SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70484; File No. SR-FICC-2013-08)

September 24, 2013

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change Concerning the Mortgage-Backed Securities Division's Notification of Settlement Process

I. Introduction

On August 9, 2013, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2013-08 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder.[2] The proposed rule change was published for comment in the Federal Register on August 23, 2013.[3] The Commission received no comment letters. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

A. Nature of the Proposed Rule Change

FICC is making two changes to the notification of settlement ("NOS") process currently utilized by FICC's mortgage-backed securities division ("MBSD"). First, FICC's rule change would shorten, from two days to one, the grace period during which members must reconcile NOS submissions. Second, the rule change would increase from \$25 to \$150 the penalty that members must pay each day if they fail to reconcile an NOS submission within this grace period.

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

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 70232 (August 19, 2013), 78 FR 52598 (August 23, 2013) (SR-FICC-2013-08).

B. The Notification of Settlement Process

MBSD members settle certain trades between themselves, without using the MBSD as a central counterparty.[4] The NOS process ensures that the MBSD is notified when these bilateral settlements occur.[5] Under the NOS process, both counterparties to a bilaterally settled trade must provide the MBSD with an NOS submission stating that settlement has occurred and on what terms.[6] If the trade details set forth in the counterparties' respective NOS submissions match, the MBSD updates each counterparty's purchase and sale report to reflect that the transaction has settled, and deletes the transaction from the counterparties' respective open commitment reports.[7]

Members seeking to initiate the NOS process are required to provide the MBSD with an NOS submission on clearance day.[8] The counterparties to these trades must reconcile the initiator's NOS submission within two days of its receipt by the MBSD. To reconcile an NOS submission, the counterparty must either provide the MBSD with an NOS submission that

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4 Transactions may settle bilaterally (i.e., outside of the MBSD) for several reasons, including: (i) the transactions are ineligible for pool netting, (ii) the transactions involve a specified pool trade, or (iii) the parties elect to settle the trade bilaterally. The following types of transactions are all eligible for bilateral settlement: (i) settlement-balance order, destined to-be announced ("TBA") transactions; (ii) trade-for-trade TBA transactions; and (iii) specified pool trades.

5 The MBSD must be notified when trades settle bilaterally because the trades are protected by the MBSD's trade guarantee. As a result, the MBSD will continue to hold initial margin and collect mark-to-market margin for these trades until it is notified that the trades have settled. *See generally* MBSD Rulebook, Rule 4.

6 MBSD Rulebook, Rule 10, Section 2.

7 *Id.*

8 For purposes of the NOS process, clearance day is the day on which the seller delivers the securities to the buyer. Clearance day is generally on or after the contractual settlement day.

matches the one provided by the initiator, or send the MBSD a DK notice.[9] Reconciliation can also occur when the initiator rescinds its NOS submission before its counterparty provides a matching NOS. Currently, if either the initiator or the counterparty fails to reconcile an NOS submission within two days of its receipt by the MBSD, that member is subject to a late fee of $25.00 per day. As noted, the rule change, as approved, will shorten this two-day grace period to one day, and raise the fine from $25 to $150 per day.

According to the MBSD, the timely reconciliation of NOS submissions serves to minimize the risk that the MBSD might unnecessarily continue to hold and collect margin on a trade that has, unbeknownst to the MBSD, settled bilaterally. FICC contends that the timely reconciliation of NOS submissions is also important because, in the event of a member's insolvency, FICC must quickly and accurately determine which of the insolvent member's positions need to be liquidated.

III. Discussion

Section 19(b)(2)(C) of the Act[10] directs the Commission to approve a self-regulatory organization's proposed rule change if the Commission 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[11] requires, among other things, that the rules of a clearing agency registered with the Commission be designed to (i) assure the safeguarding of securities and funds which are in the custody or control of the clearing agency, or for which it

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9 A "DK" notice is a statement that the member "does not know" (i.e., denies the existence of) a transaction. MBSD Rulebook, Rule 1, p.7.

10 15 U.S.C. 78s(b)(2)(C).

11 15 U.S.C. 78q-1(b)(3)(F).

is responsible, (ii) foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions; and (iii) protect investors and the public interest.

The Commission concludes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,[12] for several reasons. First, the proposed rule change helps protect the securities and funds in FICC's control, not only by encouraging members' timely compliance with the MBSD's risk management protocols, but also by enabling the MBSD to identify and begin liquidating an insolvent member's open trades more quickly. The latter could help the MBSD and its members avoid unnecessary losses in the event the MBSD must liquidate an insolvent member's open positions during a period of market disruption, when prices may be falling rapidly. Second, the proposed rule change fosters cooperation and coordination among those engaged in the settlement of securities transactions by encouraging members to provide the MBSD with reconciliation information more rapidly. Finally, the proposed change protects investors and the public interest by enhancing the MBSD's ability to manage an insolvent member's open positions, which should mitigate the risk that a member's insolvency could trigger instability in the broader financial system.

IV. Conclusion

On the basis of the foregoing, the Commission concludes that the proposal is consistent with the requirements of the Act, particularly the requirements of Section 17A of the Act,[13] and the rules and regulations thereunder.

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12 *Id.*

13 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[14] that the proposed rule change (File No. SR-FICC-2013-08) be and hereby is APPROVED.[15]

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.[16]

Kevin M. O'Neill
Deputy Secretary

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14 15 U.S.C. 78s(b)(2).

15 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).

16 17 CFR 200.30-3(a)(12).