

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-78206; File No. SR-FICC-2016-002)

June 30, 2016

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Suspend the Interbank Service of the GCF Repo[®] Service

On May 5, 2016, the Fixed Income Clearing Corporation (“FICC” or the “Corporation”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2016-002 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 May 20, 2016.³ The Commission received no comments on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description of the Proposed Rule Change

FICC seeks the Commission’s approval to suspend the interbank service of the GCF Repo[®] service, as described more fully below. The suspension does not require changes to the text of the Government Securities Division (“GSD”) Rulebook (the “GSD Rules”), however, the suspension requires changes to FICC’s Real-Time Trade Matching (“RTTM[®]”) system.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 34-77840 (May 16, 2016), 81 FR 31996 (May 20, 2016) (SR-FICC-2016-002).

A. The GCF Repo Service

The GCF Repo service allows dealer members of FICC's Government Services Division to trade general collateral finance repos ("GCF Repos")⁴ throughout the day without requiring intraday, trade-for-trade settlement on a delivery-versus-payment basis.⁵ The service allows dealers to trade GCF Repos, based on rate and term, 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 type of underlying security that is eligible to serve as collateral for GCF Repos. Only Fedwire eligible, book-entry securities may serve as collateral for GCF Repos. Acceptable collateral for GCF Repos include most U.S. Treasury securities, non-mortgage-backed federal agency securities, fixed and adjustable rate mortgage-backed securities, Treasury Inflation-Protected Securities and separate trading of registered interest and principal securities.⁶

The GCF Repo service has operated on both an "interbank" and "intra-bank" basis. "Interbank" means that the two GCF Repo Participants which have been matched in a GCF Repo transaction each clear at a different clearing bank. "Intra-bank" means that the two GCF Repo Participants which have been matched in a GCF Repo transaction clear at the same clearing bank.

B. Suspension of the Interbank Service of the GCF Repo Service

⁴ A GCF Repo is one in which the lender of funds is willing to accept any of a class of U.S. Treasuries, U.S. government agency securities, and certain mortgage-backed securities as collateral for the repurchase obligation. This is in contrast to a specific collateral repo.

⁵ Delivery-versus-payment is a settlement procedure in which the buyer's cash payment for the securities it has purchased is due at the time the securities are delivered.

⁶ See Securities Exchange Act Release No. 34-58696 (September 30, 2008), 73 FR 58698, 58699 (October 7, 2008) (SR-FICC-2008-04).

Since 2011, FICC has made several changes to its GCF Repo service in order to comply with 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. The main purpose of the TPR was to develop recommendations to address the risk presented by triparty repo transactions due to the morning reversal (commonly referred to as the “unwind”) process, by replacing it with a process by which transactions are collateralized all day. The GCF Repo service was originally designed to have transactions “unwind” every morning in order to mirror the transactions in the triparty repo market. Prior to Triparty Reform, transactions submitted on “Day 1” unwound on the morning of “Day 2.” To “unwind” means that the securities are returned to the lender of securities in the transaction and the cash is returned to the borrower of securities. Because of certain changes to the way in which the Triparty Reform effort was to proceed and the impact of such changes on the interbank service of the GCF Repo service as further described below, FICC seeks to suspend the interbank service of the GCF Repo service. FICC’s proposal seeks no changes to the intrabank service.

All collateral that is settled via the interbank service is unwound the next morning to FICC’s account at the pledging Clearing Bank in order to make the collateral available for collateral substitutions. In order to facilitate this intraday collateral substitution process, the Clearing Banks currently extend credit each business day to FICC at no charge. This uncapped and uncommitted credit extension to FICC facilitates the GCF Repo settlement process for both the intra-day and end of day settlement. The final changes related to the Triparty Reform effort would have eliminated the need for uncapped and uncommitted credit (a TPR goal) by including the development of interactive messages for the collateral substitution process (this was referred

to as the “Sub Hub”), which would have eliminated the need for the current morning unwind of interbank GCF Repos, and would have allowed for substitution of collateral across the Clearing Banks with minimal intra-day credit required. The last change was also going to include a streamlined end of day GCF Repo settlement process to reduce the amount of cash and collateral needed in order to complete settlement. This change would have incorporated the concept of a “cap” on FICC credit from the Clearing Banks, and an automated solution would have been developed to process the interbank GCF Repo settlement without breaching the defined and agreed to caps. As a result, the amount of credit that FICC would have needed from the Clearing Banks would have been managed to a minimal amount.

