

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-BatsEDGX-2016-29 on the subject line.

##### *Paper Comments*

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

All submissions should refer to File No. SR-BatsEDGX-2016-29. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-BatsEDGX-2016-29, and should be submitted on or before August 11, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>26</sup>

**Robert W. Errett,**  
*Deputy Secretary.*

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**BILLING CODE 8011-01-P**

#### **SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-78347; File No. SR-FICC-2016-003]**

#### **Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change To Describe the Blackout Period Exposure Charge That May Be Imposed on GCF Repo Participants**

July 15, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 12, 2016, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change**

The proposed rule change would amend the Government Securities Division ("GSD") Rulebook (the "GSD Rules")<sup>3</sup> to include a margin charge increase (the "Blackout Period Exposure Charge" as further described below) that may be imposed on Netting Members that participate in the GCF Repo<sup>®</sup> service ("GCF Repo Participants"). The charge would be imposed at the beginning of each month for GCF Repo Participants whose portfolios experience backtesting deficiencies attributable to such Participants' use of mortgage-backed securities ("MBS") as collateral for GCF Repo Transactions. The charge is designed to mitigate FICC's exposure resulting from potential decreases in the collateral value of MBS pools that occur during the monthly Blackout Period (as defined and

discussed below). The proposed rule change would amend GSD Rule 1 (Definitions) to add certain defined terms and would amend Section 1b of GSD Rule 4 (Clearing Fund and Loss Allocations) to include the Blackout Period Exposure Charge and the manner in which FICC determines and imposes such charge. FICC is filing this proposed rule change in order to provide transparency in the GSD Rules with respect to this existing charge.

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

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

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

##### **1. Purpose**

The proposed rule change provides transparency in the GSD Rules with respect to the Blackout Period Exposure Charge, which FICC may temporarily impose on a GCF Repo Participant as part of such GCF Repo Participant's Required Fund Deposit. FICC imposes the Blackout Period Exposure Charge where FICC determines, based on prior backtesting deficiencies of such GCF Repo Participant's Required Fund Deposit, that the GCF Repo Participant may experience a deficiency due to reductions in the notional value of the MBS used by such GCF Repo Participant to collateralize its GCF Repo trading activity that occur during the monthly Blackout Period. Because this reduction in notional value that occurs during the Blackout Period is not reflected on GCF Clearing Agent Banks' collateral reports to FICC until after the Blackout Period ends, the value of GCF Repo Participants' collateral may be overstated during this period, creating an exposure for FICC that may not be covered by such Participants' Required Fund Deposits. The Blackout Period Exposure Charge is designed to mitigate that risk to FICC.

<sup>26</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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

## (i) Background

## A. GCF Repo Service and the Required Fund Deposit

The GCF Repo service enables GCF Repo Participants to trade general collateral repurchase agreements based on rate, term and underlying product throughout the day, without requiring intraday, trade-for-trade settlement on a delivery-versus-payment basis. On each trading day, GCF Repo Participants must allocate appropriate collateral to FICC's account at the GCF Repo Participant's GCF Clearing Agent Bank to cover their repurchase obligations.<sup>4</sup> FICC accepts MBS as eligible securities for such collateral allocations.<sup>5</sup> Additionally, FICC collects Required Fund Deposits from all Netting Members (including GCF Repo Participants) to protect FICC against losses in the event of a Netting Member's default.

The Required Fund Deposit serves as each Netting Member's margin. The objective of the Required Fund Deposit is to mitigate potential losses to FICC associated with liquidation of the Netting Member's portfolio in the event that FICC ceases to act for a Netting Member (hereinafter referred to as a "default"). FICC determines Required Fund Deposit amounts using a risk-based margin methodology that is intended to capture market price risk. The methodology uses historical market moves to project or forecast the potential gains or losses on the liquidation of a defaulting Netting Member's portfolio, assuming that a portfolio would take three days to liquidate or hedge in normal market conditions. The projected liquidation gains or losses are used to determine the Netting Member's Required Fund Deposit, which is calculated to cover projected liquidation losses at a 99 percent confidence level. The aggregate of all Netting Members' Required Fund Deposits constitutes FICC's Clearing Fund, which FICC would be able to access should a defaulting Netting Member's own Required Fund Deposit be insufficient to satisfy losses to FICC caused by the liquidation of that Netting Member's portfolio.

