

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65213; File No. SR-FICC-2011-05)

August 29, 2011

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Amend the Rules Regarding the GCF Repo Service to Adopt Changes Recommended by the Tri-Party Repo Infrastructure Reform Task Force

I. Introduction

On July 12, 2011, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-FICC-2011-05 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ The proposed rule change was published for comment in the Federal Register on July 29, 2011.² The Commission received no comment letters. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

This rule change will make certain changes to its GCF Repo^{®3} service in order to comply with the recommendations made by the Tri-Party Repo Infrastructure Reform Task Force (“TPR”), an industry group formed and sponsored by the Federal Reserve Bank of New York.⁴

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 34-64955 (July 25, 2011), 76 FR 45638 (July 29, 2011).

³ GCF Repo is a registered trademark of FICC/DTCC.

⁴ The main purpose of the TPR is to develop recommendations to address the risk presented by tri-party repo transactions due to the current morning reversal or “unwind” process and to move to a process by which tri-party repo transactions are collateralized all day. Currently, tri-party repo transactions unwind in the morning between 7:00 a.m. and 8:00 a.m. EST. The GSD Schedule of GCF Timeframes provides that the unwind of GCF Repo transactions (both overnight and term) must be accomplished by 7:30 a.m. The TPR has mandated that the collateral used in tri-party repo and GCF Repo transactions be “locked up”

Because the GCF Repo service operates as a tri-party repo mechanism, FICC is incorporating changes to the GCF Repo service to align the service with the other TPR recommended changes for the overall tri-party repo market.

FICC will initially implement the changes described herein in a pilot program (“Pilot Program”). FICC will run the Pilot Program for one year starting from the date of this Commission approval. If FICC wishes to extend the Pilot Program or to implement the changes in the Pilot Program permanently, FICC shall submit a proposed rule change filing to the Commission for that purpose.

A. Background: Description of the GCF Repo Service and History

(1) Creation of the GCF Repo Service

The GCF Repo service allows GSD dealer members to trade general collateral repos⁵ throughout the day without requiring intra-day, trade-for-trade settlement on a delivery-versus-payment (DVP) basis. The service allows the dealers to trade such general collateral repos, based on rate and term, throughout the day with inter-dealer broker netting members on a blind basis. Standardized, generic CUSIP numbers have been established exclusively for GCF Repo processing and are used to specify the acceptable type of underlying Fedwire book-entry eligible collateral, which includes Treasuries, Agencies and certain mortgage-backed securities.⁶

until 3:30 p.m. EST. This would serve to reduce the intraday exposure to the dealers that the clearing banks currently face with the start of daily unwind.

⁵ A general collateral repo is a repo in which the underlying securities collateral is nonspecific, general collateral whose identification is at the option of the seller. This is in contrast to a specific collateral repo.

⁶ In 2009, the Commission approved FICC rule filing 2009-04 to add debt securities issued under the Debt Guaranty Program component of the Federal Deposit Insurance Corporation’s (the “FDIC’s”) Temporary Liquidity Guarantee Program (the “TLGP”) to the GCF Repo service.

The GCF Repo service was developed as part of a collaborative effort among the Government Securities Clearing Corporation (“GSCC”) (FICC’s predecessor), its two clearing banks (The Bank of New York Mellon (“BNY”) and JPMorgan Chase Bank, National Association (“Chase”)), and industry representatives. GSCC introduced the GCF Repo service on an intra-clearing bank basis in 1998.⁷ Under the intrabank service, dealers could only engage in GCF Repo transactions with other dealers that cleared at the same clearing bank.

(2) Creation of the Interbank Version of the GCF Repo Service

In 1999, GSCC expanded the GCF Repo service to permit dealer participants to engage in GCF Repo trading on an interbank basis, meaning that dealers using different clearing banks could enter into GCF Repo transactions (on a blind brokered basis).⁸ Because dealer members that participate in the GCF Repo service do not all clear at the same clearing bank, introducing the service as an interbank service necessitated the establishment of a mechanism to permit after-hours movements of securities between the two clearing banks to deal with the fact that GSCC would likely have unbalanced net GCF securities and cash positions within each clearing bank (that is, it is likely that at the end of GCF Repo processing each business day, the dealers in one clearing bank will be net funds borrowers, while the dealers at the other clearing bank will be net

See Securities Exchange Act Release No. 34-58696 (September, 30, 2008), 73 FR 58698 (October 7, 2008). The TLGP, one of the steps taken by the U.S. Government to stabilize the credit markets and stimulate lending, was designed to allow banks to issue FDIC-insured debt, ensuring that the banks would be able to roll over any debt coming due in the coming months. The guarantee consists of timely payment of principal and interest. The expiration of the FDIC’s guarantee is the earlier of either the maturity date of the issued debt or June 2012.

