

select, and recommend Sub-Advisers to manage all or a portion of a Sub-Advised Series' assets, and (c) implement procedures reasonably designed to ensure that Sub-Advisers comply with a Sub-Advised Series' investment objective, policies and restrictions. Subject to review by the Board, the Adviser will (a) when appropriate, allocate and reallocate a Sub-Advised Series' assets among multiple Sub-Advisers; and (b) monitor and evaluate the performance of Sub-Advisers.

4. A Sub-Advised Series will not make any Ineligible Sub-Adviser Changes without the approval of the shareholders of the applicable Sub-Advised Series.

5. A Sub-Advised Series will inform shareholders (or, if the Sub-Advised Series serves as a funding medium for any sub-account of a registered separate account, the Adviser will inform the unitholders of the sub-account) of the hiring of a new Sub-Adviser within 90 days after the hiring of the new Sub-Adviser pursuant to the Modified Notice and Access Procedures.

6. At all times, at least a majority of the Board will be Independent Board Members, and the selection and nomination of new or additional Independent Board Members will be placed within the discretion of the then-existing Independent Board Members.

7. Independent Legal Counsel, as defined in rule 0-1(a)(6) under the Act, will be engaged to represent the Independent Board Members. The selection of such counsel will be within the discretion of the then-existing Independent Board Members.

8. The Adviser will provide the Board, no less frequently than quarterly, with information about the profitability of the Adviser on a per Sub-Advised Series basis. The information will reflect the impact on profitability of the hiring or termination of any sub-adviser during the applicable quarter.

9. Whenever a sub-adviser is hired or terminated, the Adviser will provide the Board with information showing the expected impact on the profitability of the Adviser.

10. Whenever a sub-adviser change is proposed for a Sub-Advised Series with an Affiliated Sub-Adviser or a Wholly-Owned Sub-Adviser, the Board, including a majority of the Independent Board Members, will make a separate finding, reflected in the Board minutes, that such change is in the best interests of the Sub-Advised Series and its shareholders and does not involve a conflict of interest from which the Adviser or the Affiliated Sub-Adviser or

Wholly-Owned Sub-Adviser derives an inappropriate advantage.

11. No Board member or officer of a Sub-Advised Series, or director or officer of the Adviser, will own directly or indirectly (other than through a pooled investment vehicle that is not controlled by such person), any interest in a Sub-Adviser, except: (1) For ownership of interests in the Adviser or any entity, except a Wholly-Owned Sub-Adviser, that controls, is controlled by, or is under common control with the Adviser; or (2) for the ownership of less than 1% of the outstanding securities of any class of equity or debt of a publicly-traded company that is either a Sub-Adviser or an entity that controls, is controlled by, or is under common control with a Sub-Adviser.

12. Each Sub-Advised Series will disclose the Aggregate Fee Disclosure in its registration statement.

13. In the event the Commission adopts a rule under the Act providing substantially similar relief to that requested in the application, the requested order will expire on the effective date of that rule.

For the Commission, by the Division of Investment Management, under delegated authority.

**Kevin M. O'Neill,**  
*Deputy Secretary.*

[FR Doc. 2013-15506 Filed 6-27-13; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

### Sunshine Act Meetings

Notice is hereby given, pursuant to the provisions of the Government in the Sunshine Act, Public Law 94-409, that the Securities and Exchange Commission will hold a Closed Meeting on Tuesday, July 2, 2013 at 11:00 a.m.

Commissioners, Counsel to the Commissioners, the Secretary to the Commission, and recording secretaries will attend the Closed Meeting. Certain staff members who have an interest in the matters also may be present.

The General Counsel of the Commission, or his designee, has certified that, in his opinion, one or more of the exemptions set forth in 5 U.S.C. 552b(c)(5), (7), 9(B) and (10) and 17 CFR 200.402(a)(5), (7), 9(ii) and (10), permit consideration of the scheduled matters at the Closed Meeting.

Commissioner Paredes, as duty officer, voted to consider the items listed for the Closed Meeting in a closed session.

The subject matter of the Closed Meeting scheduled for Tuesday, July 2, 2013 will be:

Institution and settlement of injunctive actions;  
institution and settlement of administrative proceedings;  
adjudicatory matters; and  
other matters relating to enforcement proceedings.

At times, changes in Commission priorities require alterations in the scheduling of meeting items.

For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact the Office of the Secretary at (202) 551-5400.

Dated: June 25, 2013.

**Elizabeth M. Murphy,**  
*Secretary.*

[FR Doc. 2013-15580 Filed 6-26-13; 11:15 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-69838; File No. 600-23]

### Order Granting the Fixed Income Clearing Corporation's Amended Application for Permanent Registration as a Clearing Agency

June 24, 2013.

#### I. Introduction

On April 5, 2013, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") an amended application on Form CA-1<sup>1</sup> seeking permanent registration as a clearing agency under Sections 17A and 19(a) of the Securities Exchange Act of 1934 ("Act")<sup>2</sup> and Rule 17Ab2-1 thereunder.<sup>3</sup> Notice of the amended application was published in the **Federal Register** on April 17, 2013.<sup>4</sup> The Commission received no comments on the notice. This Order grants FICC

<sup>1</sup> See Letter from Donaldine Temple, Senior Associate Counsel and Corporate Secretary, FICC, to Joseph P. Kamnik, Assistant Director, Division of Trading and Markets, Securities and Exchange Commission (April 4, 2013). The amendment filed by FICC updates all of the information required by Form CA-1, and incorporates by reference all information submitted in connection with FICC's prior application and amendments thereto, to the extent not otherwise superseded by proposed rule changes filed pursuant to Section 19(b) of the Act or by FICC's amended Form CA-1.

<sup>2</sup> 15 U.S.C. 78q-1; 15 U.S.C. 78s(a).

<sup>3</sup> 17 CFR 240.17Ab2-1.

<sup>4</sup> See Securities Exchange Act Release No. 69362 (April 11, 2013), 78 FR 22923-01 (April 17, 2013) (File No. 600-23).

permanent registration as a clearing agency.

## II. Background

On December 13, 1986, the Mortgage-Backed Securities Clearing Corporation ("MBSCC") filed with the Commission a Form CA-1<sup>5</sup> seeking registration as a clearing agency. The Commission granted MBSCC a temporary registration on February 2, 1987<sup>6</sup> and extended this temporary registration on several occasions thereafter.<sup>7</sup> On October 16, 1987, the Government Securities Clearing Corporation ("GSCC") filed with the Commission a Form CA-1<sup>8</sup> seeking registration as a clearing agency. The Commission granted GSCC a temporary registration on May 24, 1988<sup>9</sup> and extended this temporary registration on several occasions thereafter.<sup>10</sup> On January 1, 2003, GSCC

acquired MBSCC and named the resulting entity FICC,<sup>11</sup> which has operated under a temporary registration since that time.

The temporary registrations granted to MBSCC and GSCC exempted them from certain requirements imposed by Section 17A of the Act.<sup>12</sup> Specifically, both MBSCC and GSCC were exempted from compliance with the Act's fair representation requirement,<sup>13</sup> and GSCC was further exempted from the Act's participation requirements.<sup>14</sup> The Commission has since determined that MBSCC and GSCC met the statutory requirements from which they were exempted and consequently lifted the exemptions.<sup>15</sup> As a result, FICC is

currently subject to all requirements of the Act applicable to registered clearing agencies, including the requirement to submit rule change proposals to the Commission for approval<sup>16</sup> and to make its records available for periodic, special, or other examinations by Commission staff.<sup>17</sup>

The Commission extended FICC's temporary registration on several occasions,<sup>18</sup> most recently on June 20, 2011.<sup>19</sup> At that time, the Commission explained that it would consider whether to grant FICC permanent registration after the Commission acted upon FICC's proposal to introduce central counterparty and guaranteed settlement services to FICC's Mortgage-Backed Securities Division ("FICC/MBSD"). The Commission approved FICC's request to provide central counterparty services at FICC/MBSD on March 9, 2012.<sup>20</sup> FICC's temporary registration expires on June 30, 2013.<sup>21</sup>

## III. Overview of FICC

FICC, a wholly owned subsidiary of the Depository Trust & Clearing Corporation ("DTCC"), is the sole clearing agency in the United States acting as a central counterparty and provider of significant clearance and settlement services for cash-settled U.S. Treasury and agency securities and the non-private label mortgage-backed securities markets.<sup>22</sup> FICC is comprised

GSCC's exemption from the Act's fair representation requirements).

<sup>16</sup> See 15 U.S.C. 78s(b)(1).

<sup>17</sup> See 15 U.S.C. 78q(b); see also Section 807 of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (mandating that supervisory agencies examine financial market utilities at least once each year) and n.26, *infra* (noting that FICC has been designated a financial market utility).