Plans to implement the Sub Hub have not come to fruition. Therefore, to continue providing the interbank service, FICC would need a capped line of credit (without the benefits of any re-design to manage the amounts of needed credit). In other words, the capped line of credit would be applied to the interbank service as the service currently operates, and not in the re-designed fashion that was contemplated by the Triparty Reform effort, which would have allowed for smaller settlement amounts. FICC states that there would be prohibitive operational constraints in attempting to trade and settle GCF Repos while attempting to implement a cap on interbank GCF Repo trading and settlement. Specifically, FICC states that inter-dealer brokers would need to be integrated as a group from a technological perspective in order to be able to track the GCF Repo Participants’ real-time netted positions, from an intrabank and interbank perspective, to ensure that the cap is not breached. FICC states that this would require an integrated pre-trade check across each inter-dealer broker’s platform and FICC to ensure conformity to the cap, which is not feasible.

FICC seeks to suspend the interbank service of the GCF Repo service because: (1) FICC cannot operate the current interbank service within a capped credit amount; and (2) it is not feasible to institute a pre-trade validation system. FICC seeks to suspend the interbank service of the GCF Repo service after July 15, 2016 (the “Suspension Date”), which is approximately six (6) weeks prior to the date that one of the Clearing Banks has stated it will begin to impose the capped line of credit (September 1, 2016 or the “Capped Charges Date”). According to FICC’s proposal, subsequent to the Suspension Date, inter-dealer brokers would only be permitted to execute transactions among GCF Repo Participants within the same Clearing Bank. Inter-dealer brokers would establish two markets for GCF Repo trading – one for each Clearing Bank. This is the same approach that FICC utilized when it previously suspended the interbank service between 2003 and 2008. In addition, GSD would only accept and process transactions among GCF Repo Participants that settle within the same Clearing Bank. As a result, the RTTM[®] system would not accept and process transactions among GCF Repo Participants who settle at different Clearing Banks. FICC states that it will continue to explore whether there are other ways to re-introduce the interbank service in the future.

II. Discussion

Section 19(b)(2)(C) of the Act⁷ 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 Act⁸ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of

⁷ 15 U.S.C. 78s(b)(2)(C).

⁸ 15 U.S.C. 78q-1(b)(3)(F).

securities transactions. The Commission finds that the proposed rule change is consistent with Section 17A of the Act⁹ and the rules thereunder applicable to FICC.

As described above, Triparty Reform efforts have sought to eliminate the need for Clearing Banks to provide FICC with uncapped and uncommitted credit within the settlement process. Specifically, the Sub Hub project described above, if approved and implemented, would have eliminated the need for the current morning unwind of interbank GCF Repos, and would have allowed for substitution of collateral across the Clearing Banks with minimal intra-day credit required. A streamlined end of day GCF Repo settlement process would have reduced the amount of cash and collateral needed in order to complete settlement, in which circumstances, there would have been a cap on the line of credit from the Clearing Banks to FICC, with an automated solution to process the interbank GCF Repo settlement within the cap. As a result, the amount of credit that FICC would have needed from the Clearing Banks would have been managed to a minimal amount.

However, in the Sub Hub's absence, according to FICC, a capped line of credit without the benefits of any re-design to manage the amounts of needed credit would present prohibitive operational constraints in attempting to trade and settle GCF Repos on an interbank basis. Specifically, inter-dealer brokers would need to be integrated as a group from a technological perspective in order to be able to track the GCF Repo Participants' real-time netted positions to ensure that the cap is not breached. This would require an integrated pre-trade check across each inter-dealer broker's platform and FICC to ensure conformity to the cap, which, FICC states, is not feasible. Accordingly, suspension of the interbank service will enable FICC to avoid accepting GCF Repo trades for clearing in an amount exceeding a Clearing Bank's capped line

⁹ 15 U.S.C. 78q-1.

of credit, while allowing FICC to continue to clear GCF Repo transactions on an intrabank basis, thereby promoting the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act, particularly those set forth in Section 17A,¹⁰ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-FICC-2016-002) be, and hereby is, APPROVED.¹²

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹³

Robert W. Errett
Deputy Secretary

¹⁰ 15 U.S.C. 78q-1.

¹¹ 15 U.S.C. 78s(b)(2).

¹² In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

¹³ 17 CFR 200.30-3(a)(12).