

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68555; File No. SR-FICC-2012-07)

January 2, 2013

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change Relating to Enhancements that the Mortgage-Backed Securities Division Intends to Implement to its Services and Certain Other Clarifications and Corrections to its Rules

I. Introduction

On November 6, 2012, the Fixed Income Clearing Corporation (“FICC” or the “Corporation”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2012-07 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The proposed rule change was published for comment in the Federal Register on November 21, 2012.<sup>3</sup> No comments letters were received on the proposed rule change. This order approves the proposed rule change.

II. Description

The proposed rule change relates to certain enhancements that the Mortgage-Backed Securities Division (“MBSD”) of FICC intends to implement to its services. In addition, FICC proposes to make certain corrections and clarifications to the MBSD Rules. As noted below, some of the proposed changes do not require revisions to the MBSD Rules.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 68245 (November 15, 2012), 77 FR 69913 (November 21, 2012).

*1. Expansion of Pool Netting to Include Pool Instructs from the Previous Settlement Months*

MBSD proposed to further extend pool netting benefits to its members by capturing Pool Instructs<sup>4</sup> submitted for allocations made after the traded pool's settlement month has passed. The proposed changes allow more activity into the pool net which results in fewer settlements.

Currently, MBSD's pool netting process only nets Pool Instructs for the current delivery date if their corresponding contractual settlement dates ("CSD") are also in the current month.<sup>5</sup> For example, with respect to a delivery date of August 14, 2012, MBSD's pool netting process would only net Pool Instructs having a CSD ranging from August 1, 2012 through August 14, 2012 and having a delivery date of August 14, 2012. As such, only Pool Instructs having a CSD in the current month will be included in pool netting.

The proposed new process will net Pool Instructs from previous settlement months that are submitted for delivery dates in the current month. For example, if we assume that today is August 13, 2012, and a member submits multiple Pool Instructs all having a CSD equal to July 12, 2012 and a delivery date equal to August 14, 2012, on the evening of August 13<sup>th</sup>, these Pool Instructs would be netted against each other to arrive at a single pool net settlement position for the July 12, 2012 CSD and August 14<sup>th</sup> delivery date.

The proposed changes do not require revisions to the text of the MBSD Rules.

*2. Notification of Settlement for Specified Pool Trades*

A Notification of Settlement ("NOS") is an instruction submitted to the Corporation by a purchasing or selling clearing member which reflects the settlement of a Settlement Balance

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<sup>4</sup> A Pool Instruct is an input used by a member to submit pool details directly into the Real-Time Trade Matching ® ("RTTM®") system for bilateral matching and assignment to a corresponding open TBA position as a prerequisite to the pool netting process.

<sup>5</sup> See MBSD Rule 8 Section 3.

Order Trade, Trade-for-Trade Transaction or Specified Pool Trade (“SPT”).<sup>6</sup> MBSD is proposing to change the manner in which NOS processing occurs for SPTs so that it follows similar processing rules as those applied to NOS for Settlement Balance Order Trades and Trade-for-Trade Transactions.

Currently, MBSD Rule 10 Section 2 states that the trade details for a NOS submitted by both parties of a SPT must fully match in order for the clearance of the SPTs to be reflected on the member’s Purchase and Sale Report<sup>7</sup> or both parties must submit a cancellation of the transaction in order for the transaction to be deleted from each party’s respective Open Commitment Report.<sup>8</sup>

MBSD proposed to enhance the NOS for SPTs by no longer requiring the current face value submitted on each member’s NOS to exactly match the current face value of the SPT. Instead, members will have the ability to submit and match multiple NOS to reduce the SPT current face until it is fully settled. For example, if a SPT has a current face value of \$125MM and the pool number of the trade has a factor of 0.975, FICC will accept either (a) one piece of NOS for \$125,000,000 *or* (b) three pieces of NOS for \$48,750,000, \$48,750,000 and \$27,500,000. The current face values equal an original face settlement value of \$50,000,000, \$50,000,000 and \$28,205,128.

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<sup>6</sup> See MBSD Rule 1, Definitions.

<sup>7</sup> “Purchase and Sale Report” is defined as the report furnished by the Corporation reflecting a member’s Compared Trades in Eligible Securities.” See MBSD Rule 1, Definitions.

<sup>8</sup> “Open Commitment Report” is defined as the report furnished by the Corporation to members reflecting such member’s open commitments in the Clearing System. See MBSD Rule 1, Definitions.

In addition to the above, MBSD will apply a tolerance of +/- \$1 when matching buy and sell NOS for SPT trades to account for differences in rounding conventions used by members to convert original face to current face on their NOS.

