SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-78807; File No. SR-FICC-2016-006)

September 9, 2016

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Describe the Backtesting Charge and the Holiday Charge that May Be Imposed on Members

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on September 2, 2016, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of amendments to the Government Securities Division ("GSD") Rulebook (the "GSD Rules") and the Mortgage-Backed Securities Division ("MBSD") Clearing Rules (the "MBSD Rules")[3] in order to include two margin charges (the "Backtesting Charge" and "Holiday Charge" as further described below) that may be imposed on Netting Members of GSD and Clearing Members of MBSD (for purposes of this filing, GSD Netting Members and MBSD Clearing Members will be referred to as "Members" and each of the GSD and the MBSD shall be referred to as a

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

2 17 CFR 240.19b-4.

3 The GSD Rules and MBSD Rules are available at http://www.dtcc.com/legal/rules-and-procedures. Capitalized terms used herein and not otherwise defined shall have the meaning assigned to such terms in the GSD Rules and MBSD Rules, as applicable.

"Division" and together as the "Divisions"). The Backtesting Charge is assessed for those Members whose portfolios experience backtesting deficiencies over the prior 12-month period, as described further below. The Backtesting Charge is calculated by each Division to mitigate exposures to the Division caused by settlement risks that may not be adequately captured by the Division's portfolio volatility model. The Holiday Charge is applied to all Members on the Business Day prior to any day on which the Corporation is closed, but the day is not observed as a holiday by the Securities Industry and Financial Markets Association and the bond markets are open ("Holiday"). The Holiday Charge addresses the risk exposure that a Member's portfolio on the applicable Holiday poses to the Corporation. The proposed rule change would amend GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions) to add the Backtesting Charge and the Holiday Charge as defined terms, including the manner and circumstances in which FICC calculates and imposes such charges, and would amend Section 1b of GSD Rule 4 (Clearing Fund and Loss Allocation) and Section 2(c) of MBSD Rule 4 (Clearing Fund and Loss Allocation) to include these charges as additional components of the Required Fund Deposit when applicable. FICC is filing this proposed rule change in order to provide transparency in the GSD Rules and MBSD Rules with respect to these existing charges, as described in greater detail below.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The proposed rule change provides transparency in the GSD Rules and MBSD Rules with respect to the Backtesting Charge and Holiday Charge, two margin charges that each Division may temporarily impose on a Member as part of such Member's Required Fund Deposit.

A Division may impose the Backtesting Charge on a Member when the Division has observed deficiencies in the backtesting of such Member's Required Fund Deposit over the prior 12-month period, such that the Division determines the VaR Charge being calculated for that Member may not fully address the projected liquidation losses estimated from that Member's settlement activity.

The Holiday Charge addresses the risk exposure that occurs on Holidays when the Divisions are unable to collect Clearing Fund from Members. The Divisions impose the Holiday Charge on all Members to cover the additional day of exposure that is not contemplated in the prior day's VaR Charge.

(i) Background

A. Backtesting and the Required Fund Deposit

The GSD's Clearing Fund and the MBSD's Clearing Fund each address potential Member exposure through a number of risk-based component charges (as margin) calculated and assessed daily. Each of the component charges collectively constitute [sic] a Member's Required Fund Deposit with respect to each Division. The objective of the Required Fund Deposit is to mitigate potential losses to FICC associated with liquidation of the Member's portfolio in the event that the GSD and/or the MBSD ceases to act for a Member (hereinafter referred to as a "default"). FICC determines Required Fund Deposit amounts in both the GSD and the MBSD using risk-based margin methodologies that are intended to capture market price risk. The methodologies for each Clearing Fund use historical market moves to project or forecast the potential gains or losses on the liquidation of a defaulting Member's portfolio, assuming that a portfolio would take three days to liquidate or hedge in normal market conditions. The projected liquidation gains or losses are used to determine the Member's Required Fund Deposit in each Division, which is calculated to cover projected liquidation losses at a 99 percent confidence level. The aggregate of all Members' Required Fund Deposits in each Division constitutes the Division's Clearing Fund, which the Division would be able to access should a defaulting Member's own Required Fund Deposit be insufficient to satisfy losses to the Division caused by the liquidation of that Member's portfolio.

FICC employs daily backtesting to determine the adequacy of each Member's Required Fund Deposit. FICC compares the Required Fund Deposit[4] for each Member with the simulated liquidation gains/losses using the actual positions in the Member's portfolio, and the actual historical security returns. FICC investigates the cause(s) of any backtesting deficiencies. As a part of this investigation, FICC pays particular attention to Members with backtesting deficiencies that bring the results for that Member below the 99 percent confidence target (i.e., greater than two backtesting deficiency days in a

4 For backtesting comparisons, FICC uses the Required Fund Deposit amount, without regard to the actual collateral posted by the Member.

rolling twelve-month period) to determine if there is an identifiable cause of repeat backtesting deficiencies. FICC also evaluates whether multiple Members may experience backtesting deficiencies for the same underlying reason.