⁷ See Securities Exchange Act Release No. 34-40623 (October 30, 1998), 63 FR 59831 (November 5, 1998).

⁸ See Securities Exchange Act Release No. 34-41303 (April 16, 1999), 64 FR 20346 (April 26, 1999).

funds lenders). To address this issue, GSCC and its clearing banks established, and the Commission approved, a legal mechanism by which securities would “move” across the clearing banks without the use of the Fedwire Securities Service (“Fedwire Securities”).⁹ (Movements of cash do not present the same issue because the Fedwire Funds Service (“Fedwire Funds”) is open later than Fedwire Securities). Therefore, at the end of the day, after the GCF net results are produced, securities are pledged via a tri-party-like mechanism and the interbank cash component is moved via Fedwire Funds. In the morning, the pledges are unwound; that is, funds are returned to the net funds lenders and securities are returned to the net funds borrowers.

(3) Issues with Morning Unwind Process

In 2003, FICC shifted the GCF Repo service back to intrabank status only.¹⁰ By that time, the service had grown significantly in participation and volume. However, with the increase in use of the interbank service, certain payments systems risk issues arose from the interbank funds settlements related to the service, namely, the large interbank funds movement in the morning. FICC shifted the service back to intrabank status to enable management to study the issues presented and identify a satisfactory solution for bringing the service back to interbank status.

(4) The NFE Filing and Restoration of Service to Interbank Status

In 2007, FICC submitted to the Commission a proposed rule change to address the issues raised by the interbank morning funds movement and return the GCF Repo service to

⁹ See Id. for a detailed description of the clearing bank and FICC accounts needed to effect the after-hour movement of securities.

¹⁰ See Securities Exchange Act Release No. 34-48006 (June 10, 2003), 68 FR 35745 (June 16, 2003).

interbank status (“2007 NFE Filing”).¹¹ The 2007 NFE Filing addressed these issues by using a hold against a dealer’s “net free equity” (“NFE”) at the clearing bank to collateralize its GCF Repo cash obligation to FICC on an intraday basis.¹²

The 2007 NFE Filing replaced the Day 2 morning unwind process with an alternate process, which is currently in effect. Specifically, in lieu of making funds payments, the interbank dealers grant to FICC a security interest in their NFE-related collateral equal to their prorated share of the total interbank funds amount. FICC, in turn, grants to the other clearing bank (that was due to receive the funds) a security interest in the NFE-related collateral to support the debit in the FICC account at the clearing bank. The debit in the FICC account occurs because the dealers who are due to receive funds in the morning must receive those funds at that time in return for their release of collateral. The debit in the FICC account at the clearing bank gets satisfied during the end of day GCF Repo settlement process. Specifically, that day’s new activity yields a new interbank funds amount that will move at end of day—however, this amount gets netted with the amount that would have been due in the morning, thus further reducing the interbank funds movement. The NFE holds are released when the interbank funds movement is made at end of day. The 2007 NFE Filing did not involve any changes to the after-hours movement of securities occurring at the end of the day on Day 1.

As part of the 2007 NFE Filing, FICC imposed certain additional risk management measures with respect to the GCF Repo service. First, FICC imposed a collateral premium

¹¹ See Securities Exchange Act Release No. 34-57652 (April 11, 2008), 73 FR 20999 (April 17, 2008).

¹² NFE is a methodology that clearing banks use to determine whether an account holder (such as a dealer) has sufficient collateral to enter into a specific transaction. NFE allows the clearing bank to place a limit on its customer’s activity by calculating a value on the customer’s balances at the bank. Bank customers have the ability to monitor their NFE balance throughout the day.

