

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-83767; File No. SR-FICC-2018-006)

August 2, 2018

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Codify the Processing of Conditional Prepayment Rate Claims in the MBSD Rules 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 July 26, 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 amendments to the FICC Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules”) in order to (i) add terms governing MBSD’s processing of conditional prepayment rate (“CPR”) claims to the MBSD Rules and (ii) make certain clarifications and corrections in the MBSD Rules, as described in greater detail below.³

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Capitalized terms used herein and not otherwise defined shall have the meaning assigned to such terms in the MBSD Rules, available at <http://www.dtcc.com/legal/rules-and-procedures>.

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

FICC is proposing to amend the MBSD Rules in order to (i) add terms governing MBSD's processing of CPR claims to the MBSD Rules and (ii) make certain clarifications and corrections in the MBSD Rules.

(i) Background

As discussed in more detail below, the submission of CPR claims is an established process that occurs today pursuant to FICC's procedures. FICC is proposing to add provisions to the MBSD Rules to formalize this process in the MBSD Rules.

Mortgage pools⁴ are often traded in To-Be-Announced (TBA) trades, which are trades for which the actual identities of and/or the number of pools underlying each trade are unknown at the time of trade execution. MBSD guidelines provide that two business days prior to the established settlement date of the TBA settlement obligations, the Clearing Member that has an obligation to deliver pools for the TBA transaction (i.e., the

⁴ A pool is a collection of mortgage loans or other collateral assembled by an originator or master services as collateral for a mortgaged-back security.

“seller”) must allocate the pools to be delivered.⁵ Pursuant to the MBSD Rules, Clearing Members may substitute an underlying pool after it has been allocated with respect to a pool deliver obligation by providing instructions to FICC.⁶

CPR is the percentage of the outstanding loan balance for a pool that is expected to be repaid over a one year period.⁷ For instance, a 10% CPR means that 10% of a pool’s outstanding loan balance is expected to be repaid in the next year. A CPR claim arises when an underlying TBA pool is allocated or substituted with a pool that pays down at a faster rate (i.e., has a higher CPR) than the average pay down rate for pools of the same type as the underlying pool being replaced.⁸ The result is that the buyer is receiving a pool with less value than anticipated based on the TBA terms.

⁵ See Section 1 of MBSD Rule 7, supra note 3, which provides that “[i]n order for the Corporation to process data for Pool Comparison, the Corporation must receive data from the long and short sides of the allocated pool submission in the format and within the timeframes specified in guidelines issued by the Corporation from time to time.”

⁶ Section 5 of MBSD Rule 8, supra note 3. Section 5 of MBSD Rule 8 provides that substitutions may be made pursuant to the communication links, formats, timeframes and deadlines established by FICC and that a Clearing Member with a pool receive obligation (i.e., the “buyer”) must accept the substituted pool in accordance with FICC’s procedures. Id.

⁷ See definition of “CPR” in Chapter 2 of the SIFMA Guidelines. SIFMA Guidelines refer generally to the guidelines for good delivery of mortgage-backed securities as promulgated from time to time by The Securities Industry and Financial Markets Association (“SIFMA”), an industry trade group. See definition of “SIFMA Guidelines” in MBSD Rule 1, supra note 3. The SIFMA Guidelines, located at <https://www.sifma.org/resources/general/tba-market-governance/> under “Uniform Practices Manual,” are trading, clearing and settlement guidelines prepared by SIFMA intended to reflect common industry practices relating to confirming, comparing and settling mortgage-backed securities.

⁸ See Section A.16 of Chapter 8 of the SIFMA Guidelines, supra note 7.