FICC employs daily backtesting to determine the adequacy of each Netting Member's Required Fund Deposit. FICC compares the Required Fund Deposit<sup>6</sup> for each Netting Member with the simulated liquidation gains/losses using the actual positions in the Netting

Member's portfolio, including the actual allocated collateral of GCF Repo Participants, and the actual historical security returns. FICC investigates the cause(s) of any deficiencies. As a part of this process, FICC pays particular attention to Netting Members with backtesting deficiencies that bring the results for that Netting Member below the 99 percent confidence target (*i.e.*, greater than two deficiency days in a rolling twelve-month period) to determine if there is an identifiable cause of repeat deficiencies. FICC also evaluates whether multiple Netting Members may experience deficiencies for the same underlying reason.

## B. MBS and the Blackout Period

While there can be multiple factors that contribute to a deficiency, FICC has identified that GCF Repo Participants that pledge substantial amounts of MBS collateral in respect of their GCF Repo Transactions may experience backtesting deficiencies due to an overvaluation of MBS collateral that can occur during the Blackout Period (as further described below).

FICC only accepts MBS that are issued and guaranteed by U.S. government-sponsored entities ("GSEs"). Because MBS are composed of pools of mortgages as to which the principal balances are reduced over time through scheduled and unscheduled payments by mortgagors, MBS notional values also reduce over time. Investors in MBS issued by the GSEs are informed of the amount of this reduction in value on a monthly basis when the GSEs release new "Pool Factors" for their MBS at the beginning of every month.<sup>7</sup> The period between the last business day of the prior month (the "Record Date") and the date on which the GSE releases its new Pool Factors (the "Factor Date") is known as the "Blackout Period."<sup>8</sup> During the Blackout Period, MBS values may be overstated because of uncertainty concerning the remaining principal balances of the MBS and thus the amount guaranteed by the issuing GSE.

FICC has identified that GCF Repo Participants may experience backtesting deficiencies during the Blackout Period if they allocate substantial amounts of MBS collateral to cover their repurchase obligations. Such deficiencies occur

because the value of MBS collateral allocated to cover GCF Repo Participants' repurchase obligations may be overstated on the collateral reports delivered to FICC by the GCF Clearing Agent Banks, which rely on the prior month's Pool Factors to value MBS collateral pledged by GCF Repo Participants. The Blackout Period Exposure Charge is designed to mitigate the risk posed to FICC by such deficiencies by temporarily increasing such GCF Repo Participants' Required Fund Deposits.

## C. Calculation of the Blackout Period Exposure Charge

The objective of the Blackout Period Exposure Charge is to increase Required Fund Deposits for GCF Repo Participants that are likely to experience backtesting deficiencies on the basis described above by an amount sufficient to maintain such GCF Repo Participants' backtesting coverage above the 99 percent confidence threshold. Because the size of the backtesting deficiencies caused by this issue varies among impacted GCF Repo Participants, FICC must assess a Blackout Period Exposure Charge that is specific to each impacted GCF Repo Participant. To do so, FICC examines each impacted GCF Repo Participant's historical backtesting deficiencies to identify the two largest deficiencies that have occurred during the 12-month look-back period. FICC then employs an amount equal to the *midpoint* between the two largest historical deficiencies for such member as the presumptive Blackout Period Exposure Charge amount, subject to adjustment as further described below. Although an increase equal to the third largest historical deficiency would suffice to bring the GCF Repo Participant's historically-observed backtesting coverage above the 99 percent target<sup>9</sup> if deficiencies due to Blackout Period exposures were the only deficiencies experienced, such an approach would fail to take into account potential changes in such GCF Repo Participant's MBS collateral pledges or other factors that could contribute to deficiencies during this period. Consequently, FICC has determined to use the midpoint between the two largest historical deficiencies as an amount that is (i) particular to the GCF Repo Participant and its use of MBS collateral and (ii) generally provides a reasonable buffer above the historically observed minimum increase necessary

<sup>7</sup> Pool Factors are stated as a percentage amount of the initial aggregate face value of the security that remains unpaid on the underlying mortgage pool. For example, if the face amount of a mortgage-backed security were \$100,000 and the stated pool factor were 0.4587, the remaining principal balance in the security to be paid to the investor would be \$45,870.

<sup>8</sup> The Factor Date is typically the fourth or fifth business day of each calendar month.

<sup>9</sup> Each deficiency reduces backtesting coverage by 0.4 percent (1 exception/250 observation days). Accordingly, an increase equal to the third largest deficiency would bring backtesting coverage up to 99.2 percent.

