

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81511; File No. SR-FICC-2017-019)

August 31, 2017

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Adopt the Interpretive Guidance with Respect to Watch List Consequences

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> notice is hereby given that on August 23, 2017, 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 primarily prepared by the clearing agency. FICC filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(1) thereunder.<sup>4</sup> 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 would amend FICC’s Government Securities Division (“GSD”) Rulebook (“GSD Rules”) and Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules,” and collectively with the GSD Rules, the “Rules”)<sup>5</sup> in order to adopt the Interpretive Guidance with Respect to Watch List Consequences (“Interpretive

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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> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(1).

<sup>5</sup> Capitalized terms not defined herein are defined in the GSD Rules, available at [www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_gov\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf), and the MBSD Rules, available at [www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_mbsd\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf).

Guidance”), which would provide guidance to members of GSD and MBSD regarding placement on the Watch List and its impact on their respective Clearing Fund deposits as well as other consequences.

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 would add the Interpretive Guidance into the Rules, which will provide guidance to members of GSD and MBSD regarding the Watch List and its impact on their respective Clearing Fund deposits as well as other possible consequences.

(i) Background

FICC occupies an important role in the securities settlement system by interposing itself through each of GSD and MBSD as a central counterparty between members that are counterparties to transactions accepted for clearing by FICC, thereby reducing the risks faced by its members. FICC’s ability to guarantee settlement of these transactions is dependent upon its risk management, which is the means by which it protects itself and its members from the risks inherent in the settlement process. The Watch List is one of the risk management tools that

FICC uses to monitor default risks of its members on an ongoing basis.<sup>6</sup> A member could be placed on the Watch List if its credit rating derived from the Credit Risk Rating Matrix is 5, 6 or 7,<sup>7</sup> or if, based on FICC's consideration of relevant factors, it is deemed by FICC to pose a heightened risk to FICC and its members.<sup>8</sup> Being placed on the Watch List may result in Clearing Fund-related consequences as well as other consequences under the Rules.

(ii) Detailed Description of the Proposed Rule Change

In order to provide members of GSD and MBSD guidance regarding placement on the Watch List and its impact on their respective Clearing Fund deposits and other consequences, FICC is proposing to adopt the Interpretive Guidance, as described below.

FICC is also proposing to amend the "Watch List" definition in GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions), respectively, to add a footnote referring to the Interpretive Guidance for members' ease of reference when reviewing the Rules for Watch List implications.

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<sup>6</sup> See Exchange Act Release Nos. 80734 (May 19, 2017), 82 FR 24177 (May 25, 2017) (SR-FICC-2017-006), 80731 (May 19, 2017), 82 FR 24174 (May 25, 2017) (SR-FICC-2017-804).

<sup>7</sup> The Credit Risk Rating Matrix generates credit ratings for relevant members based on a 7-point rating system, with "1" being the strongest credit rating and "7" being the weakest credit rating.

<sup>8</sup> Pursuant to GSD Rule 1, the term "Watch List" means "at any time and from time to time, the list of Members whose credit ratings derived from the Credit Risk Rating Matrix are 5, 6 or 7, as well as members that, based on the Corporation's consideration of relevant factors, including those set forth in Section 12(d) of Rule 3, are deemed by the Corporation to pose heightened risk to the Corporation and its Members." GSD Rule 1, Definitions.

Pursuant to MBSD Rule 1, the term "Watch List" means "at any time and from time to time, the list of Members whose credit ratings derived from the Credit Risk Rating Matrix are 5, 6 or 7, as well as Members that, based on the Corporation's consideration of relevant factors, including those set forth in Section 11(d) of Rule 3, are deemed by the Corporation to pose heightened risk to the Corporation and its Members." MBSD Rule 1, Definitions.

The proposed footnote would indicate to members that being placed on the Watch List may result in Clearing Fund-related consequences as well as other consequences under the Rules and would refer them to the Interpretive Guidance in the Rules.

A. *Clearing Fund-Related Consequences for Members Placed on the Watch List*

As proposed, the Interpretive Guidance would provide details on Clearing Fund-related consequences for members of GSD and MBSD placed on the Watch List, including additional Clearing Fund deposits, restriction on withdrawal of Excess Clearing Fund Deposits, and non-waiver of minimal Clearing Fund payment.