<sup>18</sup> See Securities Exchange Act Release No. 48116 (July 1, 2003), 68 FR 41031 (July 9, 2003) (File No. 600-23); Securities Exchange Act Release No. 49940 (June 29, 2004), 69 FR 40695 (July 5, 2004) (File No. 600-23); Securities Exchange Act Release No. 51911 (June 23, 2005), 70 FR 37878 (June 30, 2005) (File No. 600-23); Securities Exchange Act Release No. 54056 (June 28, 2006), 71 FR 38193 (July 5, 2006) (File No. 600-23); Securities Exchange Act Release No. 55920 (June 18, 2007), 72 FR 35270 (June 27, 2007) (File No. 600-23); and Securities Exchange Act Release No. 57949 (June 11, 2008), 73 FR 34808 (June 18, 2008) (File No. 600-23).

<sup>19</sup> See Securities Exchange Act Release No. 64707 (June 20, 2011), 76 FR 37165 (June 24, 2011) (File No. 600-23).

<sup>20</sup> See Securities Exchange Act Release No. 66550 (March 9, 2012), 77 FR 15155 (March 14, 2012) (File No. 600-23).

<sup>21</sup> See Securities Exchange Act Release No. 64707 (June 20, 2011), 76 FR 37165 (June 24, 2011) (File No. 600-23).

<sup>22</sup> See Financial Stability Oversight Council, 2012 Annual Report, Appendix A, p.167, available at <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>. In the absence of FICC, trades in the U.S. government securities market and the mortgage-backed

<sup>5</sup> See Securities Exchange Act Release No. 23929 (December 23, 1986), 52 FR 373-01 (January 5, 1987) (File No. 600-22).

<sup>6</sup> See Securities Exchange Act Release No. 24046 (February 2, 1987), 52 FR 4218-01 (February 10, 1987) (File No. 600-22).

<sup>7</sup> See Securities Exchange Act Release No. 25957 (August 2, 1988), 53 FR 29537-01 (August 2, 1988) (File No. 600-19); Securities Exchange Act Release No. 27079 (July 31, 1989), 54 FR 32412-01 (August 7, 1989) (File No. 600-22); Securities Exchange Act Release No. 28492 (September 28, 1990), 55 FR 41148-03 (October 9, 1990) (File No. 600-19); Securities Exchange Act Release No. 29751 (September 27, 1991), 56 FR 50602-01 (October 7, 1991) (File Nos. 600-19 and 600-22); Securities Exchange Act Release No. 31750 (January 21, 1993), 58 FR 6424-02 (January 28, 1993) (File Nos. 600-19 and 600-22) (noting that, "[d]ue to an inadvertent administrative error by MBSCC," MBSCC failed to request an extension of its temporary registration prior to the expiration of its last extension on September 30, 1992); Securities Exchange Act Release No. 33348 (December 15, 1993), 58 FR 68183-01 (December 23, 1993) (File Nos. 600-19 and 600-22); Securities Exchange Act Release No. 35132 (December 21, 1994), 59 FR 67743-01 (December 30, 1994) (File Nos. 600-19 and 600-22); Securities Exchange Act Release No. 37372 (June 26, 1996), 61 FR 35281-02 (July 5, 1996) (File No. 600-22); Securities Exchange Act Release No. 38784 (June 27, 1997), 62 FR 36587-01 (July 8, 1997) (File No. 600-22); Securities Exchange Act Release No. 39776 (March 20, 1998), 63 FR 14740-02 (March 26, 1998) (File No. 600-22); Securities Exchange Act Release No. 42568 (March 23, 2000), 65 FR 16980-01 (March 30, 2000) (File No. 600-22); Securities Exchange Act Release No. 44089 (March 21, 2001), 66 FR 16961-02 (March 28, 2001) (File No. 600-22); Securities Exchange Act Release No. 44831 (September 21, 2001), 66 FR 49728-01 (September 28, 2001) (File No. 600-22); Securities Exchange Act Release No. 45607 (March 20, 2002), 67 FR 14755-01 (March 27, 2002) (File No. 600-22); Securities Exchange Act Release No. 46136 (June 27, 2002), 67 FR 44655-01 (July 3, 2002) (File No. 600-22).

<sup>8</sup> See Securities Exchange Act Release No. 25129 (November 16, 1987), 52 FR 44659-01 (November 20, 1987) (File No. 600-23).

<sup>9</sup> See Securities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19839-01 (May 31, 1988) (File No. 600-23).

<sup>10</sup> See Securities Exchange Act Release No. 29236 (May 24, 1991), 56 FR 24852 (May 31, 1991) (File No. 600-23); Securities Exchange Act Release No.

32385 (June 3, 1993), 58 FR 32405 (June 9, 1993) (File No. 600-23); Securities Exchange Act Release No. 35787 (May 31, 1995), 60 FR 30324 (June 8, 1995) (File No. 600-23); Securities Exchange Act Release No. 36508 (November 27, 1995), 60 FR 61719 (December 1, 1995) (File No. 600-23); Securities Exchange Act Release No. 37983 (November 25, 1996), 61 FR 64183 (December 3, 1996) (File No. 600-23); Securities Exchange Act Release No. 38698 (May 30, 1997), 62 FR 30911 (June 5, 1997) (File No. 600-23); Securities Exchange Act Release No. 39696 (February 24, 1998), 63 FR 10253 (March 2, 1998) (File No. 600-23); Securities Exchange Act Release No. 41104 (February 24, 1999), 64 FR 10510 (March 4, 1999) (File No. 600-23); Securities Exchange Act Release No. 41805 (August 27, 1999), 64 FR 48682 (September 7, 1999) (File No. 600-23); Securities Exchange Act Release No. 42335 (January 12, 2000), 65 FR 3509 (January 21, 2000) (File No. 600-23); Securities Exchange Act Release No. 43089 (July 28, 2000), 65 FR 48032 (August 4, 2000) (File No. 600-23); Securities Exchange Act Release No. 43900 (January 29, 2001), 66 FR 8988 (February 5, 2001) (File No. 600-23); Securities Exchange Act Release No. 44553 (July 13, 2001), 66 FR 37714 (July 19, 2001) (File No. 600-23); Securities Exchange Act Release No. 45164 (December 18, 2001), 66 FR 66957 (December 27, 2001) (File No. 600-23); and Securities Exchange Act Release No. 46135 (June 27, 2002), 67 FR 44655 (July 3, 2002) (File No. 600-23).

<sup>11</sup> See Securities Exchange Act Release No. 47015 (December 17, 2002), 67 FR 78531 (December 24, 2002) (SR-GSCC-2002-07 and SR-MBSCC-2002-01).

<sup>12</sup> Pursuant to Rule 17Ab2-1(c)(1), the Commission may grant registration to a clearing agency while exempting it from one or more of the requirements of paragraphs (A) through (I) of section 17A(b)(3) of the Act. See 17 CFR 240.17Ab2-1(c)(1).

<sup>13</sup> See Securities Exchange Act Release No. 24046 (February 2, 1987), 52 FR 4218-01 (February 10, 1987) (File No. 600-22); Securities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19839-01 (May 31, 1988) (File No. 600-23).

<sup>14</sup> See Securities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19839-01 (May 31, 1988) (File No. 600-23).

<sup>15</sup> See Securities Exchange Act Release No. 26729 (April 14, 1989), 54 FR 16438-G-01 (April 24, 1989) (SR-MBSS-89-2) (lifting MBSCC's exemption from the Act's fair representation requirements); Securities Exchange Act Release No. 36508 (November 27, 1995), 60 FR 61719-02 (December 1, 1995) (File No. 600-23) (lifting GSCC's exemption from the Act's participation requirements); Securities Exchange Act Release No. 39372 (November 28, 1997), 62 FR 64415 (December 5, 1997) (SR-GSCC-97-01) (lifting

of two divisions, the Government Securities Division (“FICC/GSD”) and FICC/MBSD (collectively, the “Divisions”), each of which has its own membership and rules.<sup>23</sup> The rules are similar in most aspects and differ primarily where the clearance and settlement of specific products requires distinctions.<sup>24</sup> In 2011, the FICC/GSD and FICC/MBSD cleared transactions valued at \$1.1 quadrillion on a gross basis and \$64.8 trillion on a gross basis, respectively.<sup>25</sup> On July 18, 2012, the Financial Stability Oversight Council (“FSOC”) designated FICC systemically important under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).<sup>26</sup>

As the sole central counterparty in the United States for cash-settled U.S. government and agency securities, FICC/GSD provides clearing, netting, settlement, risk management, and a guarantee of trade completion for the following securities: (i) U.S. Treasury bills, notes, bonds, Treasury inflation-protected securities (TIPS), and Separate Trading of Registered Interest and Principal Securities (STRIPS), and (ii) Federal agency notes, bonds and zero-coupon securities that are book-entry, Fedwire eligible, and non-mortgage backed. FICC/GSD accepts buy-sell transactions, repurchase and reverse repurchase agreement transactions, and Treasury auction purchases in several types of U.S. Government securities.

