

**SECURITIES AND EXCHANGE COMMISSION****Proposed Collection; Comment Request**

*Upon Written Request, Copies Available From:* Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549-2736

**Extension:**

Rule 15c2-8, SEC File No. 270-421, OMB Control No. 3235-0481

Notice is hereby given that pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission ("Commission") is soliciting comments on the existing collection of information provided for in Rule 15c2-8 (17 CFR 240.15c2-8). The Commission plans to submit this existing collection of information to the Office of Management and Budget for extension and approval.

Rule 15c2-8 under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) requires broker-dealers to deliver preliminary and/or final prospectuses to certain people under certain circumstances. In connection with securities offerings generally, including initial public offerings ("IPOs"), the rule requires broker-dealers to take reasonable steps to distribute copies of the preliminary or final prospectus to anyone who makes a written request, as well as any broker-dealer who is expected to solicit purchases of the security and who makes a request. In connection with IPOs, the rule requires a broker-dealer to send a copy of the preliminary prospectus to any person who is expected to receive a confirmation of sale (generally, this means any person who is expected to actually purchase the security in the offering) at least 48 hours prior to the sending of such confirmation. This requirement is sometimes referred to as the "48 hour rule."

Additionally, managing underwriters are required to take reasonable steps to ensure that all broker-dealers participating in the distribution of or trading in the security have sufficient copies of the preliminary or final prospectus, as requested by them, to enable such broker-dealer to satisfy their respective prospectus delivery obligations pursuant to Rule 15c2-8, as well as Section 5 of the Securities Act of 1933.

Rule 15c2-8 implicitly requires that broker-dealers collect information, as such collection facilitates compliance with the rule. There is no requirement

to submit collected information to the Commission. In order to comply with the rule, broker-dealers participating in a securities offering must keep accurate records of persons who have indicated interest in an IPO or requested a prospectus, so that they know to whom they must send a prospectus.

The Commission estimates that the time broker-dealers will spend complying with the collection of information required by the rule is 5,950 hours for equity IPOs and 23,300 hours for other offerings. The Commission estimates that the total annualized cost burden (copying and postage costs) is \$11,900,000 for IPOs and \$932,000 for other offerings.

Written comments are invited on: (a) Whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's estimates of the burden of the proposed collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology. Consideration will be given to comments and suggestions submitted in writing within 60 days of this publication.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information under the PRA unless it displays a currently valid OMB control number.

Please direct your written comments to: Pamela Dyson, Director/Chief Information Officer, Securities and Exchange Commission, c/o Candace Kenner, 100 F Street NE, Washington, DC 20549, or send an email to: [PRA\\_Mailbox@sec.gov](mailto:PRA_Mailbox@sec.gov).

Dated: August 27, 2018.

**Eduardo A. Aleman,**  
Assistant Secretary.

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-83951; File No. SR-FICC-2017-806]

**Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of No Objection to an Advance Notice, as Modified by Amendment No. 1, To Amend the Loss Allocation Rules and Make Other Changes**

August 27, 2018.

On December 18, 2017, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-FICC-2017-806 pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 ("Act")<sup>2</sup> to amend the loss allocation rules and make other conforming and technical changes.<sup>3</sup> The

<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> On December 18, 2017, FICC filed the advance notice as proposed rule change SR-FICC-2017-022 with the Commission pursuant to Section 19(b)(1) of the Act and Rule 19b-4 thereunder ("Proposed Rule Change"). 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The Proposed Rule Change was published in the **Federal Register** on January 8, 2018. Securities Exchange Act Release No. 82427 (January 2, 2018), 83 FR 854 (January 8, 2018) (SR-FICC-2017-022). On February 8, 2018, the Commission designated a longer period within which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change. Securities Exchange Act Release No. 82670 (February 8, 2018), 83 FR 6626 (February 14, 2018) (SR-DTC-2017-022, SR-FICC-2017-022, SR-NSCC-2017-018). On March 20, 2018, the Commission instituted proceedings to determine whether to approve or disapprove the Proposed Rule Change. Securities Exchange Act Release No. 82909 (March 20, 2018), 83 FR 12990 (March 26, 2018) (SR-FICC-2017-022). On June 25, 2018, the Commission designated a longer period for Commission action on the proceedings to determine whether to approve or disapprove the Proposed Rule Change. Securities Exchange Act Release No. 83510 (June 25, 2018), 83 FR 30791 (June 29, 2018) (SR-DTC-2017-022, SR-FICC-2017-022, SR-NSCC-2017-018). On June 28, 2018, FICC filed Amendment No. 1 to the Proposed Rule Change, which was published in the **Federal Register** on July 19, 2018. Securities Exchange Act Release No. 83631 (July 13, 2018), 83 FR 34193 (July 19, 2018) (SR-FICC-2017-022). FICC submitted a courtesy copy of Amendment No. 1 to the Proposed Rule Change through the Commission's electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the Proposed Rule Change has been publicly available on the Commission's website at <https://www.sec.gov/rules/sro/ficc.htm> since June 29, 2018. The Commission did not receive any comments. The proposal, as set forth in both the advance notice and the Proposed Rule Change, each as modified by Amendments No. 1, shall not take effect until all required regulatory actions are completed.

advance notice was published for comment in the **Federal Register** on January 30, 2018.<sup>4</sup> In that publication, the Commission also extended the review period of the advance notice for an additional 60 days, pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act.<sup>5</sup> On April 10, 2018, the Commission required additional information from FICC pursuant to Section 806(e)(1)(D) of the Clearing Supervision Act,<sup>6</sup> which tolled the Commission's period of review of the advance notice until 60 days from the date the information required by the Commission was received by the Commission.<sup>7</sup> On June 28, 2018, FICC filed Amendment No. 1 to the advance notice to amend and replace in its entirety the advance notice as originally filed on December 18, 2017.<sup>8</sup> On July 6, 2018, the Commission received a response to its request for additional information in consideration of the advance notice, which, in turn, added a further 60 days to the review period pursuant to Section 806(e)(1)(E) and (G) of the Clearing Supervision Act.<sup>9</sup> The Commission did not receive any comments. This publication serves as notice that the Commission does not object to the proposed changes set forth in the advance notice, as modified by Amendment No. 1 (hereinafter, "Advance Notice").

<sup>4</sup> Securities Exchange Act Release No. 82583 (January 24, 2018), 83 FR 4358 (January 30, 2018) (SR-FICC-2017-806) ("Notice").

<sup>5</sup> Pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act, the Commission may extend the review period of an advance notice for an additional 60 days, if the changes proposed in the advance notice raise novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. 12 U.S.C. 5465(e)(1)(H). The Commission found that the advance notice raised complex issues and, accordingly, extended the review period of the advance notice for an additional 60 days until April 17, 2018. See Notice, *supra* note 4.

<sup>6</sup> 12 U.S.C. 5465(e)(1)(D).

<sup>7</sup> See 12 U.S.C. 5465(e)(1)(E)(ii) and (G)(ii); see Memorandum from the Office of Clearance and Settlement Supervision, Division of Trading and Markets, titled "Commission's Request for Additional Information," available at <http://www.sec.gov/rules/sro/ficc-an.shtml>.

