

Chapter 13

SROs, Marketplaces, Clearing Agencies and Trade Repositories

13.3 Clearing Agencies

13.3.1 Fixed Income Clearing Corporation – Application for Exemption from Recognition as a Clearing Agency – Notice and Request for Comment

NOTICE AND REQUEST FOR COMMENT

FIXED INCOME CLEARING CORPORATION

APPLICATION FOR EXEMPTION FROM RECOGNITION AS A CLEARING AGENCY

A. Background

Fixed Income Clearing Corporation (**FICC**) has applied to the Commission for an order pursuant to section 147 of the *Securities Act (Ontario)* (**OSA**) to exempt it from the requirement to be recognized as a clearing agency in subsection 21.2(0.1) of the OSA (the **Application**).

FICC is registered as a clearing agency with the U.S. Securities and Exchange Commission (**SEC**) pursuant to the provisions of Section 17A of the *Securities Exchange Act of 1934*, as amended (**Exchange Act**) and is subject to regulatory supervision by SEC. In addition, FICC is regulated in the U.S. as a systemically important financial market utility (**SIFMU**) and subject to the regulatory oversight of the Federal Reserve Bank of New York (**FRBNY**), under authority delegated by the Board of Governors of the Federal Reserve System. The Exchange Act, including the SEC's regulations and rules thereunder, in conjunction with any other U.S. rules applicable to a clearing agency and SIFMU, set out a framework for regulating and overseeing the clearing agency's organization, governance, membership, operations, systems, risk management procedures and controls, reporting and notifications.

FICC proposes to provide trade comparison, netting, risk management, settlement and central counterparty services for residents in Ontario with respect to the U.S. government securities market and the U.S. mortgage-backed securities market.

As FICC will be carrying on business in Ontario, they are required to be recognized as a clearing agency under the OSA or apply for an exemption from the recognition requirement. Among other factors set out in the Application, FICC is seeking an exemption from the recognition requirement on the basis that they are subject to a comparable regulatory regime in its home jurisdiction, the United States, by the SEC.

B. Application and Draft Exemption Order

In the Application, FICC describes its requirements under U.S. regulation that are generally comparable, or that achieve similar outcomes to the requirements of National Instrument 24-102 *Clearing Agency Requirements (NI 24-102)*. Subject to comments received, staff propose to recommend to the Commission that it grant FICC an exemption order in the form of the proposed draft order attached at Appendix A (**Draft Order**). This recommendation is based on the determination that FICC is not expected to pose significant risk to Ontario's capital markets and is subject to a comparable regulatory regime in its home jurisdiction by its home regulator.

In determining whether a clearing agency poses significant risk to Ontario, we consider the level of activity of the clearing agency in Ontario (using indicators such as notional value and volume of transactions cleared for Ontario residents) and other qualitative and quantitative factors, such as interconnectedness, size of obligations and the role and central importance of a clearing agency to a particular market.

The Draft Order requires FICC to comply with various terms and conditions set forth in Schedule "A" to the Draft Order, including relating to:

1. Regulation of FICC
2. Governance
3. Permitted scope of clearing activities in Ontario
4. Filing requirements
5. Information sharing

The Draft Order also acknowledges that the scope of, and the terms and conditions imposed by the Commission, or the determination whether it is appropriate that FICC continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets or FICC's activities or regulatory status, or as a result of any changes to the laws in the U.S. or Ontario affecting trading or clearing of securities.

C. Comment Process

The Commission is publishing for public comment the Application and Draft Order for 30 days. A copy of FICC's Application can be found on the Commission website at: http://www.osc.gov.on.ca/en/Marketplaces_clearing-agencies_index.htm

We are seeking comment on all aspects of the Application and Draft Order.

You are asked to provide your comments in writing, via e-mail and delivered on or before February 23, 2019 addressed to the attention of the:

Secretary of the Commission
Ontario Securities Commission
20 Queen Street West, Toronto,
Ontario, M5H 3S8
Fax: 416-593-2318
e-mail: comments@osc.gov.on.ca.

The confidentiality of submissions cannot be maintained as comments received during the comment period will be published.