As the sole central counterparty in the United States for the non-private label mortgage-backed securities market, FICC/MBSD provides clearing, netting, settlement, risk management, pool notification, and a guarantee of trade completion for pass-through mortgage-backed securities issued by the Government National Mortgage Association (“Ginnie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”), and the Federal National Mortgage Association (“Fannie Mae”).

securities market would have to settle bilaterally. See *id.* at 171.

<sup>23</sup> FICC/GSD currently has 113 members, 104 of which are full-service members. FICC/MBSD currently has 143 members.

<sup>24</sup> See Securities Exchange Act Release No. 66550 (March, 9, 2012), 77 FR 15155–01, 15162 (March 14, 2012) (SR–FICC–2008–01) (noting that FICC/MBSD’s rules were “revised to harmonize them with similar provisions in the current [FICC/GSD] rules, and in some cases updated to reflect the MBSD market”).

<sup>25</sup> See Financial Stability Oversight Council, 2012 Annual Report, Appendix A, p.168, available at <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

<sup>26</sup> See Financial Stability Oversight Council, 2012 Annual Report, at p.110 and Appendix A, p.167, available at <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

## IV. Discussion

### A. Statutory Requirements

Section 17A of the Act directs the Commission—having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and the maintenance of fair competition—to use its authority to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions.<sup>27</sup> The registration and continued oversight of clearing agencies represent key elements in promoting these statutory objectives. Accordingly, Section 17A of the Act requires a clearing agency, as defined in Section 3(a)(23) of the Act, to register with the Commission.<sup>28</sup> Before granting registration to a clearing agency, Section 17A(b)(3) of the Act requires that the Commission make a number of determinations with respect to the clearing agency’s organization, capacity, and rules.<sup>29</sup> Section 17A(b)(3)(A) of the Act requires a clearing agency, among other things, to be “so organized and [have] the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions for which it is responsible, to safeguard securities and funds in its custody or control or for which it is responsible, [and] to comply with the provisions of [the Act] and the rules and regulations thereunder.”<sup>30</sup> An

<sup>27</sup> 15 U.S.C. 78q–1.

<sup>28</sup> The term “clearing agency” is defined, in pertinent part, as “any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities.” 15 U.S.C. 78c(a)(23)(A).

<sup>29</sup> 15 U.S.C. 78q–1(b)(3). See also Section 19 of the Act, 15 U.S.C. 78s, and Rule 19b–4 thereunder, 17 CFR 240.19b–4, setting forth procedural requirements for registration and continuing Commission oversight of clearing agencies, and Section 17(a) of the Act, 15 U.S.C. 78q, setting forth certain recordkeeping and record retention requirements for clearing agencies.

<sup>30</sup> 15 U.S.C. 78q–1(b)(3)(A). The Commission has recently adopted standards for registered clearing agencies that establish minimum requirements regarding how registered clearing agencies must maintain effective risk management procedures and controls, as well as meet the statutory requirements under the Act on an ongoing basis. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (File No. S7–08–11) (“Clearing Agency Standards”). As the Commission noted in the Clearing Agency Standards Release, the standards were modeled on standards developed by the International Organization of Securities Commissions (“IOSCO”) and the Committee on Payment and Settlement Systems (“CPSS”) in the Recommendations for Securities Settlement Systems (2001) (“RSSS”) and Recommendations for Central Counterparties (2004)

approval of clearing agency registration does not mean that no further modifications of the applicant’s rules, systems, procedures, or practices are needed.<sup>31</sup>

In 1980, the Commission published a statement of the views and positions that the Division of Trading and Markets<sup>32</sup> (“Standards Release”) <sup>33</sup> would apply in evaluating applications for clearing agency registration. The Standards Release provides information concerning the Division’s interpretation of the requirements for clearing agency registration set forth in subparagraphs (A) through (I) of Section 17A(b)(3),<sup>34</sup> illustrates specific objectives that a clearing agency’s rules, procedures, and systems should achieve to be granted registration, and discusses the Division’s views on the national system for clearance and settlement.<sup>35</sup>

(“RCCP”) (collectively, “CPSS–IOSCO Recommendations”). See *id.* at 66222–23. Independent assessors from the International Monetary Fund (“IMF”) evaluated FICC/GSD against the standards outlined in the CPSS–IOSCO Recommendations and determined that FICC/GSD observed or broadly observed the CPSS–IOSCO Recommendations. Since that time, FICC/MBSD updated its rules generally to mirror the rules of FICC/GSD. See Securities Exchange Act Release No. 66550 (March, 9, 2012), 77 FR 15155–01, 15162 (March 14, 2012) (SR–FICC–2008–01) (noting that FICC/MBSD’s rules were “revised to harmonize them with similar provisions in the current GSD rules, and in some cases updated to reflect the [FICC/MBSD] market”). Furthermore, FICC has performed a self-assessment of the clearing agency’s rules, policies, and procedures against the Clearing Agency Standards. While the Commission believes that FICC’s practices are largely consistent with the Clearing Agency Standards, it will evaluate FICC’s continued compliance with the Act, the Clearing Agency Standards, and other applicable rules under the Act on an ongoing basis.

<sup>31</sup> See Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167–02, 45171 (October 3, 1983) (File No. 600–1 *et al.*) (order approving full registration of nine clearing agencies). In approving these registrations, the Commission noted that it “does not intend this [order approving applications for registration] to suggest that no further modifications of the subject clearing agencies’ rules, systems, procedures, and practices are needed now or in the future. Indeed, the findings made in this Order are intended to supplement the Commission’s . . . continuing authority under the Act to regulate evolving clearing systems. The Commission will continue to use its oversight, inspection, and enforcement authority as necessary and appropriate to further the purposes of the Act, and, as necessary, will use its rulemaking authority . . . to ensure continued development of the National System [for the clearance and settlement of securities transactions].” *Id.*

<sup>32</sup> In 1980, the Division of Trading and Markets was named the Division of Market Regulation.

<sup>33</sup> See Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (June 23, 1980).

<sup>34</sup> 15 U.S.C. 78q–1(b)(3)(A) through (I).

<sup>35</sup> The Commission notes that the standards reflected in the Standards Release were developed in the context registering ten clearing agencies engaged primarily in clearing domestic corporate debt and equity securities and, to a lesser extent,

Continued

## B. Membership Standards

### 1. Statutory Requirements

Section 17A(b)(3)(B) of the Act enumerates the following categories of persons that a clearing agency's rules must make eligible for membership: Registered brokers or dealers, registered clearing agencies, registered investment companies, banks, and insurance companies. While the Act requires that these entities must be eligible for membership, clearing agencies are permitted to establish additional admission criteria.<sup>36</sup>

Section 17A(b)(4)(B) of the Act contemplates that a registered clearing agency will have financial responsibility, operational capability, experience, and competency standards that are used to accept, deny, or condition participation of any member or any category of members enumerated in Section 17A(b)(3)(B), but it also provides that these criteria may not be used to unfairly discriminate among applicants.<sup>37</sup> The rules of the clearing agency must not be designed to permit unfair discrimination in the admission of members or among members in the use of the clearing agency, nor impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.<sup>38</sup>

### 2. FICC Compliance With Membership Requirements

FICC/GSD has established each of the membership categories required by Section 17A, and also offers membership to certain other types of entities.<sup>39</sup> FICC/GSD divides its members into four types depending upon the level of services offered: (i) Comparison-only members; (ii) netting members; (iii) sponsored members and their sponsors; and (iv) funds-only settling bank members. FICC/MBSD has also established each of the membership categories required by Section 17A, and also offers membership to certain other

municipal securities. The Commission recognizes that some of these standards may not be appropriate for clearing agencies that provide services for other investment products, such as mortgage-backed securities. Accordingly, the Commission intends to apply the standards flexibly and on a case-by-case basis.

<sup>36</sup> 15 U.S.C. 78q-1(b)(3)(B). The Act uses the term "participant," rather than "member," but as FICC's rules refer to its users as members rather than participants, this Order will use the term "member" for the sake of clarity. *See also* 15 U.S.C. 78c(3)(a)(24) ("The term 'participant' when used with respect to a clearing agency means any person who uses a clearing agency to clear or settle securities transactions or to transfer, pledge, lend, or hypothecate securities.").

<sup>37</sup> 15 U.S.C. 78q-1(b)(4)(B) and (b)(3)(F).

<sup>38</sup> 15 U.S.C. 78q-1(b)(3)(F) and (I).

