

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-83850; File No. SR-FICC-2018-008)

August 15, 2018

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Apply Government Securities Division Corporation Default Rule to Sponsored Members and Make Other Changes

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 August 6, 2018, 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 modifications to FICC’s Government Securities Division (“GSD”) Rulebook (“GSD Rules”)³ in order to apply GSD Rule 22B (Corporation Default) to Sponsored Members as well as make certain other changes, 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Capitalized terms not defined herein are defined in the GSD Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf.

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 purpose of this proposed rule change is to amend GSD Rule 3A (Sponsoring Members and Sponsored Members) in order to apply GSD Rule 22B (Corporation Default) to Sponsored Members. In addition, the proposed rule change would make certain other changes, as described in greater detail below.

(i) Background

Under GSD Rule 3A (Sponsoring Members and Sponsored Members), Bank Netting Members that are well-capitalized (as defined by the Federal Deposit Insurance Corporation's applicable regulations) and have at least \$5 billion in equity capital (Sponsoring Members) are permitted to sponsor qualified institutional buyers as defined by Rule 144A⁴ under the Securities Act of 1933, as amended ("Securities Act"),⁵ and certain legal entities that, although not organized as entities specifically listed in paragraph (a)(1)(i) of Rule 144A under the Securities Act, satisfy the financial requirements necessary to be qualified institutional buyers as specified in that paragraph (Sponsored Members) into GSD membership.

⁴ See 17 CFR 230.144A.

⁵ 15 U.S.C. 77a *et seq.*

In connection with the onboarding of new Sponsoring Members and their respective Sponsored Members into GSD membership, FICC has received certain questions regarding the applicability of GSD Rule 22B (Corporation Default) to Sponsoring Members and their respective Sponsored Members. GSD Rule 22B provides that close out netting will be applied to obligations between GSD and its Members in the event that a Corporation Default occurs.⁶ GSD Rule 22B currently does not apply to Sponsored Members but does apply to Sponsoring Members in their capacity as Netting Members. Not applying GSD Rule 22B to Sponsored Members creates an inconsistency with respect to the legal framework and process applicable to the Sponsored Members versus other GSD Members⁷ in the event that a Corporation Default occurs.

(ii) Proposed Changes to the GSD Rules

GSD Rule 3A (Sponsoring Members and Sponsored Members)

FICC is proposing to add an introductory paragraph to Section 17 of GSD Rule 3A (Sponsoring Members and Sponsored Members) which makes it clear that for purposes of the Rules, Schedules, Interpretations and Statements of Policy referenced in Section 17 of GSD Rule 3A, Sponsoring Members and/or Sponsored Members, in their respective capacities as such, would be “Members.” Adding this clarifying paragraph would be helpful to Sponsoring Members and Sponsored Members because it would enable them to know which Rules, Schedules, Interpretations and Statements of Policy

⁶ Events that shall constitute a Corporation Default are described in Section (b) of GSD Rule 22B. Supra note 3.

⁷ GSD Rule 1 (Definitions) defines “Member” as a Comparison-Only Member or a Netting Member. Supra note 3. For purposes of this filing, the term “Member” shall exclude Comparison-Only Members because Comparison-Only Members are not relevant in the context of Corporation Default provisions as such Members only participate in the Comparison System.

would govern their rights, liabilities and obligations in their respective capacities as Sponsoring Members and/or Sponsored Members.

In order to ensure that all GSD Members are subject to a common, transparent legal framework in a Corporation Default situation, FICC is proposing to modify GSD Rule 3A so that GSD Rule 22B (Corporation Default) would apply to Sponsored Members in the same manner as it applies to all other GSD Members. Specifically, FICC proposes to add a new subsection (a) to Section 17 of GSD Rule 3A which would provide that GSD Rule 22B would apply to Sponsored Members. This proposed change would necessitate a technical change to renumber all subsequent subsections in Section 17 of GSD Rule 3A.

GSD Rule 22B defines the term “Corporation Default” and sets forth the close out netting process in the event of a Corporation Default. Section (b)(ii) of GSD Rule 22B provides that the following events shall constitute a Corporation Default: (A) the dissolution of FICC (other than pursuant to a consolidation, amalgamation, or merger),⁸ (B) the institution by FICC of a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors’ rights, or the presentation of a petition for FICC’s winding-up or liquidation, or the making of a general assignment for the benefit of creditors,⁹ (C) the institution of a proceeding against FICC seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors’ rights, or the presentation of a petition for FICC’s winding-up or liquidation

⁸ See Section (b)(ii)(A) of GSD Rule 22B. Supra note 3.