<sup>4</sup> GSD Rule 20 Section 3.

<sup>5</sup> *Id.*

<sup>6</sup> For backtesting comparisons, FICC uses the Required Fund Deposit amount, without regard to the actual collateral posted by the Netting Member.

to achieve 99 percent coverage. The resulting Blackout Period Exposure Charge is added to the VaR Charge for such GCF Repo Participant determined pursuant to FICC's risk-based margining methodology. The Blackout Period Exposure Charge is only imposed during the Blackout Period, until the GCF Repo Participant's GCF Clearing Agent Bank updates the Pool Factors it uses to value MBS collateral.<sup>10</sup>

This charge is applicable only to those GCF Repo Participants that have two or more backtesting deficiencies that occurred during the Blackout Period and whose overall 12-month trailing backtesting coverage falls below the 99 percent coverage target.

Although the midpoint between the two largest historical Blackout Period deficiencies for a GCF Repo Participant will be used as the Blackout Period Exposure Charge in most cases, under the proposed rule FICC retains discretion to adjust the charge amount based upon other circumstances that may be relevant for assessing whether an impacted GCF Repo Participant is likely to experience future Blackout Period backtesting deficiencies and the estimated size of such deficiencies. Examples of relevant circumstances include material differences in the two largest deficiencies, variability in a GCF Repo Participant's use of MBS for collateral allocation, and variability in the magnitude of Pool Factor changes for certain categories of MBS. Based on FICC's assessment of the impact of these circumstances on the likelihood of, and estimated size of, future Blackout Period deficiencies for a GCF Repo Participant, FICC may, in its discretion, adjust the Blackout Period Exposure Charge for such Participant to an amount that FICC determines to be more appropriate for maintaining such GCF Repo Participant's backtesting results above the 99 percent coverage threshold (including a reasonable buffer).

#### D. Communication With GCF Repo Participants and Imposition of the Charge

If FICC determines that a Blackout Period Exposure Charge should apply to a GCF Repo Participant who was not assessed a Blackout Period Exposure Charge during the immediately preceding month or that the Blackout Period Exposure Charge applied to a GCF Repo Participant during the previous month should be increased, FICC will notify the Participant on or around the 25th calendar day of the

month. This notification permits the Participant to avoid or decrease the charge by notifying FICC in writing of its intent to remove or reduce its use of MBS in collateral allocations during the Blackout Period. If such Participant elects not to adjust its portfolio (or fails to do so despite such notification to FICC), then FICC will impose a Blackout Period Exposure Charge as determined above.

FICC imposes the Blackout Period Exposure Charge as an increase to each impacted GCF Repo Participant's Required Fund Deposit. The charge is imposed only during the Blackout Period: It is applied as of the morning Clearing Fund call on the Record Date through and including the intraday Clearing Fund call on the Factor Date, or until the Pool Factors have been updated to reflect the current month's Pool Factors in the GCF Clearing Agent Bank's collateral reports. Thereafter the charge is removed because updated MBS valuations are incorporated into FICC's risk-based margining methodology for the remainder of the month, alleviating the risk of potentially overvalued MBS collateral that occurs during Blackout Period. This process is repeated monthly.

If changes in an impacted GCF Repo Participant's MBS collateral pledges over time materially reduce the Blackout Period Exposure Charge calculated pursuant to the procedures described above, FICC may in its discretion reduce the Blackout Period Exposure Charge and would so notify the Participant. If an impacted GCF Repo Participant's trailing 12-month backtesting coverage exceeds 99 percent (without taking into account historically-imposed Blackout Period Exposure Charges), the Blackout Period Exposure Charge would be removed.

#### 2. Statutory Basis

Section 17A(b)(3)(F)<sup>11</sup> of the Act, requires, in part, that the rules of a clearing agency be designed to assure the safeguarding of securities and funds that are within the custody or control of the clearing agency. Rule 17Ad-22(b)(1) under the Act requires a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure its credit exposures to its participants at least once a day and limit its exposures to potential losses from defaults by its participants under normal market conditions, so that the operations of the clearing agency would not be disrupted and non-defaulting participants would not be exposed to losses that they