1. Additional Clearing Fund Deposits

Pursuant to Section 12(e) of GSD Rule 3<sup>9</sup> and Section 11(e) of MBSD Rule 3,<sup>10</sup> FICC may require a GSD Netting Member or an MBSD Clearing Member, as applicable, that has been placed on the Watch List to make and maintain a deposit to the GSD Clearing Fund or MBSD Clearing Fund, as applicable, over and above the amount determined in accordance with Section

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<sup>9</sup> Section 12(e) of GSD Rule 3, in relevant parts, states that “The Corporation may require a Netting Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Section 2 of Rule 4 (which additional deposit shall constitute a portion of the Netting Member’s Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member.” GSD Rule 3, Ongoing Membership Requirements.

<sup>10</sup> Section 11(e) of MBSD Rule 3, in relevant parts, states that “The Corporation may require a Clearing Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Section 2 of Rule 4 (which additional deposit shall constitute a portion of the Clearing Member’s Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member.” MBSD Rule 3, Ongoing Membership Requirements.

2 of GSD Rule 4 and Section 2 of MBSD Rule 4, as applicable, or such higher amount as the FICC Board may deem necessary for the protection of FICC or other members.

The determination of whether a member that is on the Watch List should be subject to an additional Clearing Fund deposit is based on factors determined to be relevant by FICC from time to time, including:

- a. The overall financial condition and financial stability or volatility of the GSD Netting Member or the MBSD Clearing Member, as applicable, which may include a review of the member's credit rating/enhanced surveillance<sup>11</sup> history and outlook. For example, FICC may require an additional Clearing Fund deposit from a member that is both rated a 7 on the Credit Risk Rating Matrix as well as under enhanced surveillance, or if the member's credit rating has deteriorated rapidly month over month.
- b. The liquidity arrangement, if any, of the GSD Netting Member or the MBSD Clearing Member, as applicable. For example, FICC may require an additional Clearing Fund deposit from a member if FICC has concerns about the member's liquidity arrangement or if FICC determines that the member has insufficient liquidity resources when compared to the volume of the member's clearing activities at FICC.
- c. The Clearing Fund requirement history, transaction volume trends, simulated closeout results, stress test results, backtest results and outstanding positions of

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<sup>11</sup> FICC maintains an enhanced surveillance list for membership monitoring. The enhanced surveillance list is generally used when members are undergoing drastic and unexpected changes in their financial conditions or operational capabilities and thus are deemed by FICC to be of the highest risk level and/or warrant additional scrutiny due to FICC's ongoing concerns about these members.

the GSD Netting Member or the MBSB Clearing Member, as applicable. For example, FICC may require an additional Clearing Fund deposit from a member that is on the Watch List if a review of the member's activity level indicates that FICC or its members could be exposed to losses from the member's activities.

- d. Adverse news reports and/or regulatory concerns relating to the GSD Netting Member or the MBSB Clearing Member, as applicable.
- e. Any additional concerns relating to the financial or operational condition of the GSD Netting Member or the MBSB Clearing Member, as applicable.

Additionally, pursuant to Section 2(a) of MBSB Rule 4,<sup>12</sup> FICC may impose an Intraday Mark-to-Market Charge on a MBSB Clearing Member that experiences an adverse Intraday Mark-to-Market change that, among other things, exceeds certain Surveillance Thresholds. The Surveillance Thresholds are set by FICC based on an MBSB Clearing Member's rating as determined by the Credit Risk Rating Matrix and/or its Watch List status.

Furthermore, pursuant to Section 2(g) of MBSB Rule 4,<sup>13</sup> FICC may subject a MBSB Clearing Member to an intraday VaR Charge if the MBSB Clearing Member is on the Watch

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<sup>12</sup> Section 2(a) of MBSB Rule 4, in relevant parts, states "on any Business Day, a Clearing Member may become subject to an Intraday Mark-to-Market Charge," and the term "Intraday Mark-to-Market Charge" as defined in MBSB Rule 1, in relevant parts, provides that "the Corporation may, in its discretion, collect the Intraday Mark-to-Market Charge from a Clearing Member that experiences an adverse Intraday Mark-to-Market change that...exceeds a certain dollar threshold ("Surveillance Threshold")" and that "the Surveillance Threshold is an amount between \$1,000,000 and \$50,000,000 that is set by the Corporation per Clearing Member based on a Clearing Member's rating as determined by the Credit Risk Rating Matrix and/or a Clearing Member's Watch List status." MBSB Rule 4, Clearing Fund and Loss Allocation.