(“GCF Premium Charge”) on the GCF Repo portion of the Clearing Fund deposits of all GCF participants to further protect FICC in the event of an intra-day default of a GCF Repo participant. FICC requires GCF Repo participants to submit a quarterly “snapshot” of their holdings by asset type to enable risk management staff to determine the appropriate GCF Premium Charge. As with all other instances of late submissions of required information, members who do not submit this required information by the deadlines established by FICC are subject to a fine and an increased Clearing Fund premium.

Second, the 2007 NFE Filing addressed the situation where FICC becomes concerned about the volume of interbank GCF Repo activity. Such a concern might arise, for example, if market events were to cause dealers to turn to the GCF Repo service for increased funding at levels beyond normal processing. The 2007 NFE Filing provides FICC with the discretion to institute risk mitigation and appropriate disincentive measures in order to bring GCF Repo levels to a comfortable level from a risk management perspective.¹³

B. Changes to the GCF Repo Service to Implement the TPR’s Recommendations

FICC is adopting the following rule changes with respect to the GCF Repo service to address the TPR’s Recommendations:

¹³ Specifically, the 2007 NFE Filing introduced the term “GCF Repo Event,” which will be declared by FICC if either of the following occurs: (i) the GCF interbank funds amount exceeds five times the average interbank funds amount over the previous ninety days for three consecutive days; or (ii) the GCF interbank funds amount exceeds fifty percent of the amount of GCF Repo collateral pledged for three consecutive days. FICC reviews these figures on a semi-annual basis to determine whether they remain adequate. FICC also has the right to declare a GCF Repo Event in any other circumstances where it is concerned about GCF Repo volumes and believes it is necessary to declare a GCF Repo Event in order to protect itself and its members. FICC will inform its members about the declaration of the GCF Repo Event via important notice. FICC will also inform the Commission about the declaration of the GCF Repo Event.

- (1) (a) to move the Day 2 unwind from 7:30 a.m. to 3:30 p.m.; (b) to move the NFE process¹⁴ from morning to a time established by FICC as announced by notice to all members;¹⁵ (c) to move the cut-off time of GCF Repo submissions from 3:35 p.m. to 3:00 p.m.; and (d) to move the cut-off time for dealer affirmation or disaffirmation from 3:45 p.m. to 3:00 p.m.; and
- (2) To establish rules for intraday GCF Repo collateral substitutions.¹⁶

(1) Change Regarding the Morning Unwind and Related Rule Changes

The TPR has recommended that the Day 2 unwind for all tri-party transactions are moved from the morning to 3:30 p.m. The TPR has made this recommendation in order to reduce the clearing banks' intraday exposure to the dealers. As previously stated, because the GCF Repo service is essentially a tri-party repo mechanism, FICC has also been requested by the TPR to accommodate this time change. For the GSD rules, this necessitates a change to the GSD's "Schedule of GCF Timeframes" ("Schedule"). Specifically, the 7:30 a.m. time in the Schedule is deleted and the language therein is moved to a new time of 3:30 p.m..

The change to the time of the intrabank unwind also necessitates a change to the cut-off time for GCF Repo trade submissions, which is currently 3:35 p.m. in the Schedule. FICC is amending the Schedule to change the cut-off time to 3:00 p.m. to allow FICC to submit files to the clearing banks which, in turn, will provide files to the dealers by 3:30 p.m. As a result,

¹⁴ No other changes are being made to the NFE process that was in place by the 2007 NFE Filing; the risk management measures that were put in place by the 2007 NFE Filing remain in place.

¹⁵ The time range initially is be between 8 a.m. and 1 p.m.

¹⁶ Only cash substitutions will be permitted for interbank GCF Repo transactions, as discussed in more detail below.

dealers should have a complete picture of their positions as the unwind occurs at 3:30 p.m. The 3:45 p.m. cutoff for dealer affirmation or disaffirmation is moved to 3:00 p.m. so that the new 3:00 p.m. cutoff for submissions is also the cutoff for dealer affirmations and disaffirmations.¹⁷

Because the Day 2 unwind is moving from the morning to 3:30 p.m. and because the NFE process established by the 2007 NFE Filing is tied to the moment of the interbank unwind, the NFE process will also move to the time established by FICC as announced by notice to all members. This range will be between 8 a.m. and 1:00 p.m. Because the NFE process is a legal process and not an operational process, it is not reflected on the Schedule. FICC is deleting the reference to the “morning” timeframe on Day 2 with respect to the NFE process in Section 3 of Rule 20 and adding language referencing “at the time established by the Corporation.”