The proposed changes will make NOS for SPTs similar to NOS for Settlement Balance Order Trades and Trade-for-Trade Transactions whereby matching is permitted within a tolerance and multiple NOS may be submitted and matched separately until the trade is fully settled.

The proposed changes require revisions to the text of the MBSD Rules.

### *3. Comparison of Dummy Pool Number to Valid Pool Number*

FICC supports the submission of a defined generic or “dummy” pool number on NOS instead of a valid pool number. A dummy pool is a standard convention used by members when the actual pool number is not readily available to some members. Currently, the pool number is a matching criterion on NOS. Consequently, if one member submits a dummy pool number and the other enters a valid pool number the NOS will not compare even though all of the other matching criteria are the same. In an effort to address this, FICC is proposing to change its processing in order to allow matching of NOS when all mandatory terms compare and one member submits a dummy pool number and the other member submits a valid pool.

The proposed changes do not require revisions to the text of the MBSD Rules.

### *4. Automatically Marking Certain Open TBA Trades as Fully Settled*

Mortgage-backed securities trades settle with an industry-accepted variance of 0.01% (i.e., \$100 per \$1MM). When FICC applies NOS to open trades, it does so using the upper limit of the variance to ensure that trades are not marked as fully settled until all NOS have been received and processed by FICC. However, because trades may settle using any value within the variance, FICC’s processing may leave residual trade amounts open on its books for trades that

have actually been fully settled. To address this, FICC is proposing to automatically generate internal NOS which will mark the residual trade as fully settled. The FICC generated NOS will occur on the last business day of each month, in every instance where a member has a To-Be-Announced (“TBA”) trade with an open par that falls below an established threshold. The threshold is initially contemplated to be \$1000 par, however, this may be modified following member feedback. All changes to the threshold will be provided in advance to members via Important Notice.

The proposed changes require revisions to the text of the MBSD Rules.

#### *5. Corrections and Clarification to the MBSD Rules*

The MBSD Rules define the term “Fully Compared” as “. . . trade input submitted by a Broker matches trade input submitted by each Dealer on whose behalf the Broker is acting-the Net Position Match Mode.”<sup>9</sup> The phrase “in accordance with” was inadvertently deleted from this definition when it was revised in connection with Amendment No. 1 to SR-FICC-2008-01.<sup>10</sup> FICC proposes to restore this phrase so that the definition states the following: “. . . trade input submitted by a Broker matches trade input submitted by each Dealer on whose behalf the Broker is acting in accordance with the Net Position Match Mode.”

In the second to last paragraph of MBSD Rule 2A Section 1, there is a sentence which states that the Corporation will determine whether the applicants in “categories (g and i)” of the referenced Section will be designated as tier one or tier two members. FICC proposes to correct the typographical error in the cross-reference so that it instead references “categories (g) and (i).”

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<sup>9</sup> See MBSD Rule 1, Definitions.

<sup>10</sup> Securities Exchange Act Release No. 66550 (March 9, 2012); 77 FR 15155 (March 14, 2012).

## Implementation

FICC proposes to implement the proposed changes relating to the MBSD enhancements during the second quarter of 2013 pending rule filing approval from the Securities and Exchange Commission. The proposed changes relating to the clarifications and corrections of the referenced rules will be effective immediately upon receipt of rule filing approval.

### III. Discussion

Section 19(b)(2)(C) of the Act<sup>11</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act<sup>12</sup> requires, among other things, that the rules of the clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions.

The proposed changes to FICC's Rules are consistent with promoting the prompt and accurate clearance and settlement of securities transactions in the following ways: (1) the expansion of the pool netting system extends the netting benefits to clearing members by capturing allocations made after the traded pools current settlement month, (2) the change in NOS processing for SPTs creates efficiency through the standardization of NOS processing for TBA trades, (3) automatically marking certain TBA trades as fully settled improves the monitoring and reporting of trade settlement status and (4) allowing the comparison of dummy Pool number to valid pool number provides for timelier matching of NOS. Each of these enhancements creates a more efficient netting system which promotes the prompt and accurate

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<sup>11</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>12</sup> 15 U.S.C. 78q-1(b)(3)(F).

clearance and settlement for securities transactions. Furthermore, the clarifications and corrections to the MBSB Rules ensure that the Rules are accurate. As a result, the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>13</sup>

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<sup>13</sup> 15 U.S.C. 78q-1(b)(3)(F).

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 Act<sup>14</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>15</sup> that the proposed rule change, as amended, (File No. SR-FICC-2012-07) be, and hereby is, approved.<sup>16</sup>

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>17</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>14</sup> 15 U.S.C. 78q-1.

<sup>15</sup> 15 U.S.C. 78s(b)(2).

<sup>16</sup> 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).

<sup>17</sup> 17 CFR 200.30-3(a)(12).