While multiple factors may contribute to a Member's backtesting deficiency, FICC has observed that some Members with position increases after the intraday calculation of their Required Fund Deposit may incur backtesting deficiencies due to the additional exposure that is not mitigated until the collection of the Required Fund Deposit on the next Business Day.

B. Calculation of the Backtesting Charge

The objective of the Backtesting Charge is to increase Required Fund Deposits for Members that are likely to experience backtesting deficiencies on the basis described above by an amount sufficient to maintain such Member's backtesting coverage above the 99 percent confidence threshold. Because the settlement activity and size of the backtesting deficiencies varies among impacted Members, FICC must assess a Backtesting Charge that is specific to each impacted Member. To do so, FICC examines each impacted Member's historical backtesting deficiencies observed over the prior 12-month period to identify the three largest backtesting deficiencies that have occurred during that time (for GSD Netting Members only, excluding any backtesting deficiencies attributable to the Blackout Period). The presumptive Backtesting Charge amount equals that Member's third largest historical backtesting deficiency, subject to adjustment as further described below. FICC believes that applying an additional margin charge equal to the third largest historical backtesting deficiency would bring the Member's historically-observed backtesting coverage above the 99 percent target.[5] If assessed, the resulting Backtesting Charge is added to the VaR Charge for such Member determined pursuant to each Division's risk-based margining methodology. The Backtesting Charge is imposed on a daily basis for a one-month period.

This charge is only applicable to those Members whose overall 12-month trailing backtesting coverage falls below the 99 percent coverage target (for GSD Netting Members only, excluding Blackout Period deficiencies).

Although the third largest historical backtesting deficiency for a Member is used as the Backtesting Charge in most cases, each Division retains discretion to adjust the charge amount based on other circumstances that may be relevant for assessing whether an impacted Member is likely to experience future backtesting deficiencies and the estimated size of such deficiencies. Examples of relevant circumstances that would be considered in calculating the final, applicable Backtesting Charge amount include material differences in the three largest backtesting deficiencies observed over the prior 12-month period, variability in the net settlement activity after the collection of the Member's intraday Required Fund Deposit, seasonality in observed backtesting deficiencies and observed market price volatility in excess of the Member's historical VaR Charge(s). Based on FICC's assessment of the impact of these circumstances on the likelihood of, and estimated size of, future backtesting deficiencies for a Member, FICC may, in its discretion, adjust the Backtesting Charge for such Member in an amount that

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5 Each occurrence of a backtesting deficiency reduces a Member's overall backtesting coverage by 0.4 percent (1 exception / 250 observation days). Accordingly, an increase equal to the third largest backtesting deficiency would bring backtesting coverage up to 99.2 percent.

FICC determines to be more appropriate for maintaining such Member's backtesting results above the 99 percent coverage threshold (including a reasonable buffer).

C. Communication with Members and Imposition of the Backtesting Charge

If FICC determines that a Backtesting Charge should apply to a Member that was not assessed a Backtesting Charge during the immediately preceding month or that the Backtesting Charge applied to a Member during the previous month should be increased, the applicable Division will notify the Member on or around the 25th calendar day of the month prior to the assessment of the Backtesting Charge, or prior to the increase to the Backtesting Charge.

Each Division imposes the Backtesting Charge as an additional charge applied to each impacted Member's Required Fund Deposit on a daily basis for a one month period, and reviews each applied Backtesting Charge each month. If an impacted Member's trailing 12-month backtesting coverage exceeds 99 percent (without taking into account historically-imposed Backtesting Charges), the Backtesting Charge is removed.

D. Holidays and the Required Fund Deposit

As described above, FICC determines its Members' Required Fund Deposit amounts in each Division using a risk-based margin methodology that is intended to capture market price risk, assuming that a portfolio would take three days to liquidate or hedge in normal market conditions.

The Holiday Charge may be applied on the Business Day prior to any Holiday. This charge approximates the exposure that a Member's trading activity on the applicable Holiday could pose to the Division. Since the Divisions cannot collect margin on the Holiday, the Holiday Charge is due on the Business Day prior to the applicable Holiday.

E. Calculation and Notification of the Holiday Charge

FICC would determine the appropriate methodology for calculating the Holiday Charge in advance of each applicable Holiday. Potential methodologies for calculating the Holiday Charge include, for example, time scaling of the VaR Charge[6] or application of stress scenarios that cover potential market price risk exposure that may not be appropriately covered by scaling the VaR Charge. FICC would establish a methodology for calculating each Holiday Charge that would take into consideration the market conditions prevailing at that time in order to permit FICC to calculate a Holiday Charge that appropriately estimates the risk that may be presented to FICC on the applicable Holiday, when Members' Required Fund Deposit cannot be collected. The Holiday Charge would represent a percentage increase of the VaR Charge on the Business Day prior to the Holiday, and such percentage increase applies uniformly to all Members. This means that if the Holiday Charge is levied, the same methodology (i.e., formula) is applied to all Members (that is, the Holiday Charge is not a set dollar amount applied to all Members).

