

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71265; File No. SR-FICC-2013-10)

January 9, 2014

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Establish the Minimum Financial Requirements for the Existing Membership Category of Registered Investment Company Netting Members in the Government Securities Division

I. Introduction

On November 12, 2013, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2013-10 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 November 29, 2013.³ The Commission received one comment letter in response to the proposed rule change.⁴ For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

The purpose of this rule filing is to amend the Rulebook (“Rules”) of the Government Securities Division (“GSD”) of FICC to establish the minimum financial requirements for the existing membership category of Registered Investment Company Netting Members (“RIC”).⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 70925 (Nov. 22, 2013), 78 FR 71702 (Nov. 29, 2013) (SR-FICC-2013-09).

⁴ Letter from Peter Nowicki (December 5, 2013)(expressing general support for allowing Registered Investment Companies to participate in netting and clearing).

⁵ Pursuant to GSD Rule 1, the term "Registered Investment Company Netting Member" is an Investment Company (1) that is registered with the Commission, (2) admitted to

Historically, the GSD has served the “sell-side” community (which primarily consists of entities such as banks and broker-dealers). FICC believes the participation of RICs as guaranteed service members will contribute to the safety, efficiency, and transparency of the market by allowing FICC to capture a greater part of the activity of its existing members and by introducing activity of current non-members to FICC. FICC also believes that RICs will benefit from the GSD netting service and the associated operational efficiencies of a central counterparty service. RICs will not be permitted to use the GCF Repo® service.

Currently, RICs are already a permitted category in the GSD Rules; the rule as amended establishes minimum financial requirements for RICs.⁶ Specifically, Rule 2A (“Initial Membership Requirements”) of the GSD Rules provides that the minimum financial requirement for RICs is \$100 million in net asset value.

Currently, GSD Rule 3, “Ongoing Membership Requirements,” permits GSD to assess a premium against a netting member whose Clearing Fund requirement exceeds its specified regulatory capital figure.⁷ Pursuant to this rule change, GSD will now be permitted to assess RICs in the same manner as other members.

membership in GSD’s Netting System pursuant to the GSD Rules, and (3) whose membership in the Netting System has not been terminated.

⁶ The membership requirements for RICs will be the same as those already in place for RICs at FICC’s Mortgage-Backed Securities Division (“MBS”).

⁷ By way of example, under GSD Rule 4, if a member has a Clearing Fund requirement of \$11.4 million and excess net capital of \$10 million, its “ratio” is 1.14 (or 114 percent), and the applicable collateral premium would be 114 percent of \$1.4 million (which is equal to the amount by which the member’s Clearing Fund requirement exceeds its excess net capital), or \$1,596,000. The current GSD Rules provide that FICC has the right to: (i) apply a lesser collateral premium (including no premium) based on specific circumstances (such as a member being subject to an unexpected haircut or capital charge that does not fundamentally change its risk profile), and (ii) return all or a portion of the

Pursuant to GSD Rules, Tier One Netting Members are subject to potential loss mutualization and Tier Two Netting Members are not. Pursuant to this rule change, RICs will be Tier Two Netting Members because they are not permitted by law to mutualize loss.⁸

Under FICC's current loss allocation methodology, any loss allocation is first made against the retained earnings of FICC attributable to the GSD (after application of the defaulting member's Clearing Fund, funds-only settlement amounts and any other collateral on deposit with the GSD and any funds from any cross-margining or cross-guaranty agreements), in an amount up to 25 percent of FICC's retained earnings or such higher amount as may be approved by the Board of Directors of FICC.⁹ If a loss still remains, the GSD will divide the loss between the Tier One Netting Members and the Tier Two Netting Members. Tier One Netting Members will be allocated the loss applicable to them first by assessing the Clearing Fund deposit of each such member in the amount of up to \$50,000, equally. If a loss still remains, Tier One Netting Members will be assessed ratably, in accordance with the respective amounts of their Required Fund Deposits, based on the average daily amount of the member's Required Fund Deposit over the prior twelve months. Applicable Tier Two Netting Members will be assigned the Tier Two

collateral premium amount if it believes that the member's risk profile does not require the maintenance of that amount.

⁸ Tier One Members include banks, dealers, futures commission merchants, government securities issuers and registered clearing agencies and Tier Two Members include RICs. See Securities Exchange Act Release No. 63986 (Feb. 28, 2011), 76 FR 12144 (Mar. 4, 2011) (SR-FICC-2010-09).

⁹ See GSD Rule 4.

loss amount using a loss allocation methodology based on the activity that the Tier Two Netting Member conducted with the defaulting member.¹⁰

FICC is also amending GSD's rules to state explicitly that GSD will make its services available to Persons¹¹ in other categories as FICC may determine, subject to the approval of the Commission. A parallel provision is already contained in MBSD's rules.¹²

III. Discussion

Section 19(b)(2)(C) of the Act¹³ 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)(B)¹⁴ states that a clearing agency shall not be registered unless the Commission determines that the rules of the clearing agency provide that certain categories of parties may become participants, subject to certain provisions governing denials of participation. RICs are one of the listed categories of participants deemed appropriate to the development of a national system for the prompt and accurate clearance and settlement of securities transactions.¹⁵ Moreover, Section 17A(b)(3)(F) of the Act¹⁶ requires, among other

¹⁰ GSD Rule 4, Section 7 pertains to the satisfaction of any loss incurred by FICC as a result of the failure of a defaulting member to fulfill its obligations to FICC. MBSD Rule 4 contains the same loss allocation methodology.

¹¹ Pursuant to GSD Rule 1, the term "Person" means a partnership, corporation, limited liability corporation or other organization, entity, or individual.

¹² See MBSD Rule 2A, Section 1.

¹³ 15 U.S.C. 78s(b)(2)(C).

¹⁴ 15 U.S.C. 78q-1(b)(3)(B).

¹⁵ See Id.

¹⁶ 15 U.S.C. 78q-1(b)(3)(F).

things, that the rules of a clearing agency registered with the Commission be designed to promote the prompt and accurate clearance and settlement of securities transactions and, in general to protect investors and the public interest.

The Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(B) and (F) of the Act.¹⁷ The proposal establishes minimum financial requirements for RICs, thus extending GSD membership to participants in a category enumerated by Section 17A(b)(3)(B). Furthermore, it promotes the prompt and accurate clearance and settlement of securities transactions and protects investors and the public interest by allowing FICC to clear a greater market share of activity of its existing members and non-members.¹⁸

¹⁷ 15 U.S.C. 78q-1(b)(3)(B) and (F).

¹⁸ This Order addresses whether the proposed rule change is consistent with the Act. As such, this Order does not address any relief that may be necessary under the Investment Company Act of 1940 for an individual RIC to participate as a Registered Investment Company Netting Member as defined by GSD Rule 1. See footnote 5, supra.

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,¹⁹ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁰ that the proposed rule change (File No. SR-FICC-2013-10) be and hereby is APPROVED.²¹

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.²²

Kevin M. O'Neill
Deputy Secretary

¹⁹ 15 U.S.C. 78q-1.

²⁰ 15 U.S.C. 78s(b)(2).

²¹ 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).

²² 17 CFR 200.30-3(a)(12).