<sup>8</sup> Securities Exchange Act Release No. 83748 (July 31, 2018), 83 FR 38375 (August 6, 2018) (SR-FICC-2017-806) ("Notice of Amendment No. 1"). FICC submitted a courtesy copy of Amendment No. 1 to the advance notice through the Commission's electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the advance notice has been publicly available on the Commission's website at <http://www.sec.gov/rules/sro/ficc-an.shtml> since June 29, 2018.

<sup>9</sup> 12 U.S.C. 5465(e)(1)(E) and (G); see Memorandum from the Office of Clearance and Settlement Supervision, Division of Trading and Markets, titled "Response to the Commission's Request for Additional Information," available at <http://www.sec.gov/rules/sro/ficc-an.shtml>.

## I. Description of the Advance Notice

The Advance Notice consists of proposed changes to FICC's Government Securities Division ("GSD") Rulebook ("GSD Rules") and Mortgage-Backed Securities Division ("MBSD" and, together with GSD, the "Divisions") and, each, a "Division") Clearing Rules ("MBSD Rules," and collectively with the GSD Rules, the "Rules")<sup>10</sup> in order to (1) modify each Division's loss allocation process; (2) align the Divisions' loss allocation rules with the three clearing agencies of The Depository Trust & Clearing Corporation ("DTCC")—The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC"), and FICC (collectively, the "DTCC Clearing Agencies");<sup>11</sup> (3) amend the MBSD Rules regarding the use of the MBSD's Clearing Fund; and (4) make conforming and technical changes. Each of these proposed changes is described below. A detailed description of the specific rule text changes proposed in this Advance Notice can be found in the Notice of Amendment No. 1.<sup>12</sup>

### A. Changes to the Loss Allocation Process

The GSD Rules and the MBSD Rules each currently provide for a loss allocation process through which both FICC (by applying up to 25 percent of its retained earnings in accordance with Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4) and its members<sup>13</sup> would share in the allocation of a loss resulting from the default of a member for whom a Division has ceased to act pursuant to the Rules.<sup>14</sup> The GSD Rules

<sup>10</sup> Each capitalized term not otherwise defined herein has its respective meaning as set forth in the GSD Rules, available at [http://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).

<sup>11</sup> DTCC is a user-owned and user-governed holding company and is the parent company of DTC, FICC, and NSCC. DTCC operates on a shared services model with respect to the DTCC Clearing Agencies. Most corporate functions are established and managed on an enterprise-wide basis pursuant to intercompany agreements under which it is generally DTCC that provides a relevant service to a DTCC Clearing Agency.

<sup>12</sup> See Notice of Amendment No. 1, *supra* note 8.

<sup>13</sup> The term "Member" is defined in both the GSD Rules and the MBSD Rules, and has a different meaning under each. See *supra* note 10. In the Notice of Amendment No. 1, FICC used "member" to refer to both the Members of GSD and MBSD. See Notice of Amendment No. 1, *supra* note 8.

<sup>14</sup> GSD is permitted to cease to act for (1) a GSD Member pursuant to GSD Rule 21 (Restrictions on Access to Services) and GSD Rule 22 (Insolvency of a Member), (2) a Sponsoring Member pursuant to Section 14 and Section 16 of GSD Rule 3A (Sponsoring Members and Sponsored Members), and (3) a Sponsored Member pursuant to Section 13 and Section 15 of GSD Rule 3A (Sponsoring

and the MBSD Rules also recognize that FICC may incur losses outside the context of a defaulting member that are otherwise incident to each Division's clearance and settlement business.

The current GSD and MBSD loss allocation rules provide that, in the event the Division ceases to act for a member, the amount on deposit to the Clearing Fund from the defaulting member, along with any other resources of, or attributable to, the defaulting member that FICC may access under the GSD Rules or the MBSD Rules (*e.g.*, payments from Cross-Guaranty Agreements), are the first source of funds the Division would use to cover any losses that may result from the closeout of the defaulting member's guaranteed positions. If these amounts are not sufficient to cover all losses incurred, then each Division will apply the following available resources, in the following order: (1) As provided in the current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4, FICC's corporate contribution of up to 25 percent of FICC's retained earnings existing at the time of the failure of a defaulting member to fulfill its obligations to FICC, or such greater amount as the Board of Directors may determine; and (2) if a loss still remains, use of the Clearing Fund of the Division and assessing the Division's Members in the manner provided in GSD Rule 4 and MBSD Rule 4, as the case may be. Specifically, FICC will divide the loss ratably between Tier One Netting Members and Tier Two Members with respect to GSD, or between Tier One Members and Tier Two Members with respect to MBSD, based on original counterparty activity with the defaulting member. Then the loss allocation process applicable to Tier One Netting Members or Tier One Members, as applicable, and Tier Two Members will proceed in the manner provided in GSD Rule 4 and MBSD Rule 4, as the case may be.

Pursuant to current Rules, the applicable Division will first assess each Tier One Netting Member or Tier One Member, as applicable, an amount up to \$50,000, in an equal basis per such member. If a loss remains, the Division will allocate the remaining loss ratably among Tier One Netting Members or Tier One Members, as applicable, in

Members and Sponsored Members). MBSD is permitted to cease to act for an MBSD Member pursuant to MBSD Rule 14 (Restrictions on Access to Services) and MBSD Rule 16 (Insolvency of a Member). GSD Rule 22A (Procedures for When the Corporation Ceases to Act) and MBSD Rule 17 (Procedures for When the Corporation Ceases to Act) set out the types of actions FICC may take when it ceases to act for a member. *Supra* note 10.

accordance with the amount of each Tier One Netting Member's or Tier One Member's respective average daily Required Fund Deposit over the prior 12 months. If a Tier One Netting Member or Tier One Member, as applicable, did not maintain a Required Fund Deposit for 12 months, its loss allocation amount will be based on its average daily Required Fund Deposit over the time period during which such member did maintain a Required Fund Deposit.

Pursuant to current Section 7(g) of GSD Rule 4 and MBSD Rule 4, if, as a result of the Division's application of the Required Fund Deposit of a member, a member's actual Clearing Fund deposit is less than its Required Fund Deposit, the member will be required to eliminate such deficiency in order to satisfy its Required Fund Deposit amount. In addition to losses that may result from the closeout of the defaulting member's guaranteed positions, Tier One Netting Members or Tier One Members, as applicable, can also be assessed for non-default losses incident to each Division's clearance and settlement business, pursuant to current Section 7(f) of GSD Rule 4 and MBSD Rule 4.

The Rules of both Divisions currently provide that Tier Two Members are only subject to loss allocation to the extent they traded with the defaulting member and their trades resulted in a liquidation loss. FICC will assess Tier Two Members ratably based on their loss as a percentage of the entire remaining loss attributable to Tier Two Members.<sup>15</sup> Tier Two Members are required to pay their loss allocation obligations in full and replenish their Required Fund Deposits as needed and as applicable. The current Rule provisions which provide for loss allocation of non-default losses incident to each Division's clearance and settlement business (*i.e.*, Section 7(f) of GSD Rule 4 and MBSD Rule 4) do not apply to Tier Two Members.

