

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-84255; File No. SR-FICC-2018-008)

September 21, 2018

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

On August 6, 2018, Fixed Income Clearing Corporation (“FICC”) filed with the U. S. Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2018-008, 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 August 21, 2018.³ The Commission did not receive any comment letters on the proposed rule change. For the reasons discussed below, the Commission approves the proposed rule change.

I. Description of the Proposed Rule Change

The proposed rule change would modify FICC’s Government Securities Division (“GSD”) Rulebook (“GSD Rules”)⁴ to amend GSD Rule 3A (Sponsoring Members and Sponsored Members) to apply GSD Rule 22B (Corporation Default) to Sponsored Members. In addition, the proposed rule change would make certain other changes as described below.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 83856 (August 15, 2018), 83 FR 42340 (August 21, 2018) (SR-FICC-2018-008) (“Notice”).

⁴ 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.

A. GSD Rule 3A (Sponsoring Members and Sponsored Members)

FICC proposes to add an introductory paragraph to Section 17 of GSD Rule 3A (Sponsoring Members and Sponsored Members) to make 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, would be “Members.” FICC states that this change would clarify which Rules, Schedules, Interpretations and Statements of Policy would govern the rights, liabilities and obligations of Sponsoring Members and Sponsored Members in their respective capacities.⁵

Furthermore, FICC would 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 would 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: (1) the dissolution of FICC (other than pursuant to a consolidation, amalgamation, or merger);⁶ (2) 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

⁵ Notice, 83 FR at 42341.

⁶ See Section (b)(ii)(A) of GSD Rule 22B, supra note 4.

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;⁷ (3) 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 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;⁸ or (4) 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 Act⁹ for FICC or for all or substantially all of FICC's assets.¹⁰

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 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-day period following FICC's receipt of the notice.¹¹

⁷ See Section (b)(ii)(B) of GSD Rule 22B, supra note 4.

⁸ See Section (b)(ii)(C) of GSD Rule 22B, supra note 4.

⁹ 12 U.S.C. 5381 *et seq.*

¹⁰ See Section (b)(ii)(D) of GSD Rule 22B, supra note 4.

¹¹ See Section (b)(i) of GSD Rule 22B, supra note 4.

FICC states that its 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.¹² FICC further states that the seven-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.¹³ If FICC is not able to rectify the failure and satisfy its obligations in seven days, GSD Rule 22B requires an immediate termination of Transactions that have been subject to Novation pursuant to the GSD Rules but have not yet settled and any rights and obligations of the parties thereto.¹⁴ FICC states that the seven-day period is designed to avoid a systemic disruption in such circumstance.¹⁵

In connection with the proposed rule change to apply GSD Rule 22B to Sponsored Members, FICC would add language to clarify that (1) the commencement of the seven-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 (2) the undisputed interest payment obligation would continue to accrue in favor of the Sponsored Member for the duration of the seven-day

¹² Notice, 83 FR at 42342.

¹³ Id.

¹⁴ See Section (a) of GSD Rule 22B, supra note 4.

¹⁵ Notice, 83 FR at 42342.

period. Specifically, FICC would specify in the proposed subsection (a) to Section 17 of GSD Rule 3A 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.

B. GSD Rule 22B (Corporation Default)

FICC proposes to clarify the third sentence of Section (a) of GSD Rule 22B regarding the close out netting process upon a Corporation Default. Specifically, FICC would 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 states that 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.¹⁶ However, Section (a) of GSD Rule 22B already contains a statement regarding which Transactions are subject to the close out netting process in the event of a Corporation Default: “all

¹⁶ Notice, 83 FR at 42342.

Transactions which have been subject to Novation pursuant to these [GSD] Rules”¹⁷

Accordingly, FICC would delete the reference to Section 2(a) of GSD Rule 22A in the third sentence of Section (a) of GSD Rule 22B.

In addition, FICC would 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 part, that “the Board shall determine a single net amount owed by or to each Member ... by applying the close out...procedures of Section 2(a) and (b) of [GSD] Rule 22A”¹⁸ FICC states that the reference to the entirety of Section 2(b) of GSD Rule 22A could cause confusion for GSD Members 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.¹⁹ Therefore, FICC would amend the reference to point specifically to Section 2(b)(i) of GSD Rule 22A.