The industry currently has a process pursuant to which a buyer may make a CPR claim against the seller as set forth in the SIFMA Guidelines.⁹ The CPR claim process is intended to compensate the buyer for the excess amount that it is paying for the pool being delivered.¹⁰ Pursuant to SIFMA Guidelines, an entity is entitled to make a CPR claim if (i) the allocation or substitution giving rise to the CPR claim occurred after the factor release date¹¹ following the scheduled contractual settlement date relating to the trade, (ii) the pools involved in the claim meet the criteria for fast paying pools in accordance with SIFMA Guidelines, (iii) the amount of the CPR claim is \$10,000 or greater, or, in the case that an entity is submitting a re-transmittal¹² of a CPR claim, the CPR claim is \$500 or greater, and (iv) 90% of the buyer's claimable unit has settled.¹³

FICC currently processes CPR claims that it receives from Clearing Members in a manner consistent with SIFMA Guidelines, except that (i) FICC currently uses a different definition of "claimable unit" as discussed below and (ii) for re-transmittals, FICC's current procedures provide a minimum threshold of \$5,000 (rather than \$500 as set forth in the SIFMA Guidelines). FICC is proposing to codify its existing CPR claims process

⁹ See id.

¹⁰ See Section A.16.d of Chapter 8 of the SIFMA Guidelines, supra note 7.

¹¹ The term "factor release date" means, with respect to a pool, the date on which the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the Government National Mortgage Association ("Ginnie Mae"), as applicable, release the "factor" that represents the percentage of the agency's original balance of the pool that remains outstanding as of such date.

¹² A re-transmittal of a CPR claim occurs when a party with the pool deliver obligation passes the CPR claims it received to the entities that sent it the pools it used for delivery.

¹³ See Section A.16 of Chapter 8 of the SIFMA Guidelines, supra note 7.

in the MBSD Rules, including adding a provision providing that a Clearing Member's cash settlement obligations would include the positive or negative amount of any valid CPR claim. The proposed MBSD CPR claims process would generally follow the CPR claims process set forth in the SIFMA Guidelines and MBSD's current CPR claims process, with the following exceptions:

(A) Definition of Claimable Unit

FICC is proposing to add to the MBSD Rules two definitions of "claimable unit," the use of which would depend on the type of transaction. Pursuant to SIFMA Guidelines and FICC's current process, CPR claims are based on a "claimable unit" which defines the pool or group of pools that are included in a particular CPR claim.¹⁴ Pursuant to SIFMA Guidelines a claimable unit is based on all pools allocated for a trade between factor release dates that have the same underlying TBA characteristics, such as product, coupon, trade date, settlement date and price.¹⁵

FICC currently processes CPR claims using a different definition of claimable unit than the SIFMA definition. FICC's CPR claims process currently uses a definition of claimable unit based on characteristics of pools after MBSD Pool Netting¹⁶ takes place rather than based on underlying TBA characteristics. The Pool Netting process generally reduces the number of pool settlements by aggregating and matching offsetting allocated pools submitted by Clearing Members to arrive at a single net position per counterparty

¹⁴ See Section A.16.b of Chapter 8 of the SIFMA Guidelines, supra note 7.

¹⁵ See Section A.16.f(i)(7) of Chapter 8 of the SIFMA Guidelines, supra note 7.

¹⁶ Pursuant to the MBSD Rules, the term "Pool Netting" means the service provided to Clearing Members, as applicable, and the operations carried out by FICC in the course of providing such service in accordance with MBSD Rule 8. MBSD Rule 1, supra note 3.

in a particular pool number. If a pool obligation is a result of Pool Netting, FICC is unable to track the pool obligation to an original TBA trade or trades and would be unable to group pool obligations for CPR claims based on TBA characteristics as provided in SIFMA Guidelines.

FICC is proposing to use the same definition of claimable unit for CPR claims as SIFMA Guidelines if the pool obligations upon which the CPR claims are based have not been through MBSD Pool Netting, as provided in subsection (1) below. FICC is proposing to use a different definition of claimable unit for CPR claims if the pool obligations upon which the CPR claims are based have been through the MBSD Pool Netting process, as described in subsection (2) below.

- (1) Proposed definition of Claimable Unit consistent with SIFMA Guidelines for CPR Claims that are not a result of Pool Netting

FICC is proposing to use the same definition of claimable unit used in the SIFMA Guidelines for CPR claims based on pool obligations that are not a result of Pool Netting. This definition would be used for pool allocations or substitutions for pool obligations that have been allocated after the factor release date because pool obligations allocated after the factor release date do not go through the Pool Netting process. As a result, FICC would be able to track the pool obligation to an original TBA trade, which would allow FICC to group the pool obligation with other pool obligations based on TBA characteristics. This proposed definition would be the same as the definition used in the SIFMA Guidelines but would be different from the definition used in FICC's existing CPR claims process.