⁹ See Section (b)(ii)(B) of GSD Rule 22B. Supra note 3.

and, in each case, such proceeding or petition resulting in a judgement of insolvency or bankruptcy or the entry of an order for relief or the making of an order for FICC's winding-up or liquidation,¹⁰ or (D) FICC seeking or becoming subject to the appointment of a receiver, trustee, or other similar official pursuant to the federal securities laws or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act¹¹ for FICC or for all or substantially all of FICC's assets.¹²

In addition, subject to the limitations set forth therein, Section (b)(i) of GSD Rule 22B provides that a Corporation Default is deemed to have occurred on the eighth (8th) day after FICC receives notice from a GSD Member of FICC's failure to make, when due, an undisputed payment or delivery to such Member that is required to be made by FICC under the GSD Rules; provided that, such failure remains unremedied throughout the seven (7) day period following FICC's receipt of the notice.¹³

FICC's provision of clearance and settlement services, including the timely settlement of Transactions in the ordinary course of business, are a part of FICC's fundamental directive as a registered clearing agency under the Act. The seven (7) day period provided by Section (b)(i) of GSD Rule 22B is intended to address the circumstance where FICC experiences an operational issue that prevents it from completing such clearance and settlement services. In this circumstance, if FICC is not able to rectify the failure and satisfy its obligations in seven (7) days, GSD Rule 22B

¹⁰ See Section (b)(ii)(C) of GSD Rule 22B. Supra note 3.

¹¹ 12 U.S.C. 5381 *et seq.*

¹² See Section (b)(ii)(D) of GSD Rule 22B. Supra note 3.

¹³ See Section (b)(i) of GSD Rule 22B. Supra note 3.

requires that all Transactions which have been subject to Novation pursuant to the GSD Rules but have not yet settled and any rights and obligations of the parties thereto to be immediately terminated.¹⁴ The seven (7) day period is designed to avoid a systemic disruption in such circumstance.

In connection with the proposed rule change to apply GSD Rule 22B to Sponsored Members, FICC is also proposing to add language to clarify that the commencement of the seven (7) day period preceding a potential Corporation Default, as provided by Section (b)(i) of GSD Rule 22B, would not modify FICC's obligations to satisfy any undisputed payment or delivery obligation to a Sponsored Member under the GSD Rules, including any undisputed interest payment obligation owing to the Sponsored Member on an open Sponsored Member Trade, and that such obligation would continue to accrue in favor of the Sponsored Member for the duration of the seven (7) day period. Specifically, FICC is proposing to include in the proposed new subsection (a) to Section 17 of GSD Rule 3A language that makes it clear that FICC would be responsible for satisfying any undisputed payment or delivery obligation required to be made by FICC to a Sponsored Member under the GSD Rules, including, but not limited to, any undisputed interest payment obligation that accrues in favor of a Sponsored Member on a Sponsored Member Trade that has been subject to Novation pursuant to the GSD Rules but has not yet settled and for which FICC has received notice from such Sponsored Member of FICC's failure to make, when due, such undisputed interest payment to such Sponsored Member within the meaning of Section (b)(i) of GSD Rule 22B.

¹⁴ See Section (a) of GSD Rule 22B. Supra note 3.

GSD Rule 22B (Corporation Default)

FICC is proposing to amend the wording of the third sentence of Section (a) of GSD Rule 22B to provide greater clarity regarding the close out netting process upon a Corporation Default. Specifically, FICC is proposing to delete a reference to Section 2(a) of GSD Rule 22A in that sentence and modify the reference to Section 2(b) of GSD Rule 22A to specifically refer to Section 2(b)(i) of GSD Rule 22A.

FICC is proposing to delete the reference to Section 2(a) of GSD Rule 22A in the third sentence of Section (a) of GSD Rule 22B because this reference is unnecessary and potentially confusing to GSD Members. The reference to Section 2(a) of GSD Rule 22A is meant to set forth Transactions that would not be subject to the close out netting process in the event of a Corporation Default by referring (by way of analogy) to Transactions that FICC would not close out in the event FICC ceases to act for a GSD Member. However, Section (a) of GSD Rule 22B already contains a statement that makes it clear which Transactions are subject to the close out netting process in the event of a Corporation Default: “all Transactions which have been subject to Novation pursuant to these [GSD] Rules”¹⁵ Therefore, the reference to Section 2(a) of GSD Rule 22A is not necessary and potentially confusing to GSD Members, and FICC proposes to delete it from the third sentence of Section (a) of GSD Rule 22B.

In addition, FICC is proposing to modify the reference to Section 2(b) of GSD Rule 22A in the third sentence of Section (a) of GSD Rule 22B to specifically refer to Section 2(b)(i) of GSD Rule 22A. Section (a) of GSD Rule 22B provides, in relevant part, that “the Board shall determine a single net amount owed by or to each Member ...