<sup>13</sup> Section 2(g) of MBSB Rule 4, in relevant parts, states "any VaR Charge may be collected on an intra-day basis," that "such intra-day VaR Charge amount shall be based upon certain parameter breaks defined by the Corporation from time to time" and "qualitative factors including, but not limited to, Watch List status and internal rating will

List; however, FICC does not currently collect a VaR Charge on an intraday basis from any MBSD Clearing Members.

2. Restriction on Withdrawal of Excess Clearing Fund Deposits

Pursuant to Section 9 of GSD Rule 4<sup>14</sup> and Section 9 of MBSD Rule 4,<sup>15</sup> FICC may retain some or all of the Excess Clearing Fund Deposit of a GSD Member or an MBSD Member, as applicable, who is on the Watch List.<sup>16</sup> Nonetheless, FICC generally does not retain the Excess Clearing Fund Deposit of a Watch List member unless the member fails to pay the Required Fund Deposit within the required timeframes established by FICC, or if FICC has a concern that the member will not be able to satisfy its obligation to FICC.

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also be considered in the application of intraday VaR Charge.” MBSD Rule 4, Clearing Fund and Loss Allocation.

<sup>14</sup> Section 9 of GSD Rule 4, in relevant parts, states “at the discretion of the Corporation, some or all of the Excess Clearing Fund Deposit may not be returned...if the Member is on the Watch List.” GSD Rule 4, Clearing Fund and Loss Allocation.

<sup>15</sup> Section 9 of MBSD Rule 4, in relevant parts, states “at the discretion of the Corporation, some or all of the Excess Clearing Fund Deposit may not be returned...if the Member is on the Watch List.” MBSD Rule 4, Clearing Fund and Loss Allocation.

<sup>16</sup> Pursuant to Section 9 of GSD Rule 4, FICC may also retain some or all of the Excess Clearing Fund Deposits of a GSD Member if FICC determines that the GSD Member’s anticipated Funds-Only Settlement Amounts or Net Settlement Positions in the near future may reasonably be expected to be materially different than those of the recent past. GSD Rules, supra note 5.

Pursuant to Section 9 of MBSD Rule 4, FICC may also retain some or all of the Excess Clearing Fund Deposits of a MBSD Member if the MBSD Member has an outstanding payment obligation to FICC, if FICC determines that the MBSD Member’s anticipated Cash Settlement Obligations, Pool Net Obligations or Transactions over the next 90 calendar days may reasonably be expected to be materially different than during the prior 90 calendar days. MBSD Rules, supra note 5.

### 3. Non-Waiver of Minimal Clearing Fund Payment

Pursuant to Section 2(a) of GSD Rule 4<sup>17</sup> and Section 2(c) of MBSD Rule 4,<sup>18</sup> a GSD Member or an MBSD Member, as applicable, is not required to make any payment to its Clearing Fund on a given day if the difference between the amount of the GSD Member's or the MBSD Member's, as applicable, Required Fund Deposit as reported on that day and the amount then on deposit towards satisfaction thereof is less than both (i) \$250,000 and (ii) 25 percent of the amount then on deposit, provided that the GSD Member or the MBSD Member, as applicable, is not on the Watch List. As such, GSD Members and MBSD Members that are on the Watch List must satisfy all margin calls for their respective Clearing Funds regardless of the amount.

#### *B. Other Consequences for GSD Netting Members Placed on the Watch List*

As proposed, the Interpretive Guidance would also describe other consequences that may affect GSD Netting Members placed on the Watch List.

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<sup>17</sup> Section 2(a) of GSD Rule 4, in relevant parts, states that “A Netting Member’s Required Fund Deposit shall be reported daily, and payment shall be due by the time specified in the Corporation’s procedures; however, such payment shall not be due on a given day if: (a) the difference between the amount of a Member’s Required Fund Deposit as reported on that day, and the amount then on deposit towards satisfaction thereof is less than both (i) \$250,000, and (ii) 25 percent of the amount then on deposit; and (b) the Member is not on the Watch List. GSD Rule 4, Clearing Fund and Loss Allocation.

<sup>18</sup> Section 2(c) of MBSD Rule 4, in relevant parts, states that “A Clearing Member’s Required Fund Deposit shall be reported daily, and payment shall be due by the time specified in the Corporation’s procedures; however, such payment shall not be due on a given day if: (a) the difference between the amount of a Member’s Required Fund Deposit as reported on that day and the amount then on deposit towards satisfaction thereof is less than both (i) \$250,000, and (ii) 25 percent of the amount then on deposit from the Clearing Member; and (b) the Member is not on the Watch List.” MBSD Rule 4, Clearing Fund and Loss Allocation.

