligations over \$15 billion to other members. Specifically, as described above, under the current Rules, if a Sponsoring Member enters into a Sponsored Member trade without entering into an offsetting transaction, the Sponsoring Member is subject to CCLF obligations for the position of its Sponsored Member recorded in its omnibus account as well as its own position arising from the Sponsored Member trade recorded in its netting account. Under the proposal, the Sponsoring Member would not incur CCLF obligations for such

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<sup>44</sup> For Sponsored GC Trades, this proposed change would ensure that FICC applies an appropriate CCLF obligation to a Sponsoring Member in the event a Sponsored GC Clearing Agent Bank allocates to a Sponsored GC Trade a different security than the security that underlies an offsetting Sponsored Member Trade. For example, a Sponsoring Member may enter into a Sponsored GC Trade on a Generic CUSIP Number and a separate offsetting Sponsored Member trade in a specific CUSIP Number. Although the specific CUSIP Number might also be an eligible security under the Generic CUSIP Number underlying the Sponsored GC Trade, the Sponsored GC Clearing Agent Bank could allocate to the Sponsored GC Trade a different eligible CUSIP Number from the list of eligible securities. FICC's proposed change would offset these positions across the Sponsoring Member's netting account and omnibus account to ensure that the CCLF obligation applicable to the Sponsoring Member accurately reflects the liquidity risk associated with those positions.

transactions. Therefore, a Sponsoring Member's peak daily liquidity is currently higher than it would be under the proposal. This, in turn, may decrease the frequency with which a Sponsoring Member's daily peak liquidity reaches into higher supplemental liquidity tiers. As a result, the pro-rata allocation of CCLF obligations among members with daily peak liquidity in those supplemental liquidity tiers would increase.<sup>45</sup> When fewer members generate peak liquidity needs in a supplemental liquidity tier, the remaining members that generate peak liquidity in that tier bear a larger pro-rata share of the CCLF allocations for that tier.

## II. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the Advance Notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FICC-2020-802 on the subject line.

### Paper Comments:

Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549.

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<sup>45</sup> The proposals in the Advance Notice would not change FICC's current methodology for calculating the total amount of the CCLF.

All submissions should refer to File Number SR-FICC-2021-801. 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 advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of FICC and FICC's website at <https://www.dtcc.com/legal>.

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-2021-801 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

### III. DISCUSSION AND COMMISSION FINDINGS

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs and strengthening the liquidity of SIFMUs.<sup>46</sup>

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe regulations containing risk management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency.<sup>47</sup> Section 805(b) of the Clearing Supervision Act provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):<sup>48</sup>

- to promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

Section 805(c) provides, in addition, that the Commission's risk management standards may address such areas as risk management and default policies and procedures, among others areas.<sup>49</sup>

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<sup>46</sup> See 12 U.S.C. 5461(b).

<sup>47</sup> 12 U.S.C. 5464(a)(2).

<sup>48</sup> 12 U.S.C. 5464(b).

<sup>49</sup> 12 U.S.C. 5464(c).

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the “Clearing Agency Rules”).<sup>50</sup> The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk management practices on an ongoing basis.<sup>51</sup> As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the proposal in the Advance Notice is consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,<sup>52</sup> and in the Clearing Agency Rules, in particular Rules 17Ad-22(e)(7) and (21).<sup>53</sup>

**A. Consistency with Section 805(b) of the Clearing Supervision Act**

**1. Reducing Systemic Risks and Supporting the Stability of the Broader Financial System**

The Commission believes that the Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act because the

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<sup>50</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 Fed. Reg. 66220 (November 2, 2012) (S7-08-11). See also Securities Exchange Act Release No. 78961 (September 28, 2016), 81 Fed. Reg. 70786 (October 13, 2016) (S7-03-14) (“Covered Clearing Agency Standards”). FICC is a “covered clearing agency” as defined in Rule 17Ad-22(a)(5).

<sup>51</sup> 17 CFR 240.17Ad-22.

<sup>52</sup> 12 U.S.C. 5464(b).