<sup>39</sup> *See* GSD Rulebook, Rule 2(b).

types of entities.<sup>40</sup> FICC/MBSD offers two principal categories of membership: one for clearing members, and one for cash-settling bank members.<sup>41</sup>

FICC has established requirements for applicants' financial resources, operational capacity, creditworthiness, and business experience. The financial requirements vary depending upon the nature of the applicant's business, the types of clearing services the applicant uses, and the accounting principles the applicant follows in preparing its audited financial statements.<sup>42</sup> FICC's financial standards require, among other things, that applicants have sufficient resources to make any required clearing fund contributions, to pay cash settlement amounts, to meet any applicable regulatory capital requirements, and to satisfy all obligations to FICC.<sup>43</sup> FICC ensures members' creditworthiness by retaining the authority to deny membership to entities that, among other things, are subject to statutory disqualification under Section 3(a)(39) of the Act,<sup>44</sup> have violated the anti-fraud provisions of federal securities laws, or have been convicted of a criminal offense.<sup>45</sup> FICC's operational criteria require applicants to have adequate personnel, physical facilities, books and records, accounting systems, and internal procedures to process transactions promptly and accurately, to communicate with FICC, and to conform to any conditions imposed by FICC.<sup>46</sup> FICC's business experience criteria require certain applicants to have a profitable business history of at least six months, or personnel with sufficient operational background and experience to ensure the firm's ability to conduct business.<sup>47</sup>

FICC routinely monitors its members to ensure they adhere to FICC's membership requirements on an

ongoing basis. In this regard, FICC requires members to provide it with interim and annual financial statements and, periodically, certain regulatory reports (e.g., the FOCUS reports broker-dealers must file with the Financial Industry Regulatory Authority).<sup>48</sup> FICC can require members to undergo periodic operational testing, and members must promptly notify FICC if they cease to satisfy any of FICC's membership requirements.<sup>49</sup> FICC also assigns its bank and broker-dealer members a rating based on their financial stability, and this rating can affect both the level of financial scrutiny these members receive and the members' clearing fund requirement.<sup>50</sup>

FICC has the authority to take action with respect to members that fail to maintain FICC's membership standards. A member that no longer satisfies FICC's membership requirements is subject to enhanced monitoring, increased clearing fund requirements, limitations on its access to FICC's services, and possible loss of membership privileges.<sup>51</sup>

### 3. Commission Findings on FICC's Compliance With Membership Standards

At the time of GSCC's initial temporary registration, the Commission granted GSCC exemptions from compliance with the participation standards of Section 17A(b)(3)(B) and 17A(b)(4)(B) because the Commission determined that GSCC rules did not provide for all the statutory categories of membership required under the Act or the financial standards for membership as contemplated by the Act.<sup>52</sup> Since the Commission's original order granting temporary registration, the Commission has approved a number of rule filings that amended GSCC's membership categories and membership requirements.<sup>53</sup> The Division

<sup>40</sup> *See* MBSD Rulebook, Rule 2A.

<sup>41</sup> *See* MBSD Rulebook, Rule 2(b).

<sup>42</sup> For example, a FICC/GSD member that is a broker-dealer member registered under Section 15 of the Act whose financial statements are prepared in accordance with U.S. GAAP must have at least \$25 million in net worth and at least \$10 million in excess net capital. *See* GSD Rulebook, Rule 2A, Section 4(b)(ii)(A)(1) and (2). Similarly, a FICC/MBSD member that is a broker-dealer registered under Section 15 of the Act whose financial statements are prepared in accordance with U.S. GAAP must have at least \$25 million in net worth and at least \$10 million in excess net capital. *See* MBSD Rulebook, Rule 2A, Section 2(e)(ii)(A)(1) and (2).

<sup>43</sup> *See* GSD Rulebook, Rule 2A, Sections 3 and 4; MBSD Rulebook, Rule 2A, Section 2.

<sup>44</sup> 15 U.S.C. 78c(a)(39).

<sup>45</sup> *See* GSD Rulebook, Rule 2A, Sections 3 and 4(a); MBSD Rulebook, Rule 2A, Section 2.

<sup>46</sup> *See* GSD Rulebook, Rule 2A, Section 3; MBSD Rulebook, Rule 2A, Section 2.

<sup>47</sup> *See* GSD Rulebook, Rule 2A, Section 4(c); MBSD Rulebook, Rule 2A, Section 2(f).

<sup>48</sup> *See* GSD Rulebook, Rule 3, Section 2; MBSD Rulebook, Rule 3, Section 2.

<sup>49</sup> *See* GSD Rulebook, Rule 3, Sections 6 and 7; MBSD Rulebook, Rule 3, Sections 5 and 6.

<sup>50</sup> *See* GSD Rulebook, Rule 3; MBSD Rulebook, Rule 3.

<sup>51</sup> *See* GSD Rulebook Rule 3; MBSD Rulebook, Rule 3.

<sup>52</sup> *See* Securities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19839-01 (May 31, 1988) (File No. 600-23) (granting GSCC a temporary registration and exempting it from the Act's fair representation and participation requirements).

<sup>53</sup> *See* Securities Exchange Act Release Nos. 32722 (August 5, 1993), 58 FR 42993 (August 12, 1993) (SR-GSCC-93-01) (order approving establishment of new categories of netting system membership of Category 2 dealers and inter-dealer brokers, issuers of government securities, insurance companies, registered clearing agencies, and registered investment companies) and 34935 (November 3, 1994), 59 FR 56100 (November 10, 1994) (SR-GSCC-94-04) (order approving

thoroughly reviewed FICC's membership eligibility criteria and membership requirements when GSCC and MBSCC merged and determined that FICC's participation standards were consistent with the requirements under the Act.<sup>54</sup> FICC/MBSD updated its membership standards in 2012 to generally mirror the FICC/GSD standards.<sup>55</sup>

FICC's current rules provide for membership for those entities enumerated in the statute and provide for robust financial and operational competency standards. By clearly denoting ongoing compliance obligations and setting forth the consequences for failing to meet those obligations, FICC's rules are designed to sufficiently protect the clearing agency from risk associated with not meeting those competency standards. In addition, FICC's rules are not designed to permit unfair discrimination in the admission of members or among members in the use of the clearing agency, nor do they impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Therefore, the Commission reaffirms its 2002 and 2012 findings and finds that FICC's membership standards are in compliance with the Act.

### C. Fair Representation

#### 1. Statutory Requirements

Section 17A(b)(3)(C) of the Act requires that the rules of a clearing agency assure fair representation of the clearing agency's members in the selection of the clearing agency's directors and in the administration of the clearing agency's affairs.<sup>56</sup> The Standards Release interprets this section to require that a clearing agency's rules: (i) Provide members with a meaningful opportunity to be represented in the selection of the clearing agency's directors and the administration of its affairs; and (ii) provide members with sufficient information concerning the clearing agency's affairs to ensure meaningful participation.<sup>57</sup> In particular, clearing agencies should furnish members with audited annual

financial statements, an annual report on internal accounting controls prepared by an independent public accountant, and notice of any proposed rule changes.<sup>58</sup>

#### 2. FICC's Compliance With the Fair Representation Requirement

With respect to the selection of directors and the administration of the affairs of FICC, individuals elected to the DTCC Board of Directors are also elected to and constitute the Board of Directors of FICC (collectively, "Board"). The Board consists of between fifteen and twenty-five directors, as determined by the Board periodically.<sup>59</sup> A majority of the Board must be composed of member representatives.<sup>60</sup> DTCC currently maintains eight Board Committees, with at least one director serving on each Committee.<sup>61</sup> Collectively, these eight committees advise DTCC's Board on matters including, but not limited to, clearing agency operations, membership, credit, and risk. Finally, members that make full use of FICC's services are required to purchase DTCC common shares in proportion to their relative use of FICC's services.<sup>62</sup> Holders of DTCC common shares elect all but two of the Directors of DTCC.<sup>63</sup>

FICC's rules require FICC/GSD and FICC/MBSD to provide members with copies of audited annual financial statements and an annual report on

internal accounting controls.<sup>64</sup> FICC rules also require FICC to provide prompt notice of any proposals to change, revise, add or repeal any rule, along with the text or a brief description of the proposed rule and its purpose and effect.<sup>65</sup> Members also have the right to submit to FICC comments on the proposal, and FICC will file such comments with the Commission and retain them with FICC's records.

#### 3. Commission Findings Regarding FICC's Compliance With the Fair Representation Requirements

In approving the merger of GSCC and MBSCC in 2002, the Commission determined that FICC satisfied the fair representation requirements of Section 17A of the Act by (i) continuing to give the members the right to purchase shares of DTCC common stock on a basis that reflects their usage of FICC's services;<sup>66</sup> (ii) continuing to allow members of FICC to take part in the selection of individuals to the Board; and (iii) using the committee structure to ensure that FICC members will have a voice in the operations and affairs of the divisions.<sup>67</sup> Accordingly, the Commission reaffirms its conclusion that FICC's rules provide members with a meaningful opportunity to select Board directors and to participate in the administration of the affairs of the clearing agency. The Commission also finds that FICC provides members with the information necessary to make informed decisions regarding these matters.