¹⁵ See Section (a) of GSD Rule 22B. Supra note 3.

by applying the close out...procedures of Section 2(a) and (b) of [GSD] Rule 22A”¹⁶

The reference to the entirety of Section 2(b) of GSD Rule 22A could cause confusion for GSD Members. This is because only subsection (i) of Section 2(b) of GSD Rule 22A, which speaks specifically to final net settlement positions, is relevant in the context of GSD Rule 22B. The rest of Section 2(b) of GSD Rule 22A is not relevant. Therefore, FICC is proposing to amend the reference to point specifically to Section 2(b)(i) of GSD Rule 22A.

FICC is also proposing to delete the “, to the extent applicable,” and “and application” language from the third sentence of Section (a) of GSD Rule 22B. FICC is proposing to delete the “, to the extent applicable,” language because Section 2(b)(i) of GSD Rule 22A would always be applicable for purposes of the Board determining a single net amount owed by or to each Member under GSD Rule 22B after a Corporation Default has occurred. Likewise, FICC is proposing to streamline the wording of the third sentence of Section (a) of GSD Rule 22B by deleting the “and application” language because it is extraneous wording that is unnecessary and not relevant in the context of Section 2(b)(i) of GSD Rule 22A.

Lastly, FICC is proposing a change to the third sentence of Section (a) of GSD Rule 22B to make it clear that, although GSD Rule 22B would apply to Sponsored Members pursuant to this proposal, the loss allocation provisions of GSD Rule 4 (Clearing Fund and Loss Allocation) referenced in GSD Rule 22B would not apply to Sponsored Members. Specifically, FICC is proposing a clarifying change in that sentence to add “, to the extent such provisions are otherwise applicable to such Member”

¹⁶ Id.

following the reference in that sentence to the loss allocation provisions in GSD Rule 4. This proposed change is consistent with Section 12(a) of GSD Rule 3A, which provides that Sponsored Members are not obligated for allocations, pursuant to GSD Rule 4, of loss or liability incurred by FICC.

2. Statutory Basis

FICC believes this proposal is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to a registered clearing agency. Specifically, FICC believes this proposal is consistent with Section 17A(b)(3)(F) of the Act¹⁷ and Rule 17Ad-22(e)(23)(i),¹⁸ as promulgated under the Act, for the reasons described below.

Section 17A(b)(3)(F) of the Act requires, in part, that the GSD Rules be designed to “promote the prompt and accurate clearance and settlement of securities transactions.”¹⁹ FICC believes that the proposed rule change to apply GSD Rule 22B to Sponsored Members in the same manner as it applies to all other GSD Members would help to ensure that all GSD Members are subject to a common, transparent legal framework in a Corporation Default situation. Having a common, transparent legal framework in a Corporation Default situation would facilitate an orderly close out netting of obligations between FICC and the GSD Members in the event that a Corporation Default occurs. An orderly close out netting of obligations between FICC and the GSD Members would provide clarity and certainty to market participants in a time of distress regarding their rights and obligations and the rights and obligations of FICC. Clarity and

¹⁷ 15 U.S.C. 78q-1(b)(3)(F).

¹⁸ 17 CFR 240.17Ad-22(e)(23)(i).

¹⁹ 15 U.S.C. 78q-1(b)(3)(F).

certainty of the rights and obligations of market participants as well as rights and obligations of FICC would in turn promote the prompt and accurate clearance and settlement of securities transactions. Therefore, FICC believes that the proposed rule change to apply GSD Rule 22B to Sponsored Members in the same manner as it applies to all other GSD Members is consistent with Section 17A(b)(3)(F) of the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures.²⁰ FICC believes that the proposed rule changes to (i) amend the third sentence of Section (a) of GSD Rule 22B by (A) deleting the unnecessary and potentially confusing reference to Section 2(a) of GSD Rule 22A and (B) modifying the reference to Section 2(b) of GSD Rule 22A to specifically refer to Section 2(b)(i) of GSD Rule 22A, and (ii) make clarifying and/or technical changes in GSD Rule 3A and GSD Rule 22B, would ensure that the GSD Rules remain clear and accurate to GSD Members. Having clear and accurate GSD Rules would facilitate GSD Members' understanding of those rules and provide GSD Members with increased predictability and certainty regarding their obligations. As such, FICC believes that these proposed rule changes are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

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

FICC believes that the proposed rule change to apply GSD Rule 22B to Sponsored Members could have an impact on competition. This is because the proposed change to apply GSD Rule 22B to Sponsored Members would (i) provide for the

²⁰ 17 CFR 240.17Ad-22(e)(23)(i).

