

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69495; File No. SR-FICC-2013-04)

May 2, 2013

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to the Government Securities Division Rules and the Mortgage-Backed Securities Division Clearing Rules in Connection with the Implementation of The Foreign Account Tax Compliance Act (FATCA)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 22, 2013, the 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 substantially prepared by FICC. 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 changes consist of modifications to the Rulebook of the Government Securities Division (“GSD”) and the Clearing Rules of the Mortgage-Backed Securities Division (“MBSD”) (collectively, the “Rules”) of FICC in connection with implementation of sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended, that were enacted as part of the Foreign Account Tax Compliance Act, and the Treasury Regulations or other official interpretations thereunder (collectively “FATCA”).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FICC 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. FICC has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.³

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Background

FATCA was enacted on March 18, 2010, as part of the Hiring Incentives to Restore Employment Act, and became effective, subject to transition rules, on January 1, 2013. The U.S. Treasury Department finalized and issued various implementing regulations ("FATCA Regulations") on January 17, 2013. FATCA's intent is to curb tax evasion by U.S. citizens and residents through their use of offshore bank accounts. FATCA generally requires foreign financial institutions ("FFIs")⁴ to become "participating FFIs" by entering into agreements with the Internal Revenue Service ("IRS"). Under these agreements, FFIs are required to report to the IRS information on U.S. persons and entities that have (directly or indirectly) accounts with these FFIs. If an FFI does not enter into such an agreement with the IRS, FATCA will impose a 30% withholding tax on U.S.-source interest, dividends and other periodic amounts paid to such "nonparticipating FFI" ("Income Withholding"), as well as on the payment of gross

³ The Commission has modified the text of the summaries prepared by the clearing agency.

⁴ Non-U.S. financial institutions are referred to as "foreign financial institutions" or "FFIs" in the FATCA Regulations.

proceeds arising from the sale, maturity or redemption of securities or any instrument yielding U.S.-source interest and dividends (“Gross Proceeds Withholding,” and, together with Income Withholding, “FATCA Withholding”). The 30% FATCA Withholding taxes will apply to payments made to a nonparticipating FFI acting in any capacity, including payments made to a nonparticipating FFI that is not the beneficial owner of the amount paid and acting only as a custodian or other intermediary with respect to such payment. To the extent that U.S.-source interest, dividend, and other periodic amount or gross proceeds payments are due to a nonparticipating FFI in any capacity, a U.S. payor, such as FICC, transmitting such payments to the nonparticipating FFI will be liable to the IRS for any amounts of FATCA Withholding that the U.S. payor should, but does not, withhold and remit to the IRS. For the reasons described below, FICC is not in a position to accept this liability and, by making the proposed rule changes set forth herein, is implementing preventive measures to protect itself against such liability.

In addition, under FATCA, a U.S. payor, such as FICC, could be required to deduct Income Withholding with regard to a *participating* FFI if either: (x) the participating FFI makes a statutory election to shift its withholding responsibility under FATCA to the U.S. payor; or (y) the U.S. payor is required to ignore the actual recipient and treat the payment as if made instead to certain owners, principals, customers, account holders or financial counterparties of the participating FFI. FICC is not in a position to accept this burden shift and, by making the proposed rule changes set forth herein, is implementing preventive measures to protect itself against such a burden.

As an alternative to FFIs entering into individual agreements with the IRS, the U.S. Treasury Department provided another means of complying with FATCA for FFIs

which are resident in Non-U.S. jurisdictions that enter into intergovernmental agreements (“IGA”) with the United States.⁵ Generally, such a jurisdiction (“FATCA Partner”) would pass laws to eliminate the conflicts of law issues that would otherwise make it difficult for FFIs in its jurisdiction to collect the information required under FATCA and transfer this information, directly or indirectly, to the United States. An FFI resident in a FATCA Partner jurisdiction would either transmit FATCA reporting to its local competent tax authority, which in turn would transmit the information to the IRS, or the FFI would be authorized/required by FATCA Partner law to enter into an FFI agreement and transmit FATCA reporting directly to the IRS. Under both IGA models, payments to such FFIs would not be subject to FATCA Withholding so long as the FFI complies with the FATCA Partner’s laws mandated in the IGA.