- (2) Proposed definition of Claimable Unit different from SIFMA Guidelines for CPR Claims that are a result of Pool Netting

FICC is proposing to use a different definition of a claimable unit from the SIFMA Guidelines definition for CPR claims based on pool obligations that are a result of Pool Netting. FICC is proposing to define a claimable unit for such pool obligations based on pool characteristics after Pool Netting, rather than based on the original TBA pool characteristics. This definition would be used for substitutions for pool obligations that are a result of Pool Netting because FICC would be unable to track the pool obligation to an original TBA trade and thus unable to group such pool obligation with other pool obligations based on TBA characteristics. This proposed definition would be different than the definition used in the SIFMA Guidelines but would be the same as the definition currently used in FICC's existing CPR claims process.

(B) Re-transmittal threshold

FICC is proposing to add to the MBSD Rules two minimum thresholds (\$500 and \$5,000) for re-transmittals¹⁷ of CPR claims, the use of which would depend on the type of transaction. The minimum threshold for a re-transmittal of a CPR claim under SIFMA Guidelines is \$500.¹⁸ FICC's current process provides that the minimum threshold for re-transmittals is \$5,000. FICC is proposing to use the \$500 re-transmittal minimum threshold for allocations (and related substitutions) where the allocations were made after the applicable factor release date. This \$500 proposed minimum threshold would be the same as the minimum threshold in the SIFMA Guidelines but different from FICC's

¹⁷ See supra note 10.

¹⁸ See Section A.16.f(i)(6) of Chapter 8 of the SIFMA Guidelines, supra note 7.

existing CPR claims process. FICC is proposing to use a \$5,000 re-transmittal threshold for substitutions relating to allocations that were made prior to the factor release date following the contractual settlement date. This \$5,000 proposed minimum threshold would be different than the minimum threshold in the SIFMA Guidelines but would be the same as the minimum threshold used in FICC's existing CPR claims process.

FICC is proposing to change its current practice and add a proposed \$500 re-transmittal threshold for certain allocations described above in the MBSD Rules in order to be more consistent with SIFMA Guidelines and established industry practice. FICC is proposing to use a higher \$5,000 threshold, which is consistent with its current process, for re-transmittals for certain substitutions described above to avoid having to process multiple smaller transactions, which FICC believes would likely be administratively burdensome.

(ii) Proposed MBSD Rule Changes

To codify the CPR claims process as described above, the proposed rule change would add a description of the CPR claim process in a new Section 10 of MBSD Rule 9, including a defined term for "CPR Claim." In addition, the proposed rule change would specify the validation process for CPR claims, which, as described above, would codify existing FICC practices relating to CPR claims and provide that the process for CPR claims is consistent with SIFMA Guidelines, in each case, with the exceptions noted above in Items II(A)1(i)(A) and (B).

Specifically, the proposed rule change would specify that CPR claims submitted would be reviewed by FICC to validate the following: (i) the claimable unit with respect to the CPR claim meets the criteria for fast paying pools as set forth in SIFMA

Guidelines, (ii) the CPR claim amount is \$10,000 or greater, unless the CPR claim is a re-transmittal of a CPR claim, in which case, (a) if the CPR claim relates to an allocation of a pool effected after the factor release date following the contractual settlement date and/or substitution of related pools, the amount is \$500 or greater or (b) if the CPR claim relates to a substitution of a pool that was allocated prior to the factor release date following the contractual settlement date, the amount is \$5,000 or greater and (iii) 90% of the Clearing Member's claimable unit has settled. Consistent with FICC's current CPR claims process, the proposed rule change would also specify that (1) FICC maintains the right to process CPR claims with no minimum denomination, (2) CPR claims may be apportioned to more than one participant, (3) CPR claims may be comprised of both debits and credits, (4) FICC would process all CPR claims on the Class "B" settlement date in the month following the transmittal month and (5) FICC would notify the Clearing Member that the CPR claim has been rejected if the CPR claim is determined to be invalid. In addition, the proposed rule change would specify that FICC shall not guaranty CPR claim payments, and any credit to be received with respect to a CPR claim would be reduced to the extent the corresponding debit in connection with a CPR claim is not paid.