<sup>58</sup> *Id.*

<sup>59</sup> Currently, the Board is composed of nineteen directors. Twelve directors represent clearing agency members, three directors are independent representatives of non-members, two directors represent DTCC management, and two directors are designated by DTCC's preferred shareholders. For more information, see <http://www.dtcc.com/about/governance/board.php>.

<sup>60</sup> See The Board of Directors of the Depository Trust and Clearing Corporation Mission Statement and Charter, available at [http://www.dtcc.com/legal/compliance/governance/DTCC\\_BOD\\_Mission\\_and\\_Charter.pdf](http://www.dtcc.com/legal/compliance/governance/DTCC_BOD_Mission_and_Charter.pdf).

<sup>61</sup> The eight Board Committees are: Governance, Executive, Audit, Business and Products, Operations and Technology, Compensation and Human Resources, Risk, and Finance and Capital.

<sup>62</sup> DTCC common stock is reallocated at least once every three years based on members' usage of services of the DTCC clearing agencies. See *DTCC Common Stock Reallocation*, DTCC Important Notice, May 11, 2012, available at [http://www.dtcc.com/downloads/legal/imp\\_notices/2012/ficc/gov/GOV050.12.pdf](http://www.dtcc.com/downloads/legal/imp_notices/2012/ficc/gov/GOV050.12.pdf); see also The Depository Trust & Clearing Corporation Third Amended and Restated Shareholders Agreement, art. 2, Section 2.01(a). Members of one DTCC entity that use the services of other DTCC entities are entitled to purchase additional shares based on their use of those services.

<sup>63</sup> The other two directors are appointed by DTCC's preferred shareholders, NYSE-Euronext and the Financial Industry Regulatory Authority ("FINRA"), each of which hold 10,000 DTCC preferred shares.

<sup>64</sup> See GSD Rulebook, Rule 35; MBSD Rulebook, Rule 26. Although FICC/GSD's rule does not include a provision requiring it to provide members with an annual internal accounting controls report, both FICC/MBSD and FICC/GSD make the report available to members on DTCC's Web site within the requisite 60-day period after FICC receives the report. See Letter from Nikki Poulos, Managing Director and General Counsel, DTCC, to Joseph Kamnik, Assistant Director, Division of Trading and Markets, Securities and Exchange Commission (May 30, 2013), available at <http://www.sec.gov/rules/other/2013/dtcc-supplemental-letter-053013.pdf>. See also [www.dtcc.com/legal/internal/FICC\\_2012.pdf](http://www.dtcc.com/legal/internal/FICC_2012.pdf).

<sup>65</sup> See MBSD Rulebook, Rule 27; GSD Rulebook, Rule 36.

<sup>66</sup> Since 2005, members of DTC, NSCC, and FICC that make full use of the services of one or more of these clearing agencies have been required to purchase DTCC common shares based on their use of those clearing agencies in which they are members. For more information, see Securities Exchange Act Release No. 52922 (December 7, 2005), 70 FR 74070 (December 14, 2005) (SR-DTC-2005-16, SR-FICC-2005-19, and SR-NSCC-2005-14).

<sup>67</sup> See Securities Exchange Act Release No. 47015 (December 17, 2002), 67 FR 78531 (December 24, 2002) (SR-GSCC-2002-09 and SR-MBSCC-2002-01).

establishing new categories of netting system membership for futures commission merchants).

<sup>54</sup> See Securities Exchange Act Release No. 47015 (December 17, 2002), 67 FR 78531 (December 24, 2002) (SR-GSCC-2002-07 and SR-MBSCC-2002-01).

<sup>55</sup> See Securities Exchange Act Release No. 66550 (March 9, 2012), 77 FR 15155 (March 14, 2012) (File No. 600-23).

<sup>56</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>57</sup> See Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920, 41293-94 (June 23, 1980).

*D. Capacity To Enforce Rules and To Discipline Members in Accordance With Fair Procedures*

1. Statutory Requirements

Section 17A(b)(3)(A) of the Act provides that a clearing agency must be organized and have the capacity to enforce compliance by its members with the rules of the clearing agency.<sup>68</sup> Section 17A(b)(3)(G) requires that the rules of a clearing agency provide that its members shall be appropriately disciplined for violations of any provision of those rules by expulsion, suspension, a limitation of activities, functions, and operations, fine, censure, or any other fitting sanction.<sup>69</sup> Section 17A(b)(3)(H) requires that the rules of the clearing agency provide a fair procedure with respect to the disciplining of members, the denial of a request for membership, and the prohibition or limitation by the clearing agency of any person with respect to the services offered by the clearing agency.<sup>70</sup>

2. FICC's Capacity To Enforce Rules and To Discipline Members in Accordance With Fair Procedures

FICC rules require members to notify FICC if they fail to maintain the relevant standards and qualifications for admission to membership, including minimum capital standards, operations testing and related reporting requirements.<sup>71</sup> If a member (i) fails to maintain such relevant standards and qualifications, including but not limited to minimum capital standards, operations testing, or reporting requirements imposed pursuant to FICC rules, (ii) violates any rule of or agreement with FICC; (iii) fails to satisfy in a timely manner any obligations to FICC; or (iv) experiences a reportable event (*e.g.*, changes in control of a member or events having a substantial effect on a member's business or financial condition), FICC may undertake appropriate action to determine the member's continued eligibility for membership. Furthermore, at any time FICC deems it necessary or advisable in order to protect FICC, its members, creditors, or investors, to safeguard securities and funds in FICC's custody or control, or to promote the prompt and accurate clearance and settlement of securities transactions, FICC may undertake appropriate action

to determine the member's eligibility for membership.<sup>72</sup>

FICC rules also set forth the clearing agency's right to discipline members for violations of any rules or member agreements, and for any error, delay, or other conduct that either constitutes an abuse or misuse of FICC's procedures or is detrimental to the clearing agency.<sup>73</sup> In addition, FICC rules describe certain member actions that may cause FICC to restrict a member's access to services, including but not limited to failing to make certain payments, deliveries, or deposits pursuant to FICC rules, and provide the process by which FICC may wind down a member's activities in the clearing agency.<sup>74</sup> FICC may discipline a member by, as appropriate, terminating membership, ceasing to act on behalf of the member,<sup>75</sup> limiting a member's access to FICC's services, fining or censuring a member, or imposing any other fitting sanctions.<sup>76</sup> FICC must notify members of the type of disciplinary sanction being imposed, the reasons for the sanction, the effective date of the sanction, and the right to a hearing.<sup>77</sup>

The rules of FICC/GSD and FICC/MBSD specify the due process protections to which members are entitled. These rules permit members accused of violations to request a hearing and require FICC to establish a panel to conduct such hearings.<sup>78</sup> The hearing panel is required to advise the requesting member of its decision and the grounds upon which its decision is based. Disciplinary sanctions may be imposed only in accordance with FICC rules. While decisions of the panel are generally final, the Board retains the discretion to modify any sanction or reverse any decision of the panel that is adverse to a member.<sup>79</sup>

3. Commission Findings Regarding FICC's Capacity To Enforce Rules and To Discipline Members in Accordance With Fair Procedures

In approving GSCC's and MBSCC's initial request for registration, the Commission reviewed the clearing

agencies' ability to enforce their rules and reviewed the processes by which the clearing agencies imposed fines, expulsions, suspensions, limitation of or restrictions on activities, functions and operations, or other sanctions. In so doing, the Commission was satisfied that GSCC and MBSCC rules met statutory requirements to have the capacity to enforce their rules and fairly discipline their members.<sup>80</sup>

The Commission continues to find that FICC has procedures for enforcing rules and disciplining members that are consistent with the requirements of the Act. Specifically, the Commission finds that FICC's rules provide it with appropriate authority to discipline members for rules violations and to impose each of the sanctions enumerated in the Act. Moreover, the Commission finds that FICC has established procedures to ensure members accused of rules violations receive notice of the alleged violations, and are afforded an opportunity to contest the allegations, including by requesting a hearing at which the accused member may be represented by counsel. In the Commission's view, these procedural safeguards are consistent with the protections envisioned by the Act. The Commission therefore concludes that FICC's capacity to enforce its rules and discipline its members comports with Section 17A(b)(3)(A), (G) and (H).

*E. Safeguarding Securities and Funds*

1. Statutory Requirements

Sections 17A(b)(3)(A) and (F) of the Act<sup>81</sup> require that a clearing agency be organized and that its rules be designed both to promote the prompt and accurate clearance and settlement of securities transactions for which it is responsible and to safeguard securities and funds in its custody or control, or for which it is responsible. The clearing agency is permitted to use clearing fund resources in limited amounts on a temporary basis to meet unexpected and unusual requirements for funds.<sup>82</sup>

The Standards Release also enumerated certain requirements that should be met to comply with the Act, including that a clearing agency should: (i) Be organized in a manner that effectively establishes operational and audit controls while fostering director independence; (ii) have an audit

<sup>72</sup> See GSD Rulebook, Rule 3, Section 7; MBSD Rulebook, Rule 3, Section 6.