FICC proposes to change the manner in which each of the aspects of the loss allocation process described above would be employed. GSD and MBSD would clarify or adjust certain elements and introduce certain new loss allocation concepts, as further discussed below. In addition, the proposal would

address the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time, also as described below.

FICC proposes six key changes to enhance each Division's loss allocation process. Specifically, FICC proposes to make changes to each Division regarding (1) its Corporate Contribution, (2) the Event Period, (3) the loss allocation round and notice, (4) the look-back period, (5) the loss allocation withdrawal notice and cap, and (6) the governance around non-default losses, each of which is discussed below.

#### (1) Corporate Contribution

As stated above, Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4 currently provide that FICC will contribute up to 25 percent of its retained earnings (or such higher amount as the Board of Directors shall determine) to a loss or liability that is not satisfied by the defaulting member's Clearing Fund deposit. Under the proposal, FICC would amend the calculation of its corporate contribution from a percentage of its retained earnings to a mandatory amount equal to 50 percent of the FICC General Business Risk Capital Requirement.<sup>16</sup> FICC's General Business Risk Capital Requirement, as defined in FICC's Clearing Agency Policy on Capital Requirements,<sup>17</sup> is, at a minimum, equal to the regulatory capital that FICC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>18</sup> The proposed Corporate Contribution would be held in addition to FICC's General Business Risk Capital Requirement.

Currently, the Rules do not require FICC to contribute its retained earnings to losses and liabilities other than those from member defaults. Under the proposal, FICC would apply its Corporate Contribution to non-default losses as well. The proposed Corporate Contribution would apply to losses arising from Defaulting Member Events and Declared Non-Default Loss Events (as such terms are defined below), and would be a mandatory contribution by

FICC prior to any allocation of the loss among the applicable Division's members.<sup>19</sup> As proposed, if the Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period by one or both Divisions, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following 250 Business Days in order to permit FICC to replenish the Corporate Contribution.<sup>20</sup> To ensure transparency, all GSD Members and MBSD Members would receive notice of any such reduction to the Corporate Contribution.

There would be one FICC Corporate Contribution, the amount of which would be available to both Divisions and would be applied against a loss or liability in either Division in the order in which such loss or liability occurs. In other words, FICC would not have two separate Corporate Contributions for each Division. In the event of a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, attributable to only one Division, the Corporate Contribution would be applied to that Division up to the amount then available. If a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, the Corporate Contribution would be applied to the respective Divisions in the same proportion that the aggregate Average RFDs of all members in that Division bear to the aggregate Average RFDs of all members in both Divisions.<sup>21</sup>

<sup>19</sup> The proposed change would not require a Corporate Contribution with respect to the use of each Division's Clearing Fund as a liquidity resource; however, if FICC uses a Division's Clearing Fund as a liquidity resource for more than 30 calendar days, as set forth in proposed Section 5 of GSD Rule 4 and MBSD Rule 4, then FICC would have to consider the amount used as a loss to the respective Division's Clearing Fund incurred as a result of a Defaulting Member Event and allocate the loss pursuant to proposed Section 7 of Rule 4, which would then require the application of FICC's Corporate Contribution.

<sup>20</sup> FICC states that 250 Business Days would be a reasonable estimate of the time frame that FICC would be required to replenish the Corporate Contribution by equity in accordance with FICC's Clearing Agency Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

<sup>21</sup> FICC states that if a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, occurs simultaneously at both Divisions, allocating the Corporate Contribution ratably between the two Divisions based on the aggregate Average RFDs of their respective members

<sup>15</sup> GSD Rule 3B, Section 7 (Loss Allocation Obligations of CCIT Members) provides that CCIT Members will be allocated losses as Tier Two Members and will be responsible for the total amount of loss allocated to them. With respect to CCIT Members with a Joint Account Submitter, loss allocation will be calculated at the Joint Account level and then applied pro rata to each CCIT Member within the Joint Account based on the trade settlement allocation instructions. *Supra* note 10.

<sup>16</sup> FICC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (1) an amount determined based on its general business profile, (2) an amount determined based on the time estimated to execute a recovery or orderly wind-down of FICC's critical operations, and (3) an amount determined based on an analysis of FICC's estimated operating expenses for a six month period.

<sup>17</sup> See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-DTC-2017-003, SR-NSCC-2017-004, SR-FICC-2017-007).

<sup>18</sup> 17 CFR 240.17Ad-22(e)(15).

As compared to the current approach of applying “up to” a percentage of retained earnings to defaulting member losses, the proposed Corporate Contribution would be a fixed percentage of FICC’s General Business Risk Capital Requirement, which would provide greater transparency and accessibility to members. The proposed Corporate Contribution would apply not only towards losses and liabilities arising out of or relating to Defaulting Member Events but also those arising out of or relating to Declared Non-Default Loss Events.

Under current Section 7(b) of GSD Rule 4 and Section 7(c) of MBSD Rule 4, FICC has the discretion to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by FICC as result of the failure of a Defaulting Member to fulfill its obligations to FICC. This option would be retained and expanded under the proposal so that it would be clear that FICC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of the Divisions, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

## (2) Event Period

FICC states that in order to clearly define the obligations of each Division and its respective members regarding loss allocation and to balance the need to manage the risk of sequential loss events against members’ need for certainty concerning their maximum loss allocation exposures, FICC proposes to introduce the concept of an Event Period to the GSD Rules and the MBSD Rules to address the losses and liabilities that may arise from or relate to multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession in a Division. Specifically, the proposal would group Defaulting Member Events and Declared Non-Default Loss Events occurring within a period of 10 Business Days (“Event Period”) for purposes of allocating losses to members of the respective Divisions in one or more rounds, subject to the limitations of loss allocation as explained below.<sup>22</sup>

is appropriate because the aggregate Average RFDs of all members in a Division represent the amount of risks that those members bring to FICC over the look-back period of 70 Business Days.

<sup>22</sup> FICC states that having a 10 Business Day Event Period would provide a reasonable period of time to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an

In the case of a loss or liability arising from or relating to a Defaulting Member Event, an Event Period would begin on the day one or both Divisions notify their respective members that FICC has ceased to act for the GSD Defaulting Member and/or the MBSD Defaulting Member (or the next Business Day, if such day is not a Business Day). In the case of a loss or liability arising from or relating to a Declared Non-Default Loss Event, an Event Period would begin on the day that FICC notifies members of the respective Divisions of the Declared Non-Default Loss Event (or the next Business Day, if such day is not a Business Day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Defaulting Member Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for Defaulting Member Events or Declared Non-Default Loss Events occurring during overlapping 10 Business Day periods.

The amount of losses that may be allocated by each Division, subject to the required Corporate Contribution, and to which a Loss Allocation Cap would apply for any Member that elects to withdraw from membership in respect of a loss allocation round, would include any and all losses from any Defaulting Member Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.<sup>23</sup>

## (3) Loss Allocation Round and Loss Allocation Notice

Under the proposal, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Tier One

initial event and/or a severe market dislocation episode, while still providing appropriate certainty for members concerning their maximum exposure to mutualized losses with respect to such events.