<sup>53</sup> 17 CFR 240.17Ad-22(e)(7) and (21).

changes proposed in the Advance Notice are consistent with reducing systemic risks, supporting the stability of the broader financial system, promoting robust risk management, and promoting safety and soundness.<sup>54</sup>

The Commission believes that FICC's proposal to add the Sponsored GC Service to the existing Sponsored Service is consistent with the principles of reducing systemic risk and supporting the stability of the broader financial system. As described above in Section I.B., FICC proposes to add the Sponsored GC Service to facilitate centrally cleared tri-party repo trading between a Sponsored Member and its Sponsoring Member within FICC's Sponsored Service. The Sponsored GC Service is designed to enable a greater number of tri-party repo transactions to be eligible for FICC's netting services and subject to FICC's guaranteed settlement, novation, and risk management, which should help decrease the settlement and operational risk of such transactions relative to those made outside of central clearing. This risk reduction should, in turn, enhance the stability of the tri-party repo market.<sup>55</sup> Furthermore, by enabling FICC to provide CCP services covering a greater number of tri-party repo transactions, the Sponsored GC Service would enable FICC to control the liquidation of a greater number of positions in a member default scenario, which in turn, should help protect against the risk of a large-

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<sup>54</sup> 12 U.S.C. 5464(b).

<sup>55</sup> FICC notes that the centrally cleared repo market has functioned well during periods of extreme market volatility, as evidenced during the unprecedented market volatility in March-April 2020. See Notice of Filing, supra note 5 at 29835.

scale exit by institutional firms from the U.S. financial market in a stress scenario.<sup>56</sup>

Accordingly, the Commission believes that an increase in centrally cleared tri-party repo activity via the Sponsored GC Service would help reduce systemic risks and support the stability of the broader financial system, consistent with Section 805(b) of the Act.<sup>57</sup>

The Commission also believes that FICC’s proposal to change the CCLF allocation methodology is consistent with the principles of reducing systemic risks and supporting the stability of the broader financial system. As discussed above in Section I.C., trades between a Sponsoring Member and its Sponsored Member do not independently create liquidity risk for FICC. However, under the current Rules, if a Sponsoring Member enters into a Sponsored Member trade without entering into an offsetting transaction, the Sponsoring Member is subject to CCLF obligations for the Sponsored Member’s position in the Sponsoring Member’s omnibus account as well as its own position arising from the Sponsored Member trade recorded in its netting account. Although the positions in the Sponsoring Member’s omnibus account and netting account offset each other, FICC does not currently net such positions for CCLF purposes because

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<sup>56</sup> See Letter from Robert Toomey, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (June 18, 2021) at 2 (commenting that the proposed Sponsored GC Service should incentivize more central clearing of tri-party repos, thereby contributing to enhancing the capacity and resiliency of the repo market and mitigating the risk of a large-scale exit by institutional firms from the market in a stress scenario). The U.S. financial market experienced such a liquidity drain from the repo market in the 2007–2008 financial crisis when the bankruptcy of Lehman Brothers gave rise to concerns among cash provider institutional firms about the creditworthiness of their borrower counterparties. See Ben S. Bernanke, The Courage to Act: A Memoir of a Crisis and its Aftermath 397 (2017) (discussing “the paralyzing uncertainty [on the part of repo lenders] about banks’ financial health” in 2007 and 2008).

<sup>57</sup> 12 U.S.C. 5464(b).

CCLF allocations are determined at the participant account level. FICC proposes to change the Rules to allow netting, for CCLF allocation purposes, of offsetting positions in a Sponsoring Member's omnibus account and netting account. FICC designed this proposal to ensure that a Sponsoring Member's CCLF obligation aligns more closely with the actual liquidity risk its trading activity presents to FICC. This, in turn, may decrease the frequency with which a Sponsoring Member's daily peak liquidity needs reach into higher CCLF supplemental liquidity tiers, resulting in a larger pro-rata allocation of CCLF obligations among other members whose daily peak liquidity needs reach into those supplemental liquidity tiers.