Under the FATCA Regulations, (A) beginning January 1, 2014, FICC will be required to do Income Withholding on any payments made to any nonparticipating FFI approved for membership by FICC as of such date or thereafter, (B) beginning July 1, 2014, FICC will be required to do Income Withholding on any payments made to any nonparticipating FFI approved for membership by FICC prior to January 1, 2014 and (C) beginning January 1, 2017, FICC will be required to do Gross Proceeds Withholding on all nonparticipating FFIs, regardless when any such FFI’s membership was approved.

Preparing for Implementation of FATCA

In preparation for FATCA’s implementation, FFIs are being asked to identify their expected FATCA status as a condition of continuing to do business. Customary

⁵ As of the date of this proposed rule change filing, the United Kingdom, Mexico, Ireland, Switzerland, Spain, Norway Denmark, Italy and Germany have signed or initialed an IGA with the United States. The U.S. Treasury Department has announced that it is engaged in negotiations with more than 50 countries and jurisdictions regarding entering into an IGA.

legal agreements in the financial services industry already contain provisions allocating the risk of any FATCA Withholding tax that will need to be collected, and requiring that, upon FATCA's effectiveness, foreign counterparties must certify (and periodically recertify) their FATCA status using the relevant tax forms that the IRS has announced it will provide.⁶ Advance disclosure by an FFI client or counterparty would permit a withholding agent to readily determine whether it must, under FATCA, withhold on payments it makes to the FFI. If an FFI fails to provide appropriate compliance documentation to a withholding agent, such FFI would be presumed to be a nonparticipating FFI and the withholding agent will be obligated to withhold on certain payments.

As it applies to FICC specifically, FATCA will require FICC to deduct FATCA Withholding on payments to certain members arising from certain transactions processed by FICC on behalf of such members.⁷ Because FATCA treats any entity holding financial assets for the account of others as a "financial institution," FICC believes that almost all of its members which are treated as non-U.S. entities for federal income tax purposes, including those members that are U.S. branches of non-U.S. entities, will likely be FFIs under FATCA (collectively, "FFI Members").⁸ As such, FICC will be liable to

⁶ For example, credit agreements now routinely require foreign lenders to agree to provide certifications of their FATCA status under approved IRS forms to U.S. borrowers, and subscription agreements for alternative investment funds that are anticipated to earn U.S.-source income are routinely requiring similar covenants.

⁷ FFI Members resident in IGA countries, that are compliant with the terms of applicable IGAs, should not be subject to FATCA Withholding.

⁸ Currently, only a small percentage of the Corporation's members are treated as non-U.S. entities for federal income tax purposes.

the IRS for any failures to withhold correctly under FATCA on payments made to its FFI Members.

In light of this, FICC has evaluated its existing systems and services to determine whether and how it may comply with its FATCA obligations. As a result of this evaluation, FICC has determined that its existing systems currently cannot process the new FATCA Withholding obligations with regard to the securities transactions processed by it, as no similar withholding obligation of this magnitude has ever been imposed upon it to date, and FICC has therefore not built its systems to support such an obligation.

Further, the vast majority of the transactions that are processed at FICC are processed through its netting and settlement systems at its GSD and MBSD divisions (the “Systems”). At GSD, the netting and settlement system service provides centralized, automated clearance and guaranteed settlement of eligible U.S. Treasury bills, notes, bonds, strips and book-entry non-mortgage-backed agency securities. Through netting, the GSD establishes a single net long or short position for each participant’s daily trading activity in a given security. The participant’s net position is the difference between all long and all short positions in a given security.

At MBSD, the mortgage-backed securities trades entering the MBSD clearing and settlement systems are settled using either the Settlement Balance Order system (SBO) or the Trade-for-Trade system (TFTD). The SBO settlement system is MBSD’s trade netting system, which nets by automatically pairing off settlement obligations with like terms, such as MBS product, coupon rate, maturity and settlement date, on a multilateral basis, i.e., regardless of contra party identity, resulting in the fewest possible number of receive/deliver obligations. Through the Trade-for-Trade settlement system, members

are given the opportunity to settle individual trades on a gross basis, as originally executed, following matching and comparison of each trade. Further netting is accomplished through MBSD's CCP Pool Netting service ("Pool Netting"). Members submit pool details ("Pool Instructs") into the Pool Netting system for bilateral matching versus their counterparties' submissions. As many of the matched Pool Instructs as possible are then netted by the Pool Netting system. For pools that meet all the criteria, FICC steps in as the central counter-party to settle the net pool obligations with its members.