(2) Change Regarding Intraday GCF Repo Securities Collateral Substitutions

As a result of the time change of the unwind (*i.e.*, the reversal on Day 2 of collateral allocations established by FICC for each netting member’s GCF net funds borrower positions and GCF net funds lender positions on Day 1 to 3:30 p.m., the provider of GCF Repo securities collateral in a GCF Repo transaction on Day 1 will no longer have access to such securities at the beginning of Day 2. Therefore, during Day 2 prior to the unwind of the Day 1 collateral allocations, the provider of GCF Repo securities collateral needs a substitution mechanism for the return of its posted GCF Repo securities collateral in order to utilize such securities in its business activities. FICC is establishing a substitution process for this purpose in conjunction with its clearing banks. The language for the substitution mechanism is being added to Section 3 of GSD Rule 20. The rule change provides that all requests for substitution for the GCF Repo

¹⁷ This change updates the current Schedule to provide that the cutoff for submissions and dealer affirmations/disaffirmations is at the same time, which is consistent with current practice.

securities collateral must be submitted by the provider of the GCF Repo securities collateral by the applicable deadline on Day 2 (“Substitution Deadline”).¹⁸

(3) Substitutions on Intraday GCF Repos

If the GCF Repo transaction is between dealer counterparties effecting the transaction through the same clearing bank, on Day 2 such clearing bank will process each substitution request of the provider of GCF Repo securities collateral submitted prior to the substitution deadline promptly upon receipt of such request. The return of the GCF Repo securities collateral in exchange for cash and/or eligible securities of equivalent value can be accomplished by simple debits and credits to the accounts of the GCF Repo dealer counterparties at the clearing bank. Eligible securities for this purpose will be the same as those currently permitted under the GSD rules for collateral allocations, namely, (i) Comparable Securities,¹⁹ (ii) Other Acceptable Securities,²⁰ or (iii) U.S. Treasury bills, notes or bonds maturing in a time frame no greater than

¹⁸ FICC will establish such deadline prior to the implementation of the changes to this service in conjunction with the clearing banks and the Federal Reserve in light of market circumstances. The initial substitution deadline is anticipated to be 1:00 p.m.; however, this will be finalized with the Federal Reserve and the clearing banks. The time range will be between 8:00 a.m. and 1:00 p.m. FICC will provide members advanced notice of the substitution deadline and any future changes thereto by important notice.

¹⁹ GSD Rule 1 defines “Comparable Securities” as follows: The term “Comparable Securities” means, with respect to a security or securities that are represented by a particular Generic CUSIP Number, any other security or securities that are represented by the same Generic CUSIP Number. Fixed Income Clearing Corporation, Government Securities Division Rulebook, Rule 1 – Definitions.

²⁰ GSD Rule 1 defines “Other Acceptable Securities” as follows: The term “Other Acceptable Securities” means, with respect to: (an) adjustable-rate mortgage-backed security or securities issued by Ginnie Mae, any fixed-rate mortgage-backed security or securities issued by Ginnie Mae, or (an) adjustable-rate mortgage-backed security or securities issued by either Fannie Mae or Freddie Mac: (a) any fixed-rate mortgage-backed security or securities issued by Fannie Mae and Freddie Mac, (b) any fixed-rate mortgage-backed security or securities issued by Ginnie Mae, or (c) any adjustable-rate mortgage-backed security or securities issued by Ginnie Mae. Fixed Income Clearing

that of the securities that have been traded (except where such traded securities are U.S. Treasury bills, substitution may be with Comparable Securities and/or cash only).