cannot anticipate or control.<sup>12</sup> Rule 17Ad-22(b)(2) under the Act requires a clearing agency to maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions.<sup>13</sup> FICC's Blackout Period Exposure Charge is calculated and imposed to cover credit exposures estimated by FICC based on a GCF Repo Participant's trailing 12-month backtesting results with the goal of maintaining such Participant's Required Fund Deposit above the 99 percent coverage threshold. This management of FICC's credit exposures to GCF Repo Participants is consistent with Rule 17Ad-22(b)(1) under the Act. Further, when it is imposed, the charge is a component of the applicable GCF Repo Participant's Required Fund Deposit, or margin, and is intended to maintain coverage of FICC's credit exposures to such GCF Repo Participant at a confidence level of at least 99 percent. This limits FICC's exposures to GCF Repo Participants under normal market conditions. It therefore is also consistent with Rule 17Ad-22(b)(2) under the Act.

By incorporating the Blackout Period Exposure Charge into the GSD Rules, the proposed change addresses an exposure that could subject FICC to potential losses under normal market conditions due to potentially overstated values of MBS pledged as collateral for GCF Repo Transactions in the event that a GCF Repo Participant defaults during the Blackout Period. Therefore, FICC believes the proposed rule change enhances the safeguarding of securities and funds that are in the custody or control of FICC, consistent with Section 17(b)(3)(F) of the Act.

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

FICC does not believe that the proposed rule change imposes any burden on competition that is not necessary or appropriate.<sup>14</sup> The proposed charge is necessary for FICC to limit its exposure to potential losses from defaults by its participants, and it is imposed on GCF Repo Participants on an individualized basis in an amount reasonably calculated to maintain their Required Fund Deposits above FICC's 99 percent coverage threshold. The charge only applies to GCF Repo Participants that use MBS collateral pledges in an amount that generates Blackout Period backtesting deficiencies specific to such GCF Repo Participants.

<sup>10</sup> The GCF Clearing Agent Banks typically have a one-day lag in updating their databases with the most recent Pool Factor information.

<sup>11</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>12</sup> 17 CFR 240.17Ad-22(b)(1).

<sup>13</sup> 17 CFR 240.17Ad-22(b)(2).

<sup>14</sup> 15 U.S.C. 78q-1(b)(3)(I).

FICC employs reasonable methods to calculate and impose an individualized charge in an amount designed to maintain each impacted GCF Repo Participant's future backtesting coverage above the 99 percent coverage threshold, including a reasonable buffer. Additionally, prior to imposing the Blackout Period Exposure Charge, FICC notifies each impacted GCF Repo Participant and provides it the opportunity to adjust its use of MBS collateral pledges in order to avoid having the charge applied to its Required Fund Deposit or to reduce the amount of such charge.

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

FICC has not received any written comments relating to this proposal. FICC will notify the Commission of any written comments received.

**III. Date of Effectiveness of the Proposed Rule Change, and Timing for Commission Action**

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) By order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FICC-2016-003 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549.

All submissions should refer to File Number SR-FICC-2016-003. This file number should be included on the

subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FICC and on DTCC's Web site (<http://dtcc.com/legal/sec-rule-filings.aspx>).

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-FICC-2016-003 and should be submitted on or before August 11, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

**Robert W. Errett,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-78348; File No. SR-NYSEMKT-2016-48]**

**Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing of Proposed Rule Change To Amend Certain Rules Related to Flexible Exchange Options**

July 15, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 1, 2016, NYSE MKT LLC ("NYSE MKT" or the "Exchange") filed with the

Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to amend certain rules related to Flexible Exchange ("FLEX") Options. The proposed change is available on the Exchange's Web site at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission's Public Reference Room.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

*A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change*

**1. Purpose**

The purpose of this filing is to amend certain rules related to FLEX Options, as described below.

FLEX Options are customized equity or index contracts that allow investors to tailor contract terms for exchange-listed equity and index options.<sup>3</sup> The Exchange is proposing to modify rules related to FLEX Options to offer new alternative terms for FLEX Options and to update rule text to more accurately reflect trading in FLEX Options on the Exchange.

FLEX Options for Binary Return Derivatives Contracts ("ByRDs")

The Exchange proposes to modify its rules to enable market participants to trade customized—or FLEX—options contracts in ByRDs.<sup>4</sup> Specifically, the

<sup>3</sup> See generally Section 15, Flexible Exchange Options, Rules 900G–909G.

<sup>4</sup> ByRDs are European-style option contracts on individual stocks, exchange-traded funds ("ETFs")

<sup>15</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.