<sup>23</sup> Under the proposal, each Tier One Netting Member or Tier One Member, as applicable, that is a Tier One Netting Member or Tier One Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period.

Netting Members or Tier One Members, as applicable (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. FICC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4.

Each loss allocation would be communicated to each Tier One Netting Member or Tier One Member, as applicable, by the issuance of a notice that advises the Tier One Netting Member or Tier One Member, as applicable, of the amount being allocated to it (“Loss Allocation Notice”). Each Tier One Netting Member’s or Tier One Member’s, as applicable, pro rata share of losses and liabilities to be allocated in any round would be equal to (1) the average of its Required Fund Deposit for the 70 Business Days preceding the first day of the applicable Event Period or such shorter period of time that the Tier One Netting Member or Tier One Member, as applicable, has been a member (each member’s “Average RFD”), divided by (2) the sum of Average RFD amounts of all Tier One Netting Members or Tier One Members, as applicable, subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Tier One Netting Member or Tier One Member, as applicable, in that round has five Business Days from the issuance of such first Loss Allocation Notice for the round to notify FICC of its election to withdraw from membership with GSD or MBSD, as applicable, pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, and thereby benefit from its Loss Allocation Cap.<sup>24</sup> In other words, the proposed

<sup>24</sup> Pursuant to current Section 7(g) of GSD Rule 4 and MBSD Rule 4, the time period for a member to give notice, pursuant to Section 13 of GSD Rule 3 and MBSD Rule 3, of its election to terminate its membership in GSD or MBSD, as applicable, in respect of an allocation arising from any Remaining Loss allocated by FICC pursuant to Section 7(d) of GSD Rule 4 or Section 7(e) of MBSD Rule 4, as

change would link the Loss Allocation Cap to a round in order to provide Tier One Netting Members or Tier One Members, as applicable, the option to limit their loss allocation exposure at the beginning of each round. After a first round of loss allocations with respect to an Event Period, only Tier One Netting Members or Tier One Members, as applicable, that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would be subject to further loss allocation with respect to that Event Period.

Currently, pursuant to Section 7(g) of GSD Rule 4 and MBSD Rule 4, if notification is provided to a member that an allocation has been made against the member pursuant to GSD Rule 4 or MBSD Rule 4, as applicable, and that application of the member's Required Fund Deposit is not sufficient to satisfy such obligation to make payment to FICC, the member is required to deliver to FICC by the Close of Business on the next Business Day, or by the Close of Business on the Business Day of issuance of the notification if so determined by FICC, that amount which is necessary to eliminate any such deficiency, unless the member elects to terminate its membership in FICC. Under the proposal, FICC is proposing that members would receive two Business Days' notice of a loss allocation, and members would be required to pay the requisite amount no later than the second Business Day following issuance of such notice.<sup>25</sup>

#### (4) Look-Back Period

Currently, the GSD Rules and the MBSD Rules calculate a Tier One Netting Member's or a Tier One Member's pro rata share for purposes of loss allocation based on the member's average daily Required Fund Deposit over the prior 12 months or such shorter

period as may be available in the case of a member which has not maintained a deposit over such time period.

GSD and MBSD propose to calculate each Tier One Netting Member's or Tier One Member's, as applicable, pro rata share of losses and liabilities to be allocated in any round to be equal to (1) the Tier One Netting Member's or Tier One Member's, as applicable, Average RFD divided by (2) the sum of Average RFD amounts for all Tier One Netting Members or a Tier One Members, as applicable, that are subject to loss allocation in such round. Additionally, if a Tier One Netting Member or Tier One Member, as applicable, withdraws from membership pursuant to proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, GSD and MBSD are proposing that such member's Loss Allocation Cap be equal to the greater of (1) its Required Fund Deposit on the first day of the applicable Event Period or (2) its Average RFD.

FICC states that employing a revised look-back period of 70 Business Days instead of 12 months to calculate a Tier One Netting Member's or a Tier One Member's, as applicable, loss allocation pro rata share and Loss Allocation Cap is appropriate because FICC states that the current look-back period of 12 months is a very long period during which a member's business strategy and outlook could have shifted significantly, resulting in material changes to the size of its portfolios. FICC states that a look-back period of 70 Business Days would minimize that issue yet still would be long enough to enable FICC to capture a full calendar quarter of such members' activities and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred.

#### (5) Loss Allocation Withdrawal Notice and Loss Allocation Cap

Currently, pursuant to Section 7(g) of GSD Rule 4 and MBSD Rule 4, a member can withdraw from membership in order to avail itself of a member's cap on loss allocation if the member notifies FICC via a written notice, in accordance with Section 13 of GSD Rule 3 or MBSD Rule 3, as applicable, of its election to terminate its membership. Current Section 13 of GSD Rule 3 and MBSD Rule 3 require a member to provide FICC with 10 days written notice of the member's termination; however, FICC, in its discretion, may accept such termination within a shorter notice period. Such notice must be provided by the Close of Business on the Business Day on which the loss allocation payment is due to FICC and, if properly provided to FICC, would limit the member's liability for a

loss allocation to its Required Fund Deposit for the Business Day on which the notification of allocation is provided to the member.

Under the proposal, a Tier One Netting Member or Tier One Member, as applicable, would be able to limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to withdraw from membership within five Business Days from the issuance of the first Loss Allocation Notice in any round of an Event Period. Each round would allow a Tier One Netting Member or Tier One Member, as applicable, the opportunity to notify FICC of its election to withdraw from membership after satisfaction of the losses allocated in such round. Multiple Loss Allocation Notices may be issued with respect to each round to allocate losses up to the round cap. As proposed, if a member timely provides notice of its withdrawal from membership in respect of a loss allocation round, the maximum amount of losses it would be responsible for would be its Loss Allocation Cap,<sup>26</sup> provided that the member complies with the requirements of the withdrawal process in proposed Section 7b of GSD Rule 4 and Section 7b of MBSD Rule 4. The proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would provide that the Tier One Netting Member or Tier One Member, as applicable, must (1) specify in its Loss Allocation Withdrawal Notice an effective date of withdrawal, which date shall not be prior to the scheduled final settlement date of any remaining obligations owed by the member to FICC, unless otherwise approved by FICC; and (2) as of the time of such member's submission of the Loss Allocation Withdrawal Notice, cease submitting transactions to FICC for processing, clearance or settlement, unless otherwise approved by FICC.

As stated above, under the current Rules, the cap of a Tier One Netting Member or Tier One Member, as applicable, that provided a withdrawal notice would be its Required Fund Deposit for the Business Day on which the notification of allocation is provided to the member. Under the proposal, the Loss Allocation Cap of a Tier One Netting Member or Tier One Member, as applicable, would be equal to the greater of (1) its Required Fund Deposit on the first day of the applicable Event Period and (2) its Average RFD. Specifically, the first round and each subsequent round of loss allocation would allocate

applicable, and any Other Loss, is the Close of Business on the Business Day on which the loss allocation payment is due to FICC. Current Section 13 of GSD Rule 4 and MBSD Rule 4 requires a 10-day notice period. *Supra* note 10.