<sup>73</sup> See GSD Rulebook, Rule 48; MBSD Rulebook, Rule 38.

<sup>74</sup> See GSD Rulebook, Rule 21; MBSD Rulebook, Rule 14.

<sup>75</sup> See GSD Rulebook, Rules 22 and 22A; MBSD Rulebook, Rules 16 and 17.

<sup>76</sup> See GSD Rulebook, Rule 48; MBSD Rulebook, Rule 38.

<sup>77</sup> See GSD Rulebook, Rule 48; MBSD Rulebook, Rule 38.

<sup>78</sup> See GSD Rulebook, Rule 37; MBSD Rulebook, Rule 28.

<sup>79</sup> See GSD Rulebook, Rule 37; MBSD Rulebook, Rule 28.

<sup>80</sup> See Securities Exchange Act Release Nos. 24046 (February 2, 1987), 52 FR 4218-01 (February 10, 1987) (File No. 600-22) and 25740 (May 24, 1988), 53 FR 19839 (May 31, 1988) (File No. 600-23).

<sup>81</sup> 15 U.S.C. 78q-1(b)(3)(A) and (F).

<sup>82</sup> See Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920, 41929 (June 23, 1980).

<sup>68</sup> 15 U.S.C. 78q-1(b)(3)(A).

<sup>69</sup> 15 U.S.C. 78q-1(b)(3)(G).

<sup>70</sup> 15 U.S.C. 78q-1(b)(3)(H).

<sup>71</sup> See GSD Rulebook, Rule 3, Section 7; MBSD Rulebook, Rule 3, Section 6.

committee of its board of directors composed of non-management directors that would select, or participate in the selection of, the clearing agency's independent public accountant and that would review the nature and scope of the work to be performed by the independent public accountant and the results thereof with the independent public accountant; (iii) have an adequately and competently staffed internal audit department that reviews, monitors, and evaluates the clearing agency's system of internal accounting control; (iv) furnish annually to members audited financial statements and furnish quarterly to members on request unaudited financial statements; (v) furnish annually to members an opinion report prepared by its independent public accountant based on a study and evaluation of the clearing agency's system of internal accounting control for the period since the last such report; and (vi) have detailed plans to assure (1) the physical safeguarding of securities and funds, (2) the integrity of the automatic data processing system and (3) the recovery, under a variety of contingencies, from loss or destruction of securities, funds, or data.<sup>83</sup> The Commission provides a more detailed discussion of these requirements and FICC's compliance with each directly below.

## 2. FICC's Safeguarding Securities and Funds

### a. Clearing Fund

#### i. General

FICC maintains separate clearing funds for FICC/GSD and FICC/MBSD.<sup>84</sup> These clearing funds serve not only to provide readily accessible liquidity to facilitate timely settlement, but also to reduce costs that may be incurred in the

event a member becomes insolvent or fails to fulfill its contractual obligations to FICC. FICC calculates certain portions of each member's required clearing fund deposit twice daily<sup>85</sup> based upon the member's unsettled and pending transactions. In calculating members' clearing fund obligations, FICC employs a risk-based margining methodology that measures each Division's credit exposure to its members. Members are required to deposit cash and eligible securities into the appropriate clearing fund to cover these exposures.<sup>86</sup>

FICC calculates clearing fund requirements for cash-settled transactions at both FICC/GSD and FICC/MBSD assuming a three-day liquidation period in normal market conditions. The clearing fund requirement is calculated to provide FICC/GSD and FICC/MBSD with adequate clearing fund resources to withstand a default of the largest member 99 percent of the time in normal market conditions. FICC uses routine back and stress testing to monitor the sufficiency of clearing fund levels vis-à-vis the risk represented by the 99th percentile of expected possible losses from member portfolios and to monitor tail risk exposure that falls beyond the 99th percentile. FICC's stress tests include events from the last 10 years, as well as special stress events outside that period and hypothetical scenarios. FICC back-tests its clearing fund model on a monthly basis and has outside experts validate the model periodically.

FICC's methodology for calculating members' clearing fund requirements includes two principal components: (i) A Value at Risk ("VaR") charge, which is calculated using a historical simulation with full revaluation; and (ii) a risk-related charge, known as a "coverage charge."<sup>87</sup> The VaR component of the clearing fund addresses the risk presented by a member's unsettled positions. The coverage component seeks to address the VaR model's potential deficiencies through daily back-testing, and further serves to ensure that members' collateral

deposits are sufficient to satisfy their obligations 99 percent of the time in normal market conditions. FICC also has the authority under its rules to levy a "special charge" on individual members to account for market conditions, changes to a member's financial and operational capabilities, and other forms of risk, including credit, reputational and legal risk.<sup>88</sup>

#### ii. Investment of Clearing Fund Deposits

All securities and cash associated with FICC's settlement processes and clearing fund are held in FICC's accounts at its two clearing banks, the Bank of New York Mellon and JPMorgan Chase Bank. FICC generally invests its cash in securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States or in repurchase agreements related to securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States. FICC's investment policy also permits investments in certificates of deposit or deposits in FDIC-insured banks, but limited to the level of FDIC insurance protection, and with a time to maturity of not greater than one year. FICC's investment policy also permits it to earn money market rates in interest bearing accounts with creditworthy banks and other financial institutions deemed acceptable by FICC consistent with its investment policy.

The risk of loss of invested funds is minimized in a number of ways. Investments are placed with well-capitalized financial institutions acting as principal rather than as agent, and maturity is limited to the next business day. FICC vets its counterparties for creditworthiness. FICC ensures that its reverse repo investments are fully secured by requiring collateral to have a market value greater than or equal to 102% of the cash invested. A written confirmation of each security underlying the repo is also required to be provided by the custodian bank. In addition to these risk-minimizing measures, counterparty credit limits are established for each investment type.

#### iii. Loss Allocation

The rules of FICC/GSD and FICC/MBSD set out a loss allocation procedure, which is invoked if a defaulting member's clearing fund deposit is insufficient to cover losses incurred in the liquidation of the member's positions. If a member becomes insolvent, FICC would first use

<sup>83</sup> See Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920, 41925–29 (June 23, 1980).

<sup>84</sup> Although FICC has implemented a similar clearing fund methodology for both Divisions, some variations exist to account for the different products each Division clears. For example, to address its clearing of repurchase agreements via a general collateral fund ("GCF"), FICC/GSD's clearing fund calculation includes a GCF Premium Charge and a GCF Repo Event Premium. Moreover, FICC/GSD's clearing fund methodology includes adjustments to account for its cross-margining agreements with the Chicago Mercantile Exchange and New York Portfolio Clearing, LLC. FICC/MBSD's clearing fund formula differs in that it includes a margin requirement differential and a deterministic risk component that are absent from FICC/GSD's formula. Unlike FICC/GSD, FICC/MBSD collects clearing fund deposits once per day, and thus the margin requirement differential addresses the risk that a member may not satisfy the next day's margin requirements. The deterministic risk component captures the mark-to-market gains or losses of a member's portfolio, as well as any net cash items and adjustments.

<sup>85</sup> Only certain components of the clearing fund, such as the Value at Risk component, are calculated twice each day. Others, such as the coverage component, are calculated only once daily.

<sup>86</sup> Members' required clearing fund deposits must be made and maintained in cash, U.S. Treasury securities, securities issued by certain federal agencies, and mortgage-backed securities issued by federal agencies or entities sponsored by the federal government. FICC requires that at least 10% of a member's required deposit be maintained in cash, up to a required maximum of \$5 million.

<sup>87</sup> See GSD Rulebook, Rule 4; MBSD Rulebook, Rule 4.

<sup>88</sup> See GSD Rulebook, Rule 4; MBSD Rulebook, Rule 4.



that member's clearing fund to cover a loss incurred on the liquidation of the member's positions, along with any funds available from applicable collateral sharing arrangements between FICC and other clearing corporations.<sup>89</sup> If those resources are insufficient to cover the liquidation of all of the defaulting member's positions, FICC's loss allocation procedure would be used. Any such loss allocation would first be made against the retained earnings of FICC attributable to the Division of which the defaulter was a member, in the amount of up to 25% of the retained earnings or such higher amount as may be approved by the Board.