FICC believes that each division's net settlement functionality could make FATCA Withholding virtually impossible, or, at the very least, would create onerous efficiency and liquidity issues for both FICC and its membership.

Undertaking FATCA Withholding, given FICC's settlement functionality, could require FICC in certain circumstances to resort to a draw on FICC's clearing fund for GSD or MBSD, as applicable ("Clearing Fund") in order to fund FATCA Withholding taxes with regard to nonparticipating FFI Members in non-FATCA Partner jurisdictions whenever the net credit owed to such FFI Member is less than the 30% FATCA tax. For example, if a nonparticipating FFI (in a non-FATCA Partner jurisdiction) is owed a \$100M payment from the sale of U.S. securities, but such nonparticipating FFI is in a net debit position at the end of that day because of FICC's net settlement functionality, there would be no payment to this FFI Member from which FICC can withhold. In this example, FICC would likely need to fund the \$30M FATCA Withholding tax until such time as the FFI Member can reimburse FICC and, as FICC has no funds for this purpose,

it would likely require a draw on the Clearing Fund.⁹ FICC would need to consider an increase in the amount of cash required to be deposited into the Clearing Fund, either by FFI Members or perhaps all of its members, which would reduce such member's liquidity and could have significant systemic effects. The amount of the FATCA Withholding taxes would be removed from market liquidity, which could lead to increased risk of member failure and increased financial instability.

For the reasons explained above and the following additional reasons, FICC is proposing amendments to its Rules (detailed below) to implement preventive measures that would generally require all of FICC's (i) existing members that are treated as Non-U.S. entities for federal income tax purposes and (ii) any applicants applying to become members that are treated as Non-U.S. entities for federal income tax purposes to be participating FFIs:

- Undertaking FATCA Withholding by FICC (even if possible) would make it economically unfeasible for affected FFI Members to engage in transactions involving U.S. securities. It would likely also quickly cause a significant negative impact on such FFI Members' liquidity because such withholding taxes would be imposed on the very large sums that FICC pays to such FFI Members. Furthermore, members would be burdened with extra costs and the negative impact on liquidity caused by the likely need

⁹ We note that the FATCA Regulations provide that "clearing organizations", which settle money on a net basis, may withhold on a similar net basis for FATCA purposes. However, it is unclear whether certain amounts being netted at the Corporation would qualify for the special FATCA netting rule. Even if the end of day net settlement amount would qualify as the correct amount to do FATCA Withholding on, the liquidity risks described herein are still present. This is because the sheer volume of the Corporation's net daily payments among the Corporation and members means that withholding FATCA tax from such net settlement payments, in any material proportion, would likely reduce liquidity and thus increase financial instability.

to substantially increase the amount of cash required to be deposited into the Clearing Fund.

- The cost of implementing a FATCA Withholding system for a small number of nonparticipating FFI Members would be substantial and disproportionate to the related benefit. Under the Model I IGA form and its executed versions with various FATCA Partners, FICC would not be required to withhold with regard to FFI residents in such FATCA Partner jurisdictions. Accordingly, FICC's withholding obligations under FATCA would effectively be limited to nonparticipating FFI Members in non-FATCA Partner jurisdictions. Since the cost of developing and maintaining a complex FATCA Withholding system would be passed on to FICC's members at large, it may burden members that otherwise comply with, or are not subject to, FATCA Withholding.

- As briefly noted above, if the proposed rule changes were not to take effect, in order to avoid counterparty credit risk, FICC would likely require each of the nonparticipating FFI Members in non-FATCA Partner jurisdictions to make initial or additional cash deposits to the Clearing Fund as collateral for the approximate potential FATCA tax liability of such nonparticipating FFI Member or otherwise adjust required deposits to the Clearing Fund. The amount of such deposits, which could amount to billions of dollars, would be removed from market liquidity.

- From the nonparticipating FFI Member's perspective, having 30% of its payments withheld and sent to the IRS would have a severe negative impact on such nonparticipating FFI Member's financial status. In many cases, the gross receipts would be for client accounts, and the nonparticipating FFI Member would need to make such

accounts whole. Without receipt of full payment for its dispositions, the nonparticipating FFI Member would not have sufficient assets to fund its client accounts.

- The proposed rule changes set forth herein should not create business issues or be onerous to FICC's membership because requiring FFIs to certify (and to periodically recertify) their FATCA status, and imposing the costs of non-compliance on them, are becoming standard market practice in the United States, separate and apart from membership in FICC.