FICC states that it is appropriate to shorten such time period from 10 days to five Business Days because FICC needs timely notice of which Tier One Netting Members or Tier One Members, as applicable, would remain in its membership for purpose of calculating the loss allocation for any subsequent round. FICC states that five Business Days would provide Tier One Netting Members or Tier One Members, as applicable, with sufficient time to decide whether to cap their loss allocation obligations by withdrawing from their membership in GSD or MBSD, as applicable.

<sup>25</sup> FICC states that allowing members two Business Days to satisfy their loss allocation obligations would provide members sufficient notice to arrange funding, if necessary, while allowing FICC to address losses in a timely manner.

<sup>26</sup> If a member's Loss Allocation Cap exceeds the member's then-current Required Fund Deposit, it must still cover the excess amount.

losses up to a round cap of the aggregate of all Loss Allocation Caps of those Tier One Netting Members or Tier One Members, as applicable, included in the round. If a Tier One Netting Member or Tier One Member, as applicable, provides notice of its election to withdraw from membership, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover FICC's losses, a second round will be noticed to those members that did not elect to withdraw from membership in the previous round; however, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Tier One Netting Members or Tier One Members, as applicable, in a second or subsequent round if Tier One Netting Members or Tier One Members, as applicable, elect to withdraw from membership with GSD or MBSD, as applicable, as provided in proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, following the first Loss Allocation Notice in any round.

As proposed, a Tier One Netting Member or a Tier One Member, as applicable, that withdraws in compliance with proposed Section 7b of GSD Rule 4 or MBSD Rule 4, as applicable, would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under GSD Rule 4 or MBSD Rule 4, as applicable; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap as fixed in the round for which it withdrew.

FICC states that the proposed changes are designed to enable FICC to continue the loss allocation process in successive rounds until all of FICC's losses are allocated. To the extent that the Loss Allocation Cap of a Tier One Netting Member or Tier One Member, as applicable, exceeds such member's Required Fund Deposit on the first day of an Event Period, FICC may in its discretion retain any excess amounts on deposit from the member, up to the Loss Allocation Cap of a Tier One Netting Member or Tier One Member, as applicable.

#### (6) Declared Non-Default Loss Event

Aside from losses that FICC might face as a result of a Defaulting Member Event, FICC could incur non-default losses incident to each Division's clearance and settlement business.<sup>27</sup>

<sup>27</sup> Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

The GSD Rules and the MBSD Rules currently permit FICC to apply Clearing Fund to non-default losses.<sup>28</sup> Section 5 of GSD Rule 4 and MBSD Rule 4 provides that the use of the Clearing Fund deposits is limited to satisfaction of losses or liabilities of FICC, which includes losses or liabilities that are otherwise incident to the operation of the clearance and settlement business of FICC, although the application of the Clearing Fund to such losses or liabilities is more limited under MBSD Rule 4 when compared to GSD Rule 4.<sup>29</sup> Section 7(f) of GSD Rule 4 and MBSD Rule 4 provides that any loss or liability incurred by the Corporation incident to its clearance and settlement business arising other than from a Remaining Loss shall be allocated among Tier One Netting Members or Tier One Members, as applicable, ratably, in accordance with their Average Required Clearing Fund Deposits.<sup>30</sup>

For both the GSD Rules and the MBSD Rules, FICC proposes enhancement of the governance around non-default losses that would trigger loss allocation to Tier One Netting Members or Tier One Members, as applicable, by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of FICC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Tier One Netting Members or Tier One

<sup>28</sup> The first paragraph of Section 7 in both GSD Rule 4 and MBSD Rule 4 is not clear and may suggest that losses or liabilities may only be allocated in a member default scenario, while Section 5 in both GSD Rule 4 and MBSD Rule 4 makes it clear that the applicable Division's Clearing Fund may be used to satisfy non-default losses.

<sup>29</sup> Section 5 of GSD Rule 4 provides that "The use of the Clearing Fund deposits shall be limited to satisfaction of losses or liabilities of the Corporation . . . otherwise incident to the clearance and settlement business of the Corporation . . ." *Supra* note 10.

Section 5 of MBSD Rule 4 provides that "The use of the Clearing Fund deposits and assets and property on which the Corporation has a lien on shall be limited to satisfaction of losses or liabilities of the Corporation. . . otherwise incident to the clearance and settlement business of the Corporation with respect to losses and liabilities to meet unexpected or unusual requirements for funds that represent a small percentage of the Clearing Fund . . ." *Supra* note 10.

<sup>30</sup> Section 7(f) of GSD Rule 4 and MBSD Rule 4 provides that "Any loss or liability incurred by the Corporation incident to its clearance and settlement business . . . arising other than from a Remaining Loss (hereinafter, an "Other Loss") shall be allocated among [Tier One Netting Members/Tier One Members], ratably, in accordance with the respective amounts of their Average Required [FICC Clearing Fund Deposits/Clearing Fund Deposits]". *Supra* note 10.

Members, as applicable, in order to ensure that FICC may continue to offer clearance and settlement services in an orderly manner. The proposed change would provide that FICC would then be required to promptly notify members of this determination (a "Declared Non-Default Loss Event"). In addition, FICC proposes to specify that a mandatory Corporate Contribution would apply to a Declared Non-Default Loss Event prior to any allocation of the loss among members. Additionally, FICC proposes language to clarify members' obligations for Declared Non-Default Loss Events.

Under the proposal, FICC would clarify the Rules of both Divisions to make clear that Tier One Netting Members or Tier One Members, as applicable, are subject to loss allocation for non-default losses (*i.e.*, Declared Non-Default Loss Events under the proposal) and Tier Two Members are not subject to loss allocation for non-default losses.

#### B. Changes To Align the Loss Allocation Rules

The proposed changes would align the loss allocation rules, to the extent practicable and appropriate, of the three DTCC Clearing Agencies so as to provide consistent treatment for firms that are participants of multiple DTCC Clearing Agencies. As proposed, the loss allocation process and certain related provisions would be consistent across the DTCC Clearing Agencies to the extent practicable and appropriate.

#### C. Use of MBSD Clearing Fund

The proposed change would delete language currently in Section 5 of MBSD Rule 4 that limits certain uses by FICC of the MBSD Clearing Fund to "unexpected or unusual" requirements for funds that represent a "small percentage" of the MBSD Clearing Fund. FICC states that these limiting phrases (which appear in connection with FICC's use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event as well as to cover certain liquidity needs) are vague, imprecise, and should be replaced in their entirety. Specifically, FICC proposes to delete the limiting language with respect to FICC's use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event so as to not have such language be interpreted as impairing FICC's ability to access the MBSD Clearing Fund in order to manage non-default losses. FICC proposes to delete the limiting

language with respect to FICC's use of MBSD Clearing Fund to cover certain liquidity needs because the effect of the limitation in this context is confusing and unclear.

#### *D. Conforming and Technical Changes*

FICC proposes to make various conforming and technical changes necessary to harmonize the remaining current Rules with the proposed changes. Such changes include, but are not limited to: (1) Amending Rule 1 (Definitions; Governing Law) to add cross-references to proposed terms that would be defined in Rule 4; (2) inserting, deleting, or changing various terms for clarity and consistency; (3) modifying the voluntary termination provisions to ensure that termination provisions in the GSD Rules and the MBSD Rules are consistent, whether voluntary or in response to a loss allocation, are consistent with one another to the extent appropriate; and (4) deleting obsolete sections due to the proposal.