To ensure that Clearing Members understand the potential credits and debits relating to CPR claims, the proposed rule change would add credits and debits relating to CPR claims in Section 7 of MBSD Rule 11 as items for end of day cash balance computations.

To further describe the CPR claims process as set forth above, a cross-reference for the defined term "CPR Claim" and new defined terms "Claimable Unit" and "Factor

Release Date” would be added to MBS Rule 1, which are consistent with existing FICC practices relating to CPR claims and with SIFMA Guidelines, in each case, with the exceptions noted above in Items II(A)1(i)(A) and (B).

The definitions for Fannie Mae, Freddie Mac and Ginnie Mae would be corrected in MBS Rule 1 to be consistent with industry practice and with their usage throughout the MBS Rules. In addition, the definition of “SIFMA Guidelines” would be clarified by adding a link identifying the location of the SIFMA Guidelines on the SIFMA website.

2. Statutory Basis

Section 17A(b)(3)(F) of the Act¹⁹ requires, in part, that the MBS Rules be designed to promote the prompt and accurate clearance and settlement of securities transactions.

FICC believes that the proposed changes to add the MBS’s CPR claims process to the MBS Rules are consistent with Section 17A(b)(3)(F) of the Act.²⁰ The proposed rule changes to add the CPR claims process to the MBS Rules would provide a standard and efficient mechanism in the MBS Rules to compensate a buyer that receives faster paying pools that is consistent with accepted industry standards as set forth in the SIFMA Guidelines. While FICC provides a process for CPR claims pursuant to its existing procedures, the proposed changes would codify such procedures in the MBS Rules and would make MBS’s CPR claims process more consistent with SIFMA Guidelines, with the exceptions noted above in Items II(A)1(i)(A) and (B). Having the CPR claims

¹⁹ 15 U.S.C. 78q-1(b)(3)(F).

²⁰ Id.

process stated in the MBSD Rules would enable Clearing Members to understand how CPR claims would be validated and processed through FICC's facilities and how FICC's CPR claims process would differ from SIFMA Guidelines with respect to the definition of claimable unit and the re-transmittal minimum threshold as set forth above. Therefore, allowing Clearing Members to make and receive CPR claims through the use of FICC facilities in a manner that is consistent with industry standards and that is clearly stated in the MBSD Rules would promote the prompt and accurate clearance and settlement of securities transactions, consistent with the requirements of Section 17A(b)(3)(F) of the Act.²¹

FICC believes that the proposed changes correcting the definitions of Fannie Mae, Freddie Mac and Ginnie Mae are consistent with Section 17A(b)(3)(F) of the Act²² because the corrections would update such terms to reflect usage in the industry and current usage in the MBSD Rules. As such, the proposed changes would enable Clearing Members to have a better understanding of the MBSD Rules and the usage of such terms therein, and thereby assist in promoting the prompt and accurate clearance and settlement of securities transactions, consistent with the requirements of Section 17A(b)(3)(F) of the Act.²³

FICC believes that the proposed change clarifying the definition of SIFMA Guidelines by adding a link identifying the location of the SIFMA Guidelines on the

²¹ Id.

²² Id.

²³ Id.

SIFMA website is consistent with Section 17A(b)(3)(F) of the Act²⁴ because the proposed change would enhance clarity of the MBSD Rules by providing Clearing Members with an easier method of finding the SIFMA Guidelines that are referenced in the MBSD Rules. Providing clarity in the location of the SIFMA Guidelines would enable Clearing Members to more quickly locate the SIFMA Guidelines when such Clearing Members are reading MBSD Rules that reference the SIFMA Guidelines, thus making it easier for such Clearing Members to review such MBSD Rules and understand their rights and obligations thereunder. As such, the proposed change would assist in promoting the prompt and accurate clearance and settlement of securities transactions, consistent with the requirements of Section 17A(b)(3)(F) of the Act.²⁵

Rule 17Ad-22(e)(23)(ii) under the Act²⁶ requires FICC to 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 the covered clearing agency. The proposed rule changes to add CPR claims and corresponding credits and debits in Section 7 of MBSD Rule 11 as items for end of day cash balance computations are consistent with this provision and would help ensure that the charges relating to CPR claims are clear to Clearing Members. Having clear provisions in this regard would enable Clearing Members to better understand the operation of the pool settlement charges by providing sufficient information for Clearing Members to identify potential debits and credits that

²⁴ Id.