Questions may be referred to:

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APPENDIX "A"

DRAFT ORDER

**IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, CHAPTER S.5, AS AMENDED
(THE OSA)**

AND

**IN THE MATTER OF
FIXED INCOME CLEARING CORPORATION**

**ORDER
(Section 147 of the OSA)**

WHEREAS Fixed Income Clearing Corporation (**FICC**) has filed an application (**Application**) with the Ontario Securities Commission (**Commission**) pursuant to section 147 of the OSA requesting an order exempting FICC from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA (**Order**);

AND WHEREAS FICC has represented to the Commission that:

- 1.1 FICC is a business corporation organized under New York law providing clearing, settlement, risk management, and central counterparty (**CCP**) services for certain fixed income securities in the United States. FICC was established in 2003 through a combination of government securities and mortgage-backed securities clearing organizations.
- 1.2 FICC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (**DTCC**). DTCC is a non-public holding company that owns a number of companies operating financial market infrastructures.
- 1.3 The common shares of DTCC (**Common Shares**) are held of record by approximately 290 participants of DTCC's clearing agency subsidiaries, including FICC. The Common Shares are allocated to participants in accordance with a formula based on their relative usage of the services of the clearing agencies. Of the participants that own Common Shares, currently (i) approximately 33% are banks holding approximately 18% of the issued and outstanding Common Shares, (ii) approximately 66% are broker-dealers holding approximately 80% of the issued and outstanding Common Shares, and (iii) approximately 1% are other financial institutions.
- 1.4 FICC operates clearing services through two divisions, the Government Securities Division (**GSD**) and the Mortgage-Backed Securities Division (**MBSD**) (collectively, the **Divisions**).
- 1.5 GSD offers a suite of services to support and facilitate the submission, comparison, risk management, netting and settlement of trades executed by its members in the U.S. government securities market. It acts as a CCP, guarantees the settlement of, and novates, netting-eligible trades at the time of comparison of such trades, and processes buy-sell transactions of U.S. government securities and repurchase agreement (**repo**) transactions. Other than GSD's comparison-only service, the use of GSD for a trade would include GSD's netting and settlement and risk management services.
- 1.6 GSD currently clears buy-sell and repo transactions in securities issued by the U.S. Department of Treasury (**U.S. Treasury**) (e.g., bills, bonds, notes, and U.S. Treasury Inflation-Protected Securities (**TIPS**); Segregated Trading Registered Interest and Principle Securities (**STRIPS**) etc.); and U.S. government agency bonds and notes. GSD also currently clears General Collateral Finance Repo (**GCF Repo**[®]) trades through its GCF Repo[®] service. GCF Repo[®] trades are executed in generic CUSIPs collateralized with eligible securities, including fixed- and adjustable-rate mortgage-backed securities issued or guaranteed by Government National Mortgage Association (**Ginnie Mae**), Federal National Mortgage Association (**Fannie Mae**) and the Federal Home Loan Mortgage Corporation (**Freddie Mac**).
- 1.7 MBSD clears to-be-announced (**TBA**) transactions and specified pool transactions in pass-through mortgage-backed securities issued or guaranteed by corporations owned by the U.S. government (currently Ginnie Mae) or U.S. government-sponsored enterprises (currently Fannie Mae and Freddie Mac). TBA transactions are trades for which the actual identities of and/or the number of pools underlying each trade are not agreed to at the time of trade execution. TBA transactions are comprised of (i) settlement balance order destined trades; (ii) trade-for-trade destined trades; (iii) stipulated trades; and (iv) TBA options trades. Specified pool transactions are trades for which all pool data is agreed upon by the members at the time of execution.