(4) Substitutions on Interbank GCF Repos

For a GCF Repo that was processed on an interbank basis and to accommodate a potential substitution request, FICC will initiate a debit of the securities in the account of the lender through the FICC GCF Repo accounts at the clearing bank of the lender and the FICC GCF Repo account at the clearing bank of the borrower (“Interbank Movement”). This Interbank Movement is being done so that a borrower who elects to substitute collateral will have access to the collateral for which it is substituting. The Interbank Movement is expected to occur in the morning, though the clearing banks and FICC have the capability to have the Interbank Movement occur at any point during the day up until 2:30 p.m. The agreed upon final timeframe will be determined as between FICC and the clearing banks prior to the implementation date of the Pilot Program. During the Pilot Program, FICC and the clearing banks will unwind the intrabank GCF Repo transactions at 3:30 p.m. FICC and the clearing banks will determine the most appropriate timeframe for the Interbank Movement process to occur.

On Day 2, GCF Repo securities collateral will be debited from the securities account of the receiver of the collateral at its clearing bank, and from a FICC account at the same clearing bank. If a substitution request is received by the clearing bank of the provider of GCF Repo securities collateral prior to the substitution deadline at a time specified in FICC’s procedures,²¹

Corporation, Government Securities Division Rulebook, Rule 1 – Definitions.

²¹ This timeframe will also be established in consultation with the clearing banks and the Federal Reserve. The parties are considering whether to have the substitution process be

that clearing bank will process the substitution request by releasing the GCF Repo securities collateral from the FICC GCF Repo account at such clearing bank and crediting it to the account of the provider of GCF Repo securities collateral. All cash substituted for the GCF Repo securities collateral being released will be credited to FICC's GCF Repo account at the clearing bank of the provider of GCF Repo securities collateral.

Simultaneously, with the debit of the GCF Repo securities collateral from the account at the clearing bank of the original receiver of GCF Repo securities collateral, such clearing bank will effect a cash debit equal to the value of the securities collateral in FICC's GCF Repo account at such clearing bank and will credit the account of the original receiver of securities collateral at such clearing bank with such cash amount in order to make payment to the original receiver of securities collateral. (This is because when the original receiver of securities collateral is debited the securities, it must receive the funds.) In order to secure FICC's obligation to repay the balance in FICC's GCF Repo account at the clearing bank of the original receiver of GCF Repo securities collateral, FICC will grant to such clearing bank a security interest in the cash substituted for the GCF securities collateral in FICC's GCF repo account at the other clearing bank.

For substitutions that occur with respect to GCF Repo transactions that were processed on an interbank basis, FICC and the clearing banks will initially only permit cash substitutions in order to accommodate current processing systems. In the future, as systems are upgraded, FICC may permit securities substitutions in the same way as described above for GCF Repo

accomplished in two batches during the day depending upon the time of submission of the notifications for substitution. In any event, substitution requests will be subject to the substitution deadline. The details of the batches, if applied, will be announced to members by important notice. The deadline for submission of GCF Repo substitution requests will be the same for intrabank and interbank processing.

transactions occurring on the intra-bank basis. If interbank securities substitutions are permitted, FICC will announce this to members by important notice.

C. Other rule changes

FICC is also making technical changes to Section 7 of GSD Rule 20, which relate to the GCF Repo collateral process. Specifically, FICC is changing reference to the defined term “Security” to “security” to conform to the use of “security” throughout the rule. The rule change also introduces a term that previously had not been included in the rules inadvertently, “GCF Collateral Excess Account.” This term is defined as “the account established by a GCF Custodian Bank in the name of the Corporation to hold securities it credits to the GCF Securities Account the Corporation establishes for another GCF Clearing Bank.”

III. Discussion

Section 17A(b)(3)(F) of the Act²² requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of security transactions and assure the safeguarding of securities and funds which are in the custody or control of such clearing agency or for which it is responsible.

Because the proposed rule change aligns the GCF Repo service with recommendations being made by the TPR to address risks in the overall tri-party repo market, it will promote the prompt and accurate clearance and settlement of security transactions and assure the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible, and therefore is consistent with the requirements of Section 17A(b)(3)(F) of the

²² 15 U.S.C. 78q-1(b)(3)(F).

Act. The proposed rule change is not inconsistent with the existing rules of FICC, including any other rules proposed to be amended.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act²³ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (File No. SR-FICC-2011-05) be, and hereby is, approved.²⁵

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.²⁶

Elizabeth M. Murphy
Secretary

²³ 15 U.S.C. 78q-1.

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

²⁶ 17 CFR 200.30-3(a)(12).