Proposed Rule Changes

Managing the risks inherent in executing securities transactions is a key component of FICC's business. The globalization of financial markets, the trading of more complex instruments and the application of new technology all make risk management more critical and challenging. FICC's "risk tolerances" (i.e., the levels of risk FICC is prepared to confront, under a range of possible scenarios, in carrying out its business functions) are determined by the Board of Directors, in consultation with the Group Chief Risk Officer. FICC uses a combination of risk management tools, including strict criteria for membership, to mitigate the risks inherent in its business.

In line with its risk management focus, FICC has determined that compliance with FATCA, such that FICC shall not be responsible for FATCA Withholding, should be a general membership requirement (A) for all applicants seeking membership at GSD or MBSD, as applicable, that are treated as non-U.S. entities for federal income tax

purposes, and (B) for all existing FFI Members.¹⁰ In connection therewith, FICC proposes to amend its Rules as follows:

- Amend GSD Rule 1 and MBSD Rule 1 to add “FATCA”, “FATCA Certification”, “FATCA Compliance Date”¹¹, “FATCA Compliant” and “FFI Member”, as defined terms;

- Amend GSD Rule 2A, Section 2(a)(v) and MBSD Rule 2A, Section 1 to (1) require foreign members to certify to FICC that they are FATCA Compliant and (2) add FATCA Compliance as a qualification requirement for any applicant that will be an FFI Member;

- Amend GSD Rule 2A Section 5 and MBSD Rule 2A Section 3 to add that each applicant must complete and deliver a FATCA Certification to FICC as part of its membership application unless FICC has waived this requirement with regard to membership type;

- Amend GSD Rule 2A Section 6 and MBSD Rule 2A Section 4 to add FATCA Compliance as a qualification requirement for any applicant that will be an FFI Member;

¹⁰ FICC may grant a waiver under certain circumstances, provided, however, that FICC will not grant a waiver if it causes FICC to be obligated to withhold under FATCA on gross proceeds from the sale or other disposition of any property.

¹¹ Although Income Withholding with regard to FFI Members approved for membership by the Corporation prior to January 1, 2014 is first required under FATCA beginning July 1, 2014, the proposed amendments to the GSD Rules and MBSD Rules would require such existing FFI Members to be FATCA compliant approximately 60 days prior to July 1, 2014 in order for the Corporation to comply with its disciplinary and notice processes as set forth in its Rules.

- Amend GSD Rule 3, Section 7 and MBSD Rule 3, Section 6 to specify that failure to be FATCA Compliant creates a duty upon an FFI Member (both new and existing) to inform FICC;
- Amend GSD Rule 3, Section 9 and MBSD Rule 3, Section 8 to require that all FFI Members (both new and existing), in general: (i) agree not to conduct any transaction or activity through FICC if such FFI Member is not FATCA Compliant, (ii) certify and, as required under the timelines set forth under FATCA, periodically recertify, to FICC that they are FATCA Compliant; and (iii) indemnify FICC for any losses sustained by FICC resulting from such FFI Member's failure to be FATCA Compliant.
- FICC believes the proposed rule changes are consistent with the requirements of the Exchange Act. In particular, the proposed rule changes are consistent with Section 17A(b)(3)(F) of the Exchange Act¹² because they promote the prompt and accurate clearing and settlement of securities transactions by eliminating an uncertainty in payment settlement that would arise if FICC were subject to FATCA Withholding obligations under FATCA. The proposed rule changes are also consistent with Section 17A(b)(3)(D) of the Exchange Act¹³ because they provide for the equitable allocation of reasonable dues, fees, and other charges among FICC's members. Specifically, the proposed rule changes allow FICC to comply with FATCA Regulations without developing and maintaining a complex FATCA Withholding system, the cost of which, as discussed above, would

¹² 12 U.S.C. 78q-1(b)(3)(F).

¹³ 12 U.S.C. 78q-1(b)(3)(D).

be would be passed on to FICC's members at large for the benefit of a small number of nonparticipating FFI Members.

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

FICC does not believe that the proposed rule change will have any negative impact, or impose any burden, on competition.

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

Written comments relating to the proposed rule changes have not yet 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

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 Exchange 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-2013-04 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FICC-2013-04. 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 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of FICC and on FICC's website (http://www.dtcc.com/legal/rule_filings/ficc/2013.php). 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-2013-04 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.¹⁴

Kevin M. O'Neill
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).