- 1.8 The U.S. Securities and Exchange Commission (**SEC**) granted FICC permanent registration as a clearing agency pursuant to the provisions of Section 17A of the *Securities Exchange Act of 1934*, as amended (**Exchange Act**) on June 24, 2013 (SEC Release No. 34-69838). FICC is principally subject to regulatory supervision by the SEC and it is regulated in the United States as a systemically important financial market utility. In addition, the Federal Reserve Bank of New York supervises FICC under authority delegated by the Board of Governors of the Federal Reserve System, including through prescription of risk management standards, and consultation on examinations by the SEC and notices of material change.
- 1.9 FICC's activities are structured in accordance with the laws of the State of New York and the United States. The principal laws comprising the legal framework under which FICC operates include: (i) the Exchange Act, particularly Sections 17A and 19; (ii) the New York Business Corporation Law; (iii) the New York Uniform Commercial Code, particularly Articles 8 and 9; (iv) the *Securities Act of 1933*, as amended (**Securities Act**); (v) the *Federal Deposit Insurance Act*, as amended; (vi) the U.S. Bankruptcy Code; (vii) the *Federal Deposit Insurance Corporation Improvement Act of 1991*, as amended; (viii) the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, particularly Title II, regarding orderly liquidation authority, and Title VIII, the *Payment, Clearing, and Settlement Supervision Act of 2010*; and (ix) the *Securities Investor Protection Act of 1970*, as amended.
- 1.10 As a registered clearing agency, FICC is subject to the requirements that are contained in the Exchange Act and in the SEC's regulations and rules thereunder. These requirements include Exchange Act Rule 17Ad-22(e) (**CCA Standards**), adopted by the SEC in 2016. As a covered clearing agency, FICC complies with the CCA Standards that establish minimum requirements regarding how covered clearing agencies must maintain effective risk management procedures and controls as well as meet the statutory requirements of the Exchange Act on an ongoing basis.
- 1.11 FICC is also subject to the requirements of Regulation Systems Compliance and Integrity (**Reg SCI**) promulgated under the Exchange Act. Reg SCI requires FICC to, among other things, establish, maintain and enforce written policies and procedures reasonably designed to ensure that FICC's systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets, and operate in a manner that complies with the Exchange Act.
- 1.12 Through compliance with SEC requirements for registered clearing agencies, FICC addresses relevant international principles applicable to financial market infrastructures described in the April 2012 report *Principles for financial market infrastructures* published by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions.
- 1.13 Membership in each of the Divisions is available to various categories of members (**Members**), which currently are as set out below:
- GSD membership categories include (i) Comparison-Only Members (who are only members of the comparison system); (ii) Netting Members (which includes Bank Netting Members, Dealer Netting Members, Inter-Dealer Broker Netting Members, Futures Commission Merchant Netting Members, Foreign Netting Members, Government Securities Issuer Netting Members, Insurance Company Netting Members, Registered Clearing Agency Netting Members and Registered Investment Company Netting Members); (iii) Sponsoring Members and Sponsored Members; (iv) CCIT Members; and (v) Funds-Only Settling Bank Members (Funds-Only Settling Bank Member are banks, trust companies, and other qualified entities that satisfy the requirements prescribed in GSD's rules).
- MBSD membership categories include: (i) Clearing Members (who may be a Bank Clearing Member, a Dealer Clearing Member, an Inter-Dealer Broker Clearing Member, an Unregistered Investment Pool Clearing Member, a Government Securities Issuer Clearing Member, an Insurance Company Clearing Member, a Registered Clearing Agency Member, an Insured Credit Union Clearing Member or a Registered Investment Company Clearing Member); and (ii) Cash Settling Bank Members (Cash Settling Bank Members are banks, trust companies, and other qualified entities that satisfy the requirements prescribed in MBSD's rules).
- 1.14 Except for Sponsored Members, an applicant for membership must satisfy, among other things, requirements for operational capability and specified capital requirements. Various membership categories also have eligibility requirements in respect of regulatory or other status in the United States. As a result of current eligibility requirements, FICC expects that Members resident in Ontario would be Comparison-Only Members, Foreign Netting Members, Sponsored Members or CCIT Members of GSD and/or Foreign Clearing Members of MBSD. A Sponsored Member must be (i) a "qualified institutional buyer" as defined by Rule 144A under the Securities Act (**Rule 144A**), or (ii) a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i) of Rule 144A, satisfies the financial requirements necessary to be a "qualified institutional buyer" as specified in that paragraph.