## **II. Discussion and Commission Findings**

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive: To mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.<sup>31</sup>

Section 805(a)(2) of the Clearing Supervision Act<sup>32</sup> authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>33</sup> provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):

- To promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision

Act<sup>34</sup> and Section 17A of the Act<sup>35</sup> ("Rule 17Ad-22").<sup>36</sup> Rule 17Ad-22 requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.<sup>37</sup> Therefore, it is appropriate for the Commission to review proposed changes in advance notices against the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act<sup>38</sup> and against Rule 17Ad-22.<sup>39</sup>

#### *A. Consistency With Section 805(b) of the Clearing Supervision Act*

The Commission believes that the proposed changes in the Advance Notice are designed to help FICC promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system as discussed below.

FICC proposes to make the following changes to its loss allocation process as described above. First, for both the GSD Rules and the MBSD Rules, the proposed changes would modify the calculation of FICC's Corporate Contribution so that FICC would apply a mandatory fixed percentage of its General Business Risk Capital Requirement as compared to the current Rules which provide for a "up to" percentage of retained earnings. The proposed changes also would clarify that the proposed Corporate Contribution would apply to Declared Non-Default Loss Events, as well as Defaulting Member Events, on a mandatory basis prior to any allocation of the loss among Tier One Netting Members or Tier One Members, as applicable. The proposal would specify how the Corporate Contribution would be applied between Divisions. Moreover, the proposal specifies that if the Corporate Contribution is applied to a loss or liability relating to an Event Period, then for any subsequent Event Periods that occur during the 250 business days thereafter, the Corporate Contribution would be reduced to the remaining, unused portion of the Corporate Contribution. The Commission believes that these changes set clear expectations about how and

when FICC's Corporate Contribution would be applied to help address a loss, and allow FICC to better anticipate and prepare for potential exposures that may arise during an Event Period.

Second, as described above, FICC proposes to determine a member's loss allocation obligation based on the average of its Required Fund Deposit over a look-back period of 70 Business Days and to determine its Loss Allocation Cap based on the greater of its Required Fund Deposit or the average thereof over a look-back period of 70 Business Days. Currently, the GSD Rules and the MBSD Rules calculate a Tier One Netting Member's or a Tier One Member's pro rata share for purposes of loss allocation based on the member's average daily Required Fund Deposit over the prior 12 months or such shorter period as may be available in the case of a member which has not maintained a deposit over such time period. These proposed changes are designed to allow FICC to calculate a member's pro rata share of losses and liabilities based on the amount of risk that the member brings to FICC, and cover a sufficient amount of time to measure such risk. The look-back period of 70 Business Days is designed to be long enough to enable FICC to capture a full calendar quarter of members' activities and to smooth out the impact from any abnormalities that may have occurred, but not excessively long such that members' business strategy and outlook could have shifted significantly during the time period, resulting in material changes to the size of its portfolios. As a result of these changes, the Commission believes that FICC should be in a better position to manage its risk by using a look-back period that more accurately reflects the amount of risk that the member brings to FICC.

Third, as described above, FICC proposes to introduce the concept of an Event Period, which would group Defaulting Member Events and Declared Non-Default Loss Events occurring within a period of 10 Business Days for purposes of allocating losses to members in one or more rounds. Under the current Rules, every time each Division incurs a loss or liability, FICC will initiate its current loss allocation process by applying its retained earnings and allocating losses. The current Rules do not contemplate a situation where loss events occur in quick succession. Accordingly, even if multiple losses occur within a short period, the current Rules dictate that FICC start the loss allocation process separately for each loss event. Having multiple loss allocation calculations and notices from FICC and withdrawal

<sup>34</sup> 12 U.S.C. 5464(a)(2).

<sup>35</sup> 15 U.S.C. 78q-1.

<sup>36</sup> 17 CFR 240.17Ad-22.

<sup>37</sup> *Id.*

<sup>38</sup> 12 U.S.C. 5464(b).

<sup>39</sup> 17 CFR 240.17Ad-22.

<sup>31</sup> See 12 U.S.C. 5461(b).

<sup>32</sup> 12 U.S.C. 5464(a)(2).

<sup>33</sup> 12 U.S.C. 5464(b).



notices from members after multiple sequential loss events could cause operational risk to FICC, since multiple notices may cause confusion at a time of significant stress.

The Commission believes that the proposed change to introduce an Event Period would improve upon the current loss allocation process described immediately above. Specifically, the introduction of an Event Period would provide a more defined and transparent structure than the current loss allocation process. Such an improved structure should enable both FICC and each member to more effectively manage the risks and potential financial obligations presented by sequential Defaulting Member Events and/or Declared Non-Default Loss Events that are likely to arise in quick succession and could be closely linked to an initial event and/or market dislocation episode. In other words, the proposed Event Period structure should help clarify and define for both FICC and its members how FICC would initiate a single defined loss allocation process to cover all loss events within 10 Business Days. As a result, all loss allocation calculation and notices from FICC and potential withdrawal notices from members would be tied back to one Event Period instead of each individual loss event.

Fourth, as described above, the proposal would improve upon the approach laid out in FICC's current Rules by providing for a loss allocation round, a Loss Allocation Notice process, a Loss Allocation Withdrawal Notice process, and a Loss Allocation Cap, for both the GSD Rules and the MBSD Rules. A loss allocation round would be a series of loss allocations relating to an Event Period, the aggregate amount of which would be limited by the round cap. When the losses allocated in a round equals the round cap, any additional losses relating to the Event Period would be allocated in subsequent rounds until all losses from the Event Period are allocated among members. Each loss allocation would be communicated to members by the issuance of a Loss Allocation Notice. Each member in a loss allocation round would have five Business Days from the issuance of such first Loss Allocation Notice for the round to notify FICC of its election to withdraw from membership with FICC, and thereby benefit from its Loss Allocation Cap. The Loss Allocation Cap of a member would be equal to the greater of its Required Fund Deposit on the first day of the applicable Event Period and its Average RFD. Members would have two Business Days after FICC issues a first

round Loss Allocation Notice to pay the amount specified in such notice.

The Commission believes that those four proposed changes, to (1) establish a specific Event Period, (2) continue the loss allocation process in successive rounds, (3) clearly communicate with its members regarding their loss allocation obligations, and (4) effectively identify continuing members for the purpose of calculating loss allocation obligations in successive rounds, are designed to make FICC's loss allocation process more certain. In addition, the changes are designed to provide members with a clear set of procedures that operate within the proposed loss allocation structure, and provide increased predictability and certainty regarding members' exposures and obligations. Furthermore, by grouping all loss events within 10 business days, the loss allocation process relating to multiple loss events can be streamlined. With enhanced certainty, predictability, and efficiency, FICC would then be able to better manage its risks from loss events occurring in quick succession, and members would be able to better manage their risks by deciding whether and when to withdraw from membership and limit their exposures to FICC. Furthermore, the proposed changes are designed to reduce liquidity risk to members by providing a two-day window to arrange funding to pay for loss allocation, while still allowing FICC to address losses in a timely manner.