FICC also proposes to delete “, to the extent applicable,” and “and application” from the third sentence of Section (a) of GSD Rule 22B. FICC states that it is proposing to delete “, to the extent applicable,” 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.²⁰ Likewise, FICC would delete “and application” from the third sentence of Section (a) of

¹⁷ See Section (a) of GSD Rule 22B, supra note 4.

¹⁸ Id.

¹⁹ Notice, 83 FR at 42342.

²⁰ Id.

GSD Rule 22B because, FICC states, it is extraneous wording that is unnecessary and not relevant in the context of Section 2(b)(i) of GSD Rule 22A.²¹

Lastly, FICC proposes to clarify the third sentence of Section (a) of GSD Rule 22B by stating 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 would add “, to the extent such provisions are otherwise applicable to such Member” following the reference in that sentence to the loss allocation provisions in GSD Rule 4. FICC states that this proposed change would be 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.

II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization.²² The Commission believes the proposal is consistent with Act, specifically Section 17A(b)(3)(F) of the Act²³ and Rule 17Ad-22(e)(23)(i) under the Act.²⁴

²¹ Id.

²² 15 U.S.C. 78s(b)(2)(C).

²³ 15 U.S.C. 78q-1(b)(3)(F).

²⁴ 17 CFR 240.17Ad-22(e)(23)(i).

A. Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency, such as FICC, be designed to promote the prompt and accurate clearance and settlement of securities transactions.²⁵

As described above, the proposed rule change would apply GSD Rule 22B to Sponsored Members in the same manner as it applies to all other GSD Members. The proposed rule change is designed to ensure that all GSD Members are subject to a common, transparent legal framework in a Corporation Default situation. The Commission believes that having a common, transparent legal framework in a Corporation Default situation would help facilitate an orderly close out netting of obligations between FICC and the GSD Members in the event that a Corporation Default occurs. In turn, an orderly close out netting of obligations between FICC and the GSD Members would help provide clarity and certainty to market participants in a time of distress regarding their rights and obligations, and the rights and obligations of FICC. By providing clarity and certainty of such rights and obligations, the Commission believes the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions. Therefore, the Commission finds 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.

B. Rule 17Ad-22(e)(23)(i) under the Act

Rule 17Ad-22(e)(23)(i) under the Act requires that each covered clearing agency,²⁶ establish, implement, maintain and enforce written policies and procedures

²⁵ 15 U.S.C. 78q-1(b)(3)(F).

reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures.²⁷

As described above, the proposed rule changes to (i) apply GSD Rule 22B (Corporation Default) to Sponsored Members in the same manner as it applies to all other GSD Members, and (ii) clarify that the loss allocation provisions of GSD Rule 4 (Clearing Fund and Loss Allocation) referenced in GSD Rule 22B would not apply to Sponsored Members, are designed to publicly clarify the application of these specific rules with respect to the rights and obligations of Sponsored Members in the event Corporation Default occurs. In addition, 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, are designed to enhance the clarity and accuracy of these public rules with respect to the rights and obligations of Sponsored Members in the event Corporation Default. As such, the Commission finds that the proposed rule changes are reasonably designed to publicly disclose relevant rules and material procedures, including key aspects of its default rules and procedures, consistent with Rule 17Ad-22(e)(23)(i) under the Act.

²⁶ A “covered clearing agency” means, among other things, a clearing agency registered with the Commission under Section 17A of the Exchange Act (15 U.S.C. 78q-1 et seq.) that is designated systemically important by Financial Stability Oversight Council (“FSOC”) pursuant to the Clearing Supervision Act (12 U.S.C. 5461 et seq.). See 17 CFR 240.17Ad-22(a)(5)-(6). Because FICC is a registered clearing agency with the Commission that has been designated systemically important by FSOC, FICC is a covered clearing agency.

²⁷ 17 CFR 240.17Ad-22(e)(23)(i).

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act, in particular the requirements of Section 17A of the Act²⁸ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that proposed rule change SR-FICC-2018-008 be, and hereby is, APPROVED.²⁹

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁰

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²⁸ 15 U.S.C. 78q-1.

²⁹ In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³⁰ 17 CFR 200.30-3(a)(12).