Based on the foregoing, FICC's current CCLF allocation methodology subjects Sponsoring Members to CCLF obligations beyond the level of risk presented by their trading activity, essentially requiring those Sponsoring Members to partially subsidize the CCLF obligations of other members who would otherwise bear larger CCLF obligations under the proposal.<sup>58</sup> As a result, Sponsoring Members must currently direct capital towards CCLF obligations that could otherwise be used to support the trading activity of their clients.

FICC's proposal to change the CCLF allocation methodology would result in a distribution of CCLF obligations that better aligns with the liquidity risk each member's trading activity presents to FICC. Market stability is enhanced when market participants are incentivized to manage the actual risks presented by their trading activity.

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<sup>58</sup> In reaching this conclusion, the Commission reviewed and analyzed an impact analysis filed by FICC, comparing the changes in CCLF allocations under the current Rules and under the proposal. As part of the Advance Notice, FICC filed Exhibit 3 – FICC/GSD CCLF Allocations Impact Study. (Pursuant to 17 CFR 240.24b-2, FICC requested confidential treatment of Exhibit 3.



Accordingly, the Commission believes that FICC's proposal to change the CCLF allocation methodology would help reduce systemic risk and support the stability of the broader financial system, consistent with Section 805(b) of the Act.<sup>59</sup>

**2. Promoting Robust Risk Management and Safety and Soundness**

The Commission believes that FICC's proposals in the Advance Notice are consistent with the objectives of promoting robust risk management and promoting safety and soundness at FICC. With respect to the proposed Sponsored GC Service, FICC would leverage its existing risk management tools to manage the risks associated with repos transacted. For example, FICC would manage its market risk with respect to Sponsored GC Trades similar to the manner in which FICC manages existing trades within the Sponsored Service. Specifically, FICC would calculate the VaR Charge for each Sponsored Member based on its activity in the Sponsored Service, including its activity in the proposed Sponsored GC Service. The VaR Charge for the Sponsoring Member's omnibus account would continue to be the sum of the individual VaR Charges for each Sponsored Member client (i.e., gross-margined). Additionally, FICC would risk manage the mark-to-market risk associated with unaccrued repo interest on a Sponsored GC Trade through a proposed new interest rate mark, calculated in the same manner that FICC currently calculates the interest rate mark for GCF Repo transactions.

Moreover, the Advance Notice includes a proposal for a new risk management feature for the Sponsored Service. Specifically, FICC would assign a symbol to each Sponsored Member to facilitate FICC's ability to surveil the Sponsored Member's

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<sup>59</sup> 12 U.S.C. 5464(b).

activity across its Sponsored GC Trades as well as its other Sponsored Member Trades within the existing Sponsored Service. In addition, the new Sponsored GC Service would continue to apply certain heightened requirements on particular types of Sponsoring Members. The foregoing risk management measures would help FICC prevent and otherwise manage the risks presented by the potential default of a member within Sponsored GC Service. Accordingly, the Commission believes that the proposed Sponsored GC Service would promote robust risk management and safety and soundness at FICC, consistent with Section 805(b) of the Act.<sup>60</sup>

The Commission also believes that FICC's proposals in the Advance Notice are consistent with the objective of promoting safety and soundness in the tri-party repo market. As discussed above, the Sponsored GC Service would make the risk-reducing benefits of central clearing available to a greater portion of trades in the tri-party repo market. Also, as described above in Section III.A.1., FICC's proposed CCLF allocation methodology would reduce CCLF obligations for Sponsoring Members with respect to Sponsored Member trades entered into without offsetting (i.e., matched book) trades. As a result, the proposed CCLF allocation methodology would reduce costs for Sponsoring Members and thereby provide an additional incentive for eligible market participants to join the Sponsored Service and offer the Sponsored GC Service to a potentially broader segment of the tri-party market. By bringing a greater portion of tri-party repo trades into central clearing, the proposals in the Advance Notice would help to decrease the settlement and operational risk present when such trades are conducted outside of central clearing. The Sponsored GC Service would thereby contribute to the stability of the tri-

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<sup>60</sup> Id.