Fifth, as described above, for both the GSD Rules and the MBSD Rules, FICC proposes to clarify the governance around Declared Non-Default Loss Events by providing that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of FICC to provide its services in an orderly manner. FICC also proposes to provide that FICC would then be required to promptly notify members of this determination. In addition, FICC proposes to apply a mandatory Corporate Contribution to a Declared Non-Default Loss Event prior to any allocation of the loss among members.

The Commission believes that the immediately above described changes should provide an orderly and transparent procedure to allocate a non-default loss by requiring the Board of Directors to make a definitive decision to announce an occurrence of a Declared Non-Default Loss Event, and requiring FICC to provide a notice to members of such decision. The Commission further believes that an orderly and transparent procedure should result in a risk management process at FICC that is

more robust as a result of enhanced governance around FICC's response to non-default losses, thereby promoting safety and soundness.

Collectively, the Commission believes that the proposed changes to FICC's loss allocation process would provide greater transparency, certainty, and efficiency to both FICC and members regarding the amount of resources and the instances in which FICC would apply such resources to address risks arising from Defaulting Member Events and Declared Non-Default Loss Events, which could occur in quick succession. The Commission believes that such transparency, certainty, and efficiency would allow better predictability to FICC and its members regarding their exposures, and in turn, would allow a risk management process at FICC and its members that is more robust in response to such events and would improve their ability to continue to operate and recover in a safe and sound manner during such events. Therefore, the Commission believes that the proposal promotes robust risk management as well as safety and soundness.

In addition to the key changes discussed above, FICC proposes to delete the limiting language with respect to FICC's use of MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event so as to not have such language be interpreted as impairing FICC's ability to access the MBSD Clearing Fund in order to manage non-default losses. Further, FICC proposes to delete the limiting language with respect to FICC's use of MBSD Clearing Fund to cover certain liquidity needs because the effect of the limitation in this context is confusing and unclear. The Commission believes that the proposed change to delete certain vague and imprecise limiting language that could impair FICC's ability to access the MBSD Clearing Fund to cover losses and liabilities incident to its clearance and settlement business outside the context of an MBSD Defaulting Member Event, as well as to cover certain liquidity needs, is designed to promote robust risk management by allowing FICC to use MBSD Clearing Fund to manage its risk. In addition, the Commission believes that the change is designed to promote safety and soundness by enhancing FICC's ability to ensure that it can continue its operations and clearance and settlement services in an orderly manner in the event that it would be necessary or appropriate for FICC to access MBSD Clearing Fund deposits to



address losses, liabilities or liquidity needs to meet its settlement obligations.

Finally, FICC proposes to align the loss allocation rules of the DTCC Clearing Agencies to the extent practicable and appropriate. The alignment is designed to help provide consistent treatment for firms that are participants of multiple DTCC Clearing Agencies. The Commission believes that providing consistent treatment through consistent procedures among the DTCC Clearing Agencies would help firms that participate in multiple DTCC Clearing Agencies from encountering unnecessary complexities and confusion stemming from differences in procedures regarding loss allocation processes, particularly at times of significant stress. Accordingly, the Commission believes that the change is designed to reduce systemic risk and support the stability of the broader financial system.

Therefore, for all of the reasons stated above, the Commission believes that the changes proposed in the Advance Notice are consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.<sup>40</sup>

#### *B. Consistency With Rule 17Ad-22(e)(4)(viii)*

Rule 17Ad-22(e)(4)(viii) under the Act requires, in part, that a covered clearing agency<sup>41</sup> establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by addressing allocation of credit losses the covered clearing agency may face if its collateral and other resources are insufficient to fully cover its credit exposures.<sup>42</sup>

As described above, the proposal would revise the loss allocation process to address how FICC would manage loss events, including Defaulting Member Events. Under the proposal, if losses arise out of or relate to a Defaulting Member Event, FICC would first apply

its Corporate Contribution. If such funds prove insufficient, the proposal provides for allocating the remaining losses to the remaining members through the proposed process. Accordingly, the Commission believes that the proposal is reasonably designed to manage FICC's credit exposures to its members, by addressing allocation of credit losses.

Therefore, the Commission believes that FICC's proposal is consistent with Rule 17Ad-22(e)(4)(viii) under the Act.<sup>43</sup>

#### *C. Consistency With Rule 17Ad-22(e)(13)*

Rule 17Ad-22(e)(13) under the Act requires, in part, that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the covered clearing agency has the authority to take timely action to contain losses and liquidity demands and continue to meet its obligations.<sup>44</sup>

As described above, the proposal would establish a more detailed and structured loss allocation process by (1) modifying the calculation and application of the Corporate Contribution; (2) introducing an Event Period; (3) introducing a loss allocation round and notice process; (4) implementing a look-back period to calculate a member's loss allocation obligation; (5) modifying the withdrawal process and the cap of withdrawing member's loss allocation exposure; and (6) providing the governance around a non-default loss. The Commission believes that each of these proposed changes helps establish a more transparent and clear loss allocation process and authority of FICC to take certain actions, such as announcing a Declared Non-Default Loss Event, within the loss allocation process. Further, having a more transparent and clear loss allocation process as proposed would provide clear authority to FICC to allocate losses from Defaulting Member Events and Declared Non-Default Loss Events and take timely actions to contain losses, and continue to meet its clearance and settlement obligations.

Therefore, the Commission believes that FICC's proposal is consistent with Rule 17Ad-22(e)(13) under the Act.<sup>45</sup>

#### *D. Consistency With Rule 17Ad-22(e)(23)(i) and (ii)*

Rule 17Ad-22(e)(23)(i) under the Act requires that a covered clearing agency establish, implement, maintain and

enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures.<sup>46</sup> Rule 17Ad-22(e)(23)(ii) under the Act requires that a covered clearing agency 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.<sup>47</sup>

As described above, the proposal would publicly disclose how FICC's Corporate Contribution would be calculated and applied. In addition, the proposal would establish and publicly disclose a detailed procedure in the Rules for loss allocation. More specifically, the proposed changes would establish an Event Period, loss allocation rounds, a look-back period to calculate each member's loss allocation obligation, a withdrawal process followed by a loss allocation process, and a Loss Allocation Cap that would apply to members after withdrawal. Additionally, the proposal would align the loss allocation rules across the DTCC Clearing Agencies to help provide consistent treatment, and clarify that non-default losses would trigger loss allocation to members. The proposal would also provide for and make known to members the procedures to trigger a loss allocation procedure, contribute FICC's Corporate Contribution, allocate losses, and withdraw and limit member's loss exposure. Accordingly, the Commission believes that the proposal is reasonably designed to (1) publicly disclose all relevant rules and material procedures concerning key aspects of FICC's default rules and procedures, and (2) provide sufficient information to enable members to identify and evaluate the risks by participating in FICC.

Therefore, the Commission believes that FICC's proposal is consistent with Rules 17Ad-22(e)(23)(i) and (ii) under the Act.<sup>48</sup>

### **III. Conclusion**

*It is therefore noticed*, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,<sup>49</sup> that the Commission *does not object* to advance notice SR-FICC-2017-806, as modified by Amendment No. 1, and that FICC is *authorized* to implement the proposal as

<sup>40</sup> 12 U.S.C. 5464(b).