Members would be notified of the applicable methodology by an Important Notice issued no later than 10 Business Days prior to the application the Holiday Charge, and the charge is collected on the Business Day prior to the applicable Holiday. The Holiday Charge is removed from the Required Fund Deposit on the Business Day

[6] Market price risk and volatility increase with time as there is a greater potential for loss. This additional risk exposure is often approximated by time scaling of volatility by multiplying square root of the additional period of risk (e.g., if the VaR Charge is calibrated to a 3-day risk horizon, an additional day of exposure could be approximated by $\sqrt{4/3}$ * VaR Charge).

following the Holiday.

2. Statutory Basis

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency be designed to assure the safeguarding of securities and funds that are within the custody or control of the clearing agency.[7] Rule 17Ad-22(b)(1) under the Act requires a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure its credit exposures to its participants at least once a day and limit its exposures to potential losses from defaults by its participants under normal market conditions, so that the operations of the clearing agency would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.[8] Rule 17Ad-22(b)(2) under the Act requires a clearing agency to maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions.[9]

By incorporating the Backtesting Charge and the Holiday Charge into the GSD Rules and the MBSD Rules, the proposed change addresses exposure that could subject FICC to potential losses under normal market conditions in the event that a Member defaults. Specifically, the proposed change seeks to remedy potential situations that are described above where the Divisions could be undermargined by requiring additional margin. Therefore, FICC believes the proposed rule change enhances the safeguarding of

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7 15 U.S.C. 78q-1(b)(3)(F).

8 17 C.F.R. § 240.17Ad-22(b)(1).

9 17 C.F.R. § 240.17Ad-22(b)(2).

securities and funds that are in the custody or control of FICC, consistent with Section 17(b)(3)(F) of the Act.

The Backtesting Charge is calculated and imposed to cover credit exposures estimated by FICC based on historical backtesting deficiencies with the goal of maintaining each Member's Required Fund Deposit in each Division above the 99 percent coverage threshold. This management of FICC's credit exposures to Members is consistent with Rule 17Ad-22(b)(1) under the Act. Further, the charge is part of the Members' Required Fund Deposits designed to maintain the coverage of credit exposures in each Division at a confidence level of at least 99 percent, which limits FICC's exposures to Members under normal market conditions. The proposed Backtesting Charge seeks to address backtesting deficiencies that could potentially leave the GSD and/or the MBSD undermargined by using the risk-based methodology described above to limit its credit exposure to Members. It therefore is also consistent with Rule 17Ad-22(b)(2) under the Act.

The Holiday Charge is calculated and imposed to cover credit exposures that result from market price moves that occur on a Holiday and are not incorporated in each Member's Required Fund Deposit. This management of FICC's credit exposures to Members is consistent with Rules 17Ad-22(b)(1) and 17Ad-22(b)(2) under the Act.

(B) Clearing Agency's Statement on Burden on Competition

FICC does not believe that either the Backtesting Charge or the Holiday Charge impose any burden on competition that is not necessary or appropriate.[10] These charges are necessary for FICC to limit its exposure to potential losses from defaults by

[10] 15 U.S.C. 78q-1(b)(3)(I).

Members.

The Backtesting Charge is imposed on each Member on an individualized basis in an amount reasonably calculated to maintain its Required Fund Deposit above each Division's 99 percent coverage threshold. FICC employs reasonable methods to calculate and impose an individualized charge in an amount designed to maintain each impacted Member's future backtesting coverage above the 99 percent coverage threshold in each Division, including a reasonable buffer.

Because the market price movements that occur on Holidays are related to the behavior of the market as a whole, the impact of such price movements on FICC's risk is considered general market price risk. Therefore, the Holiday Charge is imposed on all Members on a uniform basis in an amount reasonably calculated to mitigate the market price changes that could occur on a Holiday when the Corporation is closed. The Holiday Charge would represent a percentage increase of the VaR Charge on the Business Day prior to the Holiday, and such percentage increase applies uniformly to all Members in each Division. This means that if the Holiday Charge is levied, the same methodology (i.e., formula) is applied to all Members (that is, the Holiday Charge is not a set dollar amount applied to all Members).

FICC believes, any burden on competition imposed by the addition of these two charges to the GSD Rules and MBSD Rules would be necessary and appropriate to limit FICC's exposures to the risks being mitigated by such charges.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FICC has not received any written comments relating to this proposal. FICC will notify the Commission of any written comments received.

III. Date of Effectiveness of the Proposed Rule Change, and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self- regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the 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. Please include File Number SR-FICC-2016-006 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FICC-2016-006. 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 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2016-006 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[11]

Brent J. Fields
Secretary

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[11] 17 CFR 200.30-3(a)(12).