Pursuant to Section 12(e) of GSD Rule 3,<sup>19</sup> if a GSD Netting Member is on the Watch List, FICC may (1) suspend the GSD Netting Member's right under the GSD Rules to collect a Credit Forward Mark Adjustment Payment during all or a portion of the time period that the GSD Netting Member is on the Watch List and/or (2) maintain possession of the securities and/or cash that comprise the GSD Netting Member's Collateral Allocation Entitlement as the result of its GCF Repo Transaction activity. Nonetheless, FICC generally does not retain these credits and/or entitlements unless the GSD Netting Member fails to pay the Required Fund Deposit within the required timeframes established by FICC, or if FICC has a concern that the GSD Netting Member will not be able to satisfy its obligation to FICC.

## 2. Statutory Basis

Section 17A(b)(3)(F) of the Act requires, in part, that the Rules promote the prompt and accurate clearance and settlement of securities transactions.<sup>20</sup> The proposed rule change would provide additional transparency to FICC members regarding placement on the Watch List and its impact on their respective Clearing Fund deposits as well as other consequences. The proposed rule change would also clarify FICC's current practices regarding the assessment, collection and withholding of related margin charges, credits and/or entitlements. Accordingly, the proposed rule change would ensure that the Rules are transparent and clear, which would enable all stakeholders to readily understand their respective rights and obligations in connection with

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<sup>19</sup> Section 12(e) of GSD Rule 3, in relevant parts, states that "as regards a Netting Member that has been placed on the Watch List by the Corporation, the Corporation may suspend, during all or a portion of the time period that such Member is on the Watch List, its right under these Rules to collect a Credit Forward Mark Adjustment Payment. Moreover, if a Netting Member on the Watch List has a Collateral Allocation Entitlement as the result of its GCF Repo Transaction activity, the Corporation may, in its sole discretion, maintain possession of the securities and/or cash that comprise such Collateral Allocation Entitlement." GSD Rule 3, Ongoing Membership Requirements.

<sup>20</sup> 15 U.S.C. 78q-1(b)(3)(F).

FICC's clearance and settlement of securities transactions. Therefore, FICC believes that the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for publicly disclosing all relevant rules and material procedures.<sup>21</sup> Rule 17Ad-22(e)(23)(ii) under the Act requires that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in FICC.<sup>22</sup> The proposed rule change enhances the transparency in the Rules by describing the impact that placement on the Watch List could have on members' respective Clearing Fund deposits and other consequences. By doing so, the proposed rule change would provide for the public disclosure of the rules and procedures through which FICC assesses, collects and withholds certain margin charges, credits and/or entitlements from members on the Watch List. By providing information regarding the assessment, collection and withholding of certain margin charges and other consequences of the Watch List, the proposed rule change would also enable FICC's members to identify and evaluate the risks and material costs they incur by participating in FICC. As such, FICC believes the proposed rule change is consistent with Rule 17Ad-22(e)(23)(i) and (ii) under the Act.<sup>23</sup>

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<sup>21</sup> 17 CFR 240.17Ad-22(e)(23)(i).

<sup>22</sup> 17 CFR 240.17Ad-22(e)(23)(ii).

<sup>23</sup> 17 CFR 240-17Ad-22(e)(23)(i), (ii).

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

FICC does not believe that the proposed rule change would impact competition.<sup>24</sup> The proposed rule change provides interpretive guidance with respect to existing Rules and would increase the transparency of the Rules regarding the Watch List and its impact on FICC members' respective Clearing Fund deposits and other consequences by clarifying FICC's current practices with respect to the assessment, collection and withholding of certain margin charges, credits and/or entitlements from members on the Watch List. The proposed rule change would not change such current practices. As such, FICC believes that the proposed rule change will not impact FICC members or have any impact on competition.

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

Written comments relating to this proposed rule change have not been solicited or received. 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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>25</sup> and paragraph (f) of Rule 19b-4 thereunder.<sup>26</sup> At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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<sup>24</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>25</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>26</sup> 17 CFR 240.19b-4(f).

#### 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](mailto:rule-comments@sec.gov). Please include File Number SR-FICC-2017-019 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-2017-019. 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-2017-019 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.<sup>27</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>27</sup> 17 CFR 200.30-3(a)(12).