²⁵ Id.

²⁶ 17 CFR 240.17Ad-22(e)(23)(ii).

may be incurred with respect to CPR claims. As such, FICC believes the proposed rule change is consistent with Rule 17Ad-22(e)(23)(ii) of the Act.²⁷

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

FICC believes that the proposed rule changes to add the CPR claims process in the MBSD Rules as described above could have an impact on competition because the CPR claims process would result in CPR claim charges for Clearing Members against whom CPR claims are processed. Specifically, FICC believes this proposed rule change could burden competition by negatively affecting such Clearing Members' operating costs. While such Clearing Members may experience increases in their charges as a result of CPR claims processed through FICC, FICC does not believe such change would in and of itself mean that the burden on competition is significant. Regardless of whether the burden on competition is deemed significant, FICC believes any burden on competition that is created by the proposed rule changes to add the proposed CPR claims process would be necessary and appropriate in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.²⁸

FICC believes the proposed rule changes to include the MBSD CPR claims process in the MBSD Rules would be necessary in furtherance of the purposes of the Act.²⁹ FICC believes that allocations or substitutions by sellers of TBA pool transactions with a pool that pays down at a faster rate than the average pay down rate for pools of the same type as the underlying pool being replaced can create uncertainty regarding the

²⁷ Id.

²⁸ 15 U.S.C. 78q-1(b)(3)(I).

²⁹ Id.

value of pools being received by the buyer. Persistent delivery of faster paying pools could create market inefficiencies, increase credit risk for market participants and heighten overall systemic risk. The proposed rule changes to add the CPR claims process to the MBS Rules would mitigate against this systemic risk by (i) describing the types of CPR claims that FICC would process and thereby discouraging allocations or substitutions using faster paying pools that may give rise to CPR claims and (ii) providing a clear process in the MBS Rules to compensate a buyer that receives such faster paying pools. Therefore, FICC believes the proposed rule changes to add the MBS CPR claims process to the MBS Rules would be necessary in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.³⁰

FICC also believes any burden on competition that is created by the proposed rule changes to add the MBS CPR claims process in the MBS Rules would be appropriate in furtherance of the purposes of the Act.³¹ Under the proposal, the MBS CPR claims process would be consistent, with the exceptions noted above in Items II(A)1(i)(A) and (B), with SIFMA Guidelines, which represent the current accepted industry practice with respect to CPR claims. Therefore, the MBS CPR claims process would provide a mechanism by which Clearing Members could make and receive CPR claims that would be consistent with accepted industry practice. In addition, CPR claims would be imposed upon Clearing Members that choose to allocate or substitute using faster paying pools and no Clearing Members would be disproportionately impacted. As such, FICC believes the proposed rule changes to add the CPR claims process that is consistent, to the extent

³⁰ Id.

³¹ Id.

practicable and appropriate, with SIFMA Guidelines would be appropriate in furtherance of the purposes of the Act, as permitted by Section 17A(b)(3)(I) of the Act.³²

FICC does not believe there would be an impact on competition with the proposed rule changes that would update the definitions of Fannie Mae, Freddie Mac, Ginnie Mae and SIFMA Guidelines.³³ These changes would provide enhanced clarity to the MBS Rules and would not affect Clearing Members' rights and obligations. As such, FICC believes that these proposed rule changes would not have any impact on competition.

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

FICC has not received or solicited any written comments relating to this proposal.

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.

³² Id.

³³ Id.

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-2018-006 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-2018-006. 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-2018-006 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.³⁴

Eduardo A. Aleman
Assistant Secretary

³⁴ 17 CFR 200.30-3(a)(12).