<sup>41</sup> 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 the Financial Stability Oversight Counsel ("FSOC") pursuant to the Clearing Supervision Act (12 U.S.C. 5461 *et seq.*). See 17 CFR 240.17Ad-22(a)(5) and (6). On July 18, 2012, FSOC designated FICC as systemically important. U.S. Department of the Treasury, "FSOC Makes First Designations in Effort to Protect Against Future Financial Crises," available at <https://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx>. Therefore, FICC is a covered clearing agency.

<sup>42</sup> 17 CFR 240.17Ad-22(e)(4)(viii).

<sup>43</sup> *Id.*

<sup>44</sup> 17 CFR 240.17Ad-22(e)(13).

<sup>45</sup> *Id.*

<sup>46</sup> 17 CFR 240.17Ad-22(e)(23)(i).

<sup>47</sup> 17 CFR 240.17Ad-22(e)(23)(ii).

<sup>48</sup> 17 CFR 240.17Ad-22(e)(23)(i) and (ii).

<sup>49</sup> 12 U.S.C. 5465(e)(1)(I).

of the date of this notice or the date of an order by the Commission approving proposed rule change SR-FICC-2017-022, as modified by Amendment No. 1, whichever is later.

By the Commission.

**Eduardo A. Aleman,**

*Assistant Secretary.*

[FR Doc. 2018-18865 Filed 8-29-18; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83955; File No. SR-NSCC-2017-805]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of No Objection to an Advance Notice, as Modified by Amendment No. 1, To Adopt a Recovery & Wind-Down Plan and Related Rules

August 27, 2018.

On December 18, 2017, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-NSCC-2017-805 pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”)<sup>2</sup> to adopt a recovery and wind-down plan (“R&W Plan”) and related rules.<sup>3</sup> The advance

notice was published for comment in the **Federal Register** on January 30, 2018.<sup>4</sup> In that publication, the Commission also extended the review period of the advance notice for an additional 60 days, pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act.<sup>5</sup> On April 10, 2018, the Commission required additional information from NSCC pursuant to Section 806(e)(1)(D) of the Clearing Supervision Act,<sup>6</sup> which tolled the Commission’s period of review of the advance notice until 60 days from the date the information required by the Commission was received by the Commission.<sup>7</sup> On June 28, 2018, NSCC filed Amendment No. 1 to the advance notice to amend and replace in its entirety the advance notice as originally filed on December 18, 2017.<sup>8</sup> On July 6, 2018, the Commission received a response to its request for additional information in consideration of the advance notice, which, in turn, added a further 60-days to the review period pursuant to Section 806(e)(1)(E) and (G) of the Clearing Supervision Act.<sup>9</sup> The

Proposed Rule Change. Securities Exchange Act Release No. 83632 (July 13, 2018), 83 FR 34166 (July 19, 2018) (SR-NSCC-2017-017). NSCC submitted a courtesy copy of Amendment No. 1 to the Proposed Rule Change through the Commission’s electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the Proposed Rule Change has been publicly available on the Commission’s website at <https://www.sec.gov/rules/sro/nscc.htm> since June 29, 2018. The Commission did not receive any comments. The proposal, as set forth in both the advance notice and the Proposed Rule Change, each as modified by Amendments No. 1, shall not take effect until all required regulatory actions are completed.

<sup>4</sup> Securities Exchange Act Release No. 82581 (January 24, 2018), 83 FR 4327 (January 30, 2018) (SR-NSCC-2017-805) (“Notice”).

<sup>5</sup> Pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act, the Commission may extend the review period of an advance notice for an additional 60 days, if the changes proposed in the advance notice raise novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. 12 U.S.C. 5465(e)(1)(H). The Commission found that the advance notice raised novel and complex issues and, accordingly, extended the review period of the advance notice for an additional 60 days until April 17, 2018. See Notice, *supra* note 4.

<sup>6</sup> 12 U.S.C. 5465(e)(1)(D).

<sup>7</sup> See 12 U.S.C. 5465(e)(1)(E)(ii) and (G)(ii); see Memorandum from the Office of Clearance and Settlement Supervision, Division of Trading and Markets, titled “Commission’s Request for Additional Information,” available at <https://www.sec.gov/rules/sro/nscc-an.htm>.

<sup>8</sup> Securities Exchange Act Release No. 83745 (July 31, 2018), 83 FR 38329 (August 6, 2018) (SR-NSCC-2017-805). NSCC submitted a courtesy copy of Amendment No. 1 to the advance notice through the Commission’s electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the advance notice has been publicly available on the Commission’s website at <https://www.sec.gov/rules/sro/nscc-an.htm> since June 29, 2018.

<sup>9</sup> 12 U.S.C. 5465(e)(1)(E) and (G); see Memorandum from the Office of Clearance and

Commission did not receive any comments. This publication serves as notice that the Commission does not object to the proposed changes set forth in the advance notice, as modified by Amendment No. 1 (hereinafter, “Advance Notice”).

### I. Description of the Advance Notice

In the Advance Notice, NSCC proposes to (1) adopt an R&W Plan; (2) amend NSCC’s Rules & Procedures (“Rules”)<sup>10</sup> to adopt Rule 41 (Corporation Default), Rule 42 (Wind-down of the Corporation), and Rule 60 (Market Disruption and Force Majeure) (each a “Proposed Rule” and, collectively, the “Proposed Rules”); and (3) re-number current Rule 42 (Wind-down of a Member, Fund Member or Insurance Carrier/Retirement Services Member) to Rule 40, which is currently reserved for future use.

NSCC states that the R&W Plan would be used by the Board of Directors of NSCC (“Board”) and management of NSCC in the event NSCC encounters scenarios that could potentially prevent it from being able to provide its critical services as a going concern.

NSCC states that the Proposed Rules are designed to (1) facilitate the implementation of the R&W Plan when necessary and, in particular, allow NSCC to effectuate its strategy for winding down and transferring its business; (2) provide Members and Limited Members with transparency around critical provisions of the R&W Plan that relate to their rights, responsibilities and obligations; and (3) provide NSCC with the legal basis to implement those provisions of the R&W Plan when necessary.

#### A. NSCC R&W Plan

The R&W Plan would be structured to provide a roadmap, define the strategy, and identify the tools available to NSCC to either (i) recover, in the event it experiences losses that exceed its prefunded resources (such strategies and tools referred to herein as the “Recovery Plan”) or (ii) wind-down its business in a manner designed to permit the continuation of its critical services in the event that such recovery efforts are not successful (such strategies and tools referred to herein as the “Wind-down Plan”).

The R&W Plan would identify (i) the recovery tools available to NSCC to address the risks of (a) uncovered losses

Settlement Supervision, Division of Trading and Markets, titled “Response to the Commission’s Request for Additional Information,” available at <https://www.sec.gov/rules/sro/nscc-an.htm>.

<sup>10</sup> Capitalized terms used herein and not otherwise defined herein are defined in the Rules.