immediate termination upon a Corporation Default of all Transactions to which a Sponsored Member is a party and which have been subject to Novation pursuant to GSD Rules but have not yet settled and (ii) require a Sponsored Member to provide FICC with a 7-day period under the circumstances described in Section (b)(i) of GSD Rule 22B before such termination can occur. FICC believes this proposed rule change could both promote competition and burden competition. The proposed rule change to apply GSD Rule 22B to Sponsored Members could promote competition by ensuring that GSD Members are subject to a common, transparent legal framework in a Corporation Default. Applying the close out netting process and the 7-day period requirement to Sponsored Members in the same manner as they apply to all other GSD Members would help ensure that, in the unlikely event that FICC becomes insolvent or defaults in its obligations to GSD Members, all GSD Members follow the same procedures in closing out their positions and netting them against FICC's obligations to the GSD Members. Requiring that all GSD Members follow the same procedures in closing out their positions in a Corporation Default would help promote competition because all GSD Members would be treated alike during a stressed market condition. Conversely, the propose rule change to apply GSD Rule 22B to Sponsored Members could burden competition by subjecting the Sponsored Members to the close out netting process and the 7-day period requirement. However, FICC believes any burden on competition that is created by this proposed rule change would be necessary and appropriate in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.²¹

²¹ 15 U.S.C. 78q-1(b)(3)(I).

FICC believes any burden on competition that is created by the proposed rule change to apply GSD Rule 22B to Sponsored Members would be necessary in furtherance of the purposes of the Act²² because the GSD Rules are required to be designed to “promote the prompt and accurate clearance and settlement of securities transactions.”²³ As described above, the proposed rule change to apply GSD Rule 22B to Sponsored Members would help to ensure that all GSD Members are subject to a common, transparent legal framework in a Corporation Default. Having a common, transparent legal framework in a Corporation Default situation would facilitate an orderly close out netting of obligations between FICC and the GSD Members in the event that a Corporation Default occurs. An orderly close out netting of obligations between FICC and the GSD Members would provide clarity and certainty to market participants in a time of distress regarding their rights and obligations and the rights and obligations of FICC. Clarity and certainty of the rights and obligations of market participants as well as the rights and obligations of FICC would in turn promote the prompt and accurate clearance and settlement of securities transactions. Therefore, FICC believes any burden that is created by the proposed rule change to apply GSD Rule 22B to Sponsored Members would be necessary in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.²⁴

FICC also believes any burden on competition that is created by the proposed rule change to apply GSD Rule 22B to Sponsored Members would be appropriate in

²² Id.

²³ 15 U.S.C. 78q-1(b)(3)(F).

²⁴ 15 U.S.C. 78q-1(b)(3)(I).

furtherance of the purposes of the Act.²⁵ As described above, the proposed rule change to apply GSD Rule 22B to Sponsored Members would subject Sponsored Members to the close out netting process and the 7-day period requirement. Subjecting Sponsored Members to the close out netting process would facilitate an orderly close out netting of obligations between FICC and all GSD Members (including the Sponsored Members) in the event that a Corporation Default occurs. Requiring Sponsored Members to provide FICC with a 7-day period under the circumstances described in Section (b)(i) of GSD Rule 22B would help to avoid a systemic disruption under such circumstances. Therefore, FICC believes any burden that is created by the proposed rule change to apply GSD Rule 22B to Sponsored Members would be appropriate in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.²⁶

FICC does not believe that the proposed rule changes to (i) amend the third sentence of Section (a) of GSD Rule 22B by (A) deleting the unnecessary and potentially confusing reference to Section 2(a) of GSD Rule 22A and (B) modifying the reference to Section 2(b) of GSD Rule 22A to specifically refer to Section 2(b)(i) of GSD Rule 22A, and (ii) make clarifying and/or technical changes in GSD Rule 3A and GSD Rule 22B, would have an impact on competition.²⁷ These changes would simply provide specificity, clarity and additional transparency within the GSD Rules and not affect GSD Members' rights and obligations. As such, FICC believes that these proposed rule changes would not have any impact on competition.

²⁵ Id.

²⁶ Id.

²⁷ Id.

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

FICC reviewed the proposed rule change with its Sponsoring Members in order to benefit from their expertise on the Sponsored Members. Written comments relating to this proposed rule change have not been received from the Sponsoring Members or any other person. FICC will notify the Commission of any written comments received by FICC.

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-2018-008 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-2018-008. 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make

available publicly. All submissions should refer to File Number SR-FICC-2018-008 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.²⁸

Eduardo A. Aleman
Assistant Secretary

²⁸ 17 CFR 200.30-3(a)(12).