#### iv. Use of Clearing Fund Deposits

The rules of FICC/GSD and FICC/MBSD place limits on their ability to use clearing fund deposits and assets. Specifically, the Divisions may use the clearing fund only to satisfy FICC's losses or liabilities arising from the failure of a member to satisfy an obligation to FICC, the failure of a member that is party to one of FICC's cross-guaranty or cross-margin agreements to satisfy an obligation to a counterparty that is also party to those agreements, or from unexpected or unusual requirements for funds incident to FICC's clearance and settlement business, provided these requirements represent a small percentage of the clearing fund.<sup>90</sup> FICC may also use the clearing fund as a source of collateral both to meet temporary financing needs in connection with its own settlement obligations and those of its members, and to meet unusual or unexpected funding needs, provided that these

needs also represent a small percentage of the clearing fund.<sup>91</sup>

#### b. Operational Capacity

DTCC maintains perpetually active in-region and out-of-region data centers, each of which has sufficient capacity to process the entire production workload so that any data center can function as the sole site if one or more data centers experience an outage. Capacity plans are reviewed annually by DTCC's Infrastructure Department and the Board, and FICC performs a stress test annually to determine daily capacity. DTCC's Operations and Technology Committee oversees the operational and technology capabilities that support FICC's businesses, as well as management's operation and development of technology infrastructure capabilities, technology resources, processes, and controls necessary to fulfill service delivery requirements.<sup>92</sup> The Operations and Technology Committee also monitors key operational and technology metrics associated with the delivery of services, reviews financial performance related to technology and operations, and receives reports on various operational and technological programs.<sup>93</sup> The Operations and Technology Committee meets at least four times per year and reports to the Board regularly.<sup>94</sup> The Committee is required to perform an annual self-assessment of its performance and provide the results to the DTCC Board for review.<sup>95</sup>

#### c. Audit Committee and Internal Audit Department

DTCC's Audit Committee and internal audit department oversee audit matters for all DTCC entities, including FICC. The Audit Committee's primary responsibilities include supervising the preparation of financial reports, establishing and maintaining adequate internal controls, arranging and

supervising internal and external audits, and overseeing the management of legal, compliance, and regulatory risk. The Audit Committee is composed of not less than four members, none of whom are employed by DTCC, and at least one of whom is not affiliated with a member of DTCC. The Audit Committee meets at least four times per year and reports to the Board regularly on its activities, including an annual self-assessment of its performance. DTCC's internal audit department reports directly to DTCC's Audit Committee<sup>96</sup> and provides independent validation of FICC's risk and control environment, evaluates and remediates risk, and reviews the adequacy of FICC's internal controls, procedures, and records. DTCC commissions an independent review of its internal audit department at least once every five years and uses an internal quality assurance program to test its processes on a sample basis every year.<sup>97</sup> FICC also engages independent accountants to perform an annual study and evaluation of the internal controls relating to its operations.

#### d. Financial Report and Internal Accounting Control Report

FICC provides to members annual audited financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles to members within sixty days after the close of the fiscal year.<sup>98</sup> FICC also provides to members unaudited financial statements within thirty days following the close of FICC's fiscal quarter for each of the first three quarters of each calendar year and for FICC's fourth quarter of each calendar year, within sixty days following the close of FICC's fiscal year.<sup>99</sup> The

<sup>89</sup> FICC has entered into a multilateral netting contract and limited cross-guaranty agreement with the Depository Trust Company (DTC), National Securities Clearing Corporation (NSCC), and the Options Clearing Corporation, under which these clearing agencies have agreed to make payment to each other for any remaining unsatisfied obligations of a common defaulting member to the extent they have excess resources of the defaulting member. FICC/GSD has also established cross-margining arrangements with the Chicago Mercantile Exchange ("CME") and New York Portfolio Clearing, LLC ("NYPC") pursuant to which a FICC/GSD member that is also a clearing member of CME or NYPC may elect to have its clearing fund requirement in respect of eligible positions at FICC/GSD and its margin requirements in respect of eligible positions in its proprietary account at CME and NYPC calculated by taking into consideration the net risk of such eligible positions at both clearing organizations. Copies of FICC/GSD's cross-guaranty and cross-margining agreements are appended as Exhibit G to FICC's Amended Application for Registration, and are available on the Commission's Web site at the following address: <http://www.sec.gov/rules/sro/ficc.shtml>.

<sup>90</sup> See GSD Rulebook, Rule 4, Section 5; MBSD Rulebook, Rule 4, Section 5.

<sup>91</sup> See GSD Rulebook, Rule 4, Section 5; MBSD Rulebook, Rule 4, Section 5.

<sup>92</sup> See Exhibit C to FICC's Amended Form CA-1, filed on April 5, 2013, available at <http://www.sec.gov/rules/other/2013/ficc-clearing-agency-app-exhibit-a-thru-d.pdf>.

<sup>93</sup> See Exhibit C to FICC's Amended Form CA-1, filed on April 5, 2013, available at <http://www.sec.gov/rules/other/2013/ficc-clearing-agency-app-exhibit-a-thru-d.pdf>.

<sup>94</sup> See DTCC Operations and Technology Committee Charter of June 2012. This Charter appears as Exhibit A to FICC's Amended Form CA-1, filed on April 5, 2013, available at <http://www.sec.gov/rules/other/2013/ficc-clearing-agency-app-exhibit-a-thru-d.pdf>.

<sup>95</sup> See DTCC Operations and Technology Committee Charter of June 2012. This Charter appears as Exhibit A to FICC's Amended Form CA-1, filed on April 5, 2013, available at <http://www.sec.gov/rules/other/2013/ficc-clearing-agency-app-exhibit-a-thru-d.pdf>.

<sup>96</sup> See DTCC Audit Committee Charter of June 2012. The charter provides that the head of DTCC's internal audit department, the General Auditor, has the opportunity at least four times each year to meet with the Audit Committee in an executive session. The charter appears as Exhibit A to FICC's Amended Form CA-1, filed on April 5, 2013, available at <http://www.sec.gov/rules/other/2013/ficc-clearing-agency-app-exhibit-a-thru-d.pdf>.

<sup>97</sup> See *Mitigating Risk at DTCC: The Role of Internal Audit*, DTCC Corporate Newsletter (May 2011), available at [http://www.dtcc.com/news/newsletters/dtcc/2011/may/mitigating\\_risk.php](http://www.dtcc.com/news/newsletters/dtcc/2011/may/mitigating_risk.php).

<sup>98</sup> GSD Rulebook, Rule 35; MBSD Rulebook, Rule 26. See also Letter from Nikki M. Poulos, Managing Director and General Counsel, FICC, to Joseph Kamnik, Assistant Director, Division of Trading and Markets, Securities and Exchange Commission (May 30, 2013), available at <http://www.sec.gov/rules/other/2013/dtcc-supplemental-letter-053013.pdf>.

<sup>99</sup> GSD Rulebook, Rule 35; MBSD Rulebook, Rule 26. See also Letter from Nikki M. Poulos, Managing Director and General Counsel, FICC, to Joseph Kamnik, Assistant Director, Division of Trading and Markets, Securities and Exchange Commission (May 30, 2013), available at <http://www.sec.gov/rules/other/2013/dtcc-supplemental-letter-053013.pdf>.



financial statements include, among other things, the total balances of the clearing funds of FICC/GSD and FICC/MBSD, the balances of both clearing funds' cash and securities components, the types and amounts of investments made with the cash balance, the amount charged to the clearing fund during the year in excess of a member's contribution, if any, and any other charge to clearing fund during the year not directly related to a specific member's contribution.

FICC retains an independent public accountant to evaluate FICC's system of internal accounting control with respect to the safeguarding of members' assets, the clearance and settlement of securities transactions, and the reliability of FICC's records. The evaluation is conducted in accordance with standards established by the American Institute of Certified Public Accountants and is made available to all members within a reasonable time upon receipt from FICC's independent accountant.<sup>100</sup>

#### e. Securities, Funds, and Data Controls

DTCC has multiple data center locations, including in-region and out-of-region sites. In-region sites use synchronous data replication between them, maintaining multiple exact copies of all production data in separate locations. Production processing is spread across the in-region data centers. The out-of-region site contains additional asynchronously replicated copies of in-region production data.

All data centers have emergency monitoring and backup systems, backup generators, and redundant telecommunications from multiple carriers. All sites have sufficient capacity to process FICC's entire workload independently. To guarantee continuous operation from multiple sites, DTCC decentralized its information technology and key business operations staff among in-region and out-of-region sites.

DTCC's SMART (Securely Managed and Reliable Technology) Network provides connectivity between DTCC and its customers and trading platforms.<sup>101</sup> All critical clearance and

settlement transactions use SMART. Each element of SMART is engineered with multiple independent levels of redundancy, and is capable of handling DTCC's entire clearance and settlement workload independently.