party repo market. Furthermore, the Sponsored GC Service would enable FICC to centralize and control the liquidation of a greater number of tri-party repo transactions in the event of a member default, which in turn, would help protect the tri-party repo market against the destabilizing risk of a large-scale exit by institutional firms from the U.S. financial market in a stress scenario. Accordingly, the Commission believes that the proposed Sponsored GC Service would promote safety and soundness in the tri-party repo market, consistent with Section 805(b) of the Act.<sup>61</sup>

Additionally, the Commission also believes that FICC's proposal to change the CCLF allocation methodology is consistent with the principle of promoting robust risk management. As described above in Section II.C., FICC's proposal to change the CCLF allocation methodology would not impact FICC's current methodology for determining the total amount of the CCLF. As a result, FICC would retain its current level of liquid resources. FICC's proposal would only change the allocation of CCLF obligations among FICC's members. As described above in this Section III.A.1., FICC's proposed CCLF allocation methodology would result in a CCLF obligation for each member that better corresponds to the actual liquidity risk each member's trading activity presents to FICC. Accordingly, the Commission believes FICC's proposed CCLF allocation methodology would promote robust risk management because it would better align the costs for a member to participate in FICC with the level of risk the member's trading

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<sup>61</sup> Id.

activity presents to FICC, while still maintaining the same overall level of liquidity resources at FICC.

**B. Consistency with Rule 17Ad-22(e)(7)**

Rule 17Ad-22(e)(7) under the Exchange Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency.<sup>62</sup> As described above in Section I.C.3., FICC proposes to change the Rules to allow netting, for CCLF allocation purposes, of offsetting positions in a Sponsoring Member's omnibus account and netting account.

FICC's proposal would not impact FICC's current methodology for determining the total amount of the CCLF as a liquidity resource. As discussed above in Section III.A.1., FICC proposes to change the Rules regarding CCLF allocation to ensure that a Sponsoring Member's CCLF obligation aligns more closely with the actual liquidity risk its trading activity presents to FICC. As a result, FICC's proposed CCLF allocation methodology represents more efficient liquidity risk management than the current methodology. Accordingly, the Commission believes that FICC's proposed CCLF allocation methodology is consistent with Rule 17Ad-22(e)(7).<sup>63</sup>

**C. Consistency with Rule 17Ad-22(e)(21)**

Rule 17Ad-22(e)(21) under the Exchange Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably

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<sup>62</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>63</sup> Id.

designed to be efficient and effective in meeting the requirements of its participants and the markets it serves, including the clearing agency's clearing and settlement arrangements and the scope of products cleared or settled.<sup>64</sup> As described above in Section I.B., FICC's current Sponsored Service does not accommodate the trading of tri-party repos. FICC proposes to expand the Sponsored Service to allow tri-party repo trading to meet the needs of market participants that currently transact tri-party term repos outside of central clearing because they are not operationally equipped to perform the collateral management and other functions associated with term DVP repos. By expanding the Sponsored Service to facilitate tri-party repo trading, FICC seeks to provide a viable option for its members to transact term tri-party repos in central clearing. Sponsored GC Trades would settle in a manner similar to the way Sponsoring Members and Sponsored Members currently settle tri-party repos with each other outside of central clearing, thereby making it more operationally efficient for the parties to transact term repos with each other using FICC as the CCP. The Commission believes that the proposed Sponsored GC Service is consistent with Rule 17Ad-22(e)(21)<sup>65</sup> because it is responsive to the requests from FICC's members for the ability to trade centrally cleared term tri-party repos in a manner that is efficient and effective in meeting the operational requirements of FICC's members.

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<sup>64</sup> 17 CFR 240.17Ad-22(e)(21).

<sup>65</sup> Id.

#### **IV. CONCLUSION**

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission DOES NOT OBJECT to Advance Notice (SR-FICC-2021-801) and that FICC is AUTHORIZED to implement the proposed change as of the date of this notice or the date of an order by the Commission approving Proposed Rule Change SR-FICC-2021-003, whichever is later.

By the Commission.

Vanessa A. Countryman  
Secretary