#### 3. Commission Findings Regarding FICC's Compliance With the Safeguarding Securities and Funds Requirements

As discussed above, FICC maintains a clearing fund based on a formula applicable to all users with a requirement that the lesser of \$5,000,000 or 10 percent of the total required amount, with a minimum of \$100,000, must be made and maintained in cash.<sup>102</sup> The clearing fund is used solely to protect members and the clearing agency from member defaults and from clearing agency losses that do not result from day-to-day expenses, and cash contributions to the clearing fund may generally be invested only in securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States, or in repurchase agreements related to securities issued or guaranteed as to principal and interest by the United States or agencies and instrumentalities of the United States.<sup>103</sup>

DTCC has dedicated capacity planning staff and ensures that FICC has sufficient capacity to meet operational needs and adequate controls over the review of capacity plans and operational and technological capabilities of FICC. DTCC maintains an Audit Committee composed of non-management directors and an internal audit department that reports periodically to it. FICC provides financial reports and internal control reports to members on a timely basis, and DTCC has adequate controls around the prevention of a loss of securities, funds, or data and proper recovery mechanism in the event of a loss of securities, funds, or data. The Commission finds that FICC is adequately organized and that its rules are designed both to promote the prompt and accurate clearance and

settlement of securities transactions for which it is responsible and to safeguard securities and funds in its custody or control or for which it is responsible, as required by the Act.

#### F. Obligations to Members: Standard of Care

##### 1. Statutory Requirements

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>104</sup>

The Division has interpreted section 17A(b)(3)(F) to require a clearing agency to maintain a uniform standard of care in its obligations to members, and specifically that a clearing agency is responsible for delivering securities in its custody to, or as directed by, the members for whom such securities are held.<sup>105</sup>

##### 2. FICC's Standard of Care

FICC's standard of care states in pertinent part, that "[FICC] will not be liable for any action taken, or any delay or failure to take any action, hereunder or otherwise to fulfill [FICC's] obligation to its members, other than for losses caused directly by [FICC's] gross negligence, willful misconduct, or violation of Federal securities laws for which there is a private right of action," and that FICC will not be held liable for third party actions or omissions unless FICC was grossly negligent, engaged in willful misconduct, or in violation of Federal securities laws for which there is a private right of action against the third party.<sup>106</sup>

##### 3. Commission Findings on FICC's Standard of Care

The Commission has previously approved a standard of care for FICC's predecessors, MBSCC and GSCC, that limits their liability to direct losses caused by their gross negligence, willful misconduct, or violation of Federal securities laws for which there is a private right of action.<sup>107</sup> The Commission determined that such a standard was warranted given that neither MBSCC nor GSCC has custody

rules/other/2013/dtcc-supplemental-letter-053013.pdf. The financial statements are available on DTCC's Web site at: <http://www.dtcc.com/legal/financials/2012>.

<sup>100</sup> See MBSD Rulebook, Rule 26. See also Letter from Nikki M. Poulos, Managing Director and General Counsel, FICC, to Joseph Kamnik, Assistant Director, Division of Trading and Markets, Securities and Exchange Commission (May 30, 2013), available at <http://www.sec.gov/rules/other/2013/dtcc-supplemental-letter-053013.pdf>.

<sup>101</sup> SMART is an end-to-end, privately managed communications system encompassing a

geographically dispersed complex of processing centers, communications networks and control facilities. See generally Securities Exchange Act Release No. 52655 (October 24, 2005), 70 FR 62154 (October 28, 2005) (SR-FICC-2005-15) (relating to the imposition of fees for FICC members who fail to migrate their communications systems to the SMART system); see also *The Complete Guide to SMART*, March 2004, available at <http://www.dtcc.com/products/documentation/technology/technology.php>.

<sup>102</sup> See GSD Rulebook Rule 4, Section 2(b); MBSD Rulebook Rule 4, Section 2(d).

<sup>103</sup> See GSD Rulebook Rule 4, Section 5; MBSD Rulebook Rule 4, Section 5.

<sup>104</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>105</sup> See Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920, 41930 (June 23, 1980).

<sup>106</sup> See GSD Rulebook, Rule 39; MBSD Rulebook, Rule 30.

<sup>107</sup> Securities Exchange Act Release No. 48201 (July 21, 2003), 68 FR 44128-01 (July 25, 2003) (SR-GSCC-2002-10); Securities Exchange Act Release No. 49373 (March 8, 2004), 69 FR 11921-01 (March 12, 2004) (SR-MBSCC-2003-09).

of their members' funds or securities.<sup>108</sup> As both FICC/GSD and FICC/MBSD continue to perform only non-custodial functions, the Commission reaffirms its prior determination that their standards of care are consistent with the Act.

#### *G. Dues, Fees and Charges*

Sections 17A(b)(3)(D) and (E) of the Act require a clearing agency's rules to provide for the equitable allocation of reasonable dues, fees, and other charges among its members, and prohibit the rules of a clearing agency from imposing any schedule of prices, or fixing rates or other fees, for services rendered by its members.

The fees charged by FICC are generally usage-based and apply equally to all members using the relevant service. FICC does not impose any schedule of prices or fix rates or other fees for services rendered by its customers. Accordingly, the Commission is satisfied that the method by which FICC provides for the equitable allocation of reasonable dues, fees, and other charges among its members and its prohibitions regarding the fixing of prices of its members meet the Act's requirements.

#### *H. Examination Findings; Other Considerations*

FICC is currently subject to examination<sup>109</sup> by Commission staff, and may be required by Commission staff to make records available for examination by Commission staff,<sup>110</sup> including, but not limited to, in connection with FICC's activities pertaining to risk management, membership, and the safeguarding of securities and funds.<sup>111</sup> FICC also is subject to the requirement to file all proposed rule changes with the Commission for review,<sup>112</sup> including proposed changes that could materially affect the nature or level of risks presented by FICC.<sup>113</sup> Based upon such supervisory contacts, the Commission is not aware of any reason to believe the

approval of FICC's application for permanent registration as a clearing agency would not be consistent with the public interest.

#### **V. Conclusion**

The Commission concludes that FICC's rules, policies and procedures, as set forth in its application for permanent registration as a clearing agency, meet the requirements for such registration, including those standards set forth under Section 17A of the Act.

It is therefore *ordered* that the application for permanent registration as a clearing agency filed by FICC (File No. 600-23) pursuant to Sections 17A(b) and 19(a)(1) of the Act be, and hereby is, *approved*.

By the Commission.

**Kevin M. O'Neill,**  
*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-69836; File No. SR-NYSEMKT-2013-37]**

### **Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending its Listing Standard for Reverse Merger Companies**

June 24, 2013.

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (the "Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that, on June 11, 2013, NYSE MKT LLC (the "Exchange" or "NYSE MKT") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. 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 its listing standard for Reverse Merger Companies set forth in Section 101(e) of the Exchange's Company Guide to harmonize with requirements imposed by the Nasdaq Stock Market ("Nasdaq") and modify in one respect the

circumstances under which a reverse merger company may be eligible to list under the rule.

The text of the proposed rule 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 Statutory Basis for, the Proposed Rule Change*

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

NYSE MKT proposes to amend its listing standard for Reverse Merger Companies set forth in Section 101(e) of the Exchange's Company Guide to harmonize with requirements imposed by Nasdaq and modify in one respect the circumstances under which a Reverse Merger Company may be eligible to list under the rule.

Section 101(e) of the Company Guide defines a Reverse Merger Company and establishes initial listing standards for Reverse Merger Companies.<sup>4</sup> Among

<sup>4</sup> For purposes of Section 101(e), a "Reverse Merger Company" is a company formed by means of a "Reverse Mergers." A "Reverse Merger" is defined as any transaction whereby an operating company becomes an Exchange Act reporting company by combining directly or indirectly with a shell company which is an Exchange Act reporting company, whether through a reverse merger, exchange offer, or otherwise. However, a Reverse Merger does not include the acquisition of an operating company by a listed company which qualified for initial listing under Section 119. In determining whether a company is a shell company, the Exchange will consider, among other factors: whether the Company is considered a "shell company" as defined in Rule 12b-2 under the Exchange Act; what percentage of the company's assets are active versus passive; whether the company generates revenues, and if so, whether the revenues are passively or actively generated; whether the company's expenses are reasonably related to the revenues being generated; how many employees work in the company's revenue-generating business operations; how long the company has been without material business operations; and whether the company has publicly announced a plan to begin operating activities or generate revenues, including through a near-term acquisition or transaction.

<sup>108</sup> Securities Exchange Act Release No. 48201 (July 21, 2003), 68 FR 44128-01 (July 25, 2003) (SR-GSCC-2002-10); Securities Exchange Act Release No. 49373 (March 8, 2004), 69 FR 11921-01 (March 12, 2004) (SR-MBSCC-2003-09).

<sup>109</sup> 15 U.S.C. 78q(b); *see also* Section 807 of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (mandating that supervisory agencies examine financial market utilities at least once each year) and n.26, *supra* (noting that FICC has been designated a financial market utility).

<sup>110</sup> 15 U.S.C. 78q(a).

<sup>111</sup> *See supra* n.30 for some of the standards by which Commission staff measures FICC's activities.

<sup>112</sup> 15 U.S.C. 78s(b)(1).

<sup>113</sup> Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

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

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.