- 1.15 FICC maintains separate clearing funds for each of GSD and MBSD (each a **Clearing Fund** and collectively the **Clearing Funds**). Each Division's Clearing Fund (which also operates as each Division's default fund) provides the collateralization required to cover exposure from potential default of a member. Each Division's Clearing Fund consists of deposits posted by the respective Division's members in the form of cash and eligible securities. GSD maintains liquidity resources that include the following: (i) the cash portion of the GSD Clearing Fund; (ii) the cash that would be obtained by entering into repos using the securities portion of GSD's Clearing Fund (U.S. Treasury securities, agency securities guaranteed by the U.S. government and certain U.S. agency/government-sponsored enterprise pass-through securities); and (iii) the cash that would be obtained by entering into repos using the securities underlying transactions that would have been delivered to the defaulting GSD member had it not defaulted. GSD's Capped Contingency Liquidity Facility (**CCLF**[®]), which is a supplemental liquidity contingency option, came into effect on November 15, 2018. The liquidity resources of MBSD include the following: (i) the cash portion of the MBSD Clearing Fund; (ii) the cash that would be obtained by entering into repos using the securities portion of the MBSD Clearing Fund (U.S. Treasury securities, U.S. agency securities guaranteed by the U.S. government and certain U.S. agency/government-sponsored enterprise pass-through securities); and (iii) the cash that would be obtained by entering into repos using the securities underlying transactions that would have been delivered to the defaulting MBSD member had it not defaulted. MBSD maintains a separate CCLF[®] arrangement as its supplemental liquidity contingency option.
- 1.16 FICC proposes to make membership available to entities resident in Ontario, which may include investment dealers, investment funds, banks, pension plans, asset managers and insurance companies, although it is possible there could be further unanticipated interest from other types of entities resident in Ontario in FICC's services.
- 1.17 FICC would provide its services to entities resident in Ontario without FICC establishing an office or having a physical presence in Ontario or elsewhere in Canada.
- 1.18 FICC submits that it does not pose a significant risk to the Ontario capital markets and is subject to an appropriate regulatory and oversight regime in a foreign jurisdiction.

AND WHEREAS FICC has agreed to the terms and conditions attached hereto as Schedule "A";

AND WHEREAS based on the Application and the representations of FICC to the Commission, the Commission has determined that FICC is subject to regulatory requirements in the United States that are comparable to the requirements set out in NI 24-102 *Clearing Agency Requirements* and is subject to the SEC's supervision, and that granting an order to exempt FICC from the requirement to be recognized as a clearing agency would not be prejudicial to the public interest;

AND WHEREAS FICC has acknowledged to the Commission that the scope of, and the terms and conditions imposed by, the Commission attached hereto as Schedule "A", or the determination whether it is appropriate that FICC continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets, FICC's activities or regulatory status, or any changes to the laws of the United States or Ontario affecting trading in or clearing and settlement of securities;

IT IS HEREBY ORDERED by the Commission that, pursuant to section 147 of the OSA, FICC is exempt from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA;

PROVIDED THAT FICC complies with the terms and conditions attached hereto as Schedule "A".

DATED this [●] day of [●], 2019.

SCHEDULE "A"

Terms and Conditions

Definitions:

For the purposes of this Schedule "A":

Unless the context requires otherwise, terms used in this Schedule "A" shall have the meanings ascribed to them elsewhere in this order and in Ontario securities law (as defined in the OSA).

COMPLIANCE WITH ONTARIO LAW

1. FICC will comply with Ontario securities law to the extent applicable.

SCOPE OF PERMITTED CLEARING SERVICES

2. FICC's services that may be provided pursuant to this order will be limited to GSD and MBSD offering clearing and settlement services, and associated risk management services, within the general scope of the services described in representations 1.5 and 1.7 of FICC's representations set out above in this order (**Permitted Clearing Services**).
3. For purposes of this order, **Ontario Member** means a Member resident in Ontario that uses the Permitted Clearing Services.

REGULATION OF FICC

4. FICC will maintain its status as a registered clearing agency under the Exchange Act and will continue to be subject to the regulatory oversight of the SEC or any successor.
5. FICC will continue to comply with its ongoing regulatory requirements as a registered clearing agency under the Exchange Act or any comparable successor legislation and with its ongoing regulatory requirements by the Board of Governors of the Federal Reserve System.

GOVERNANCE

6. FICC will continue to promote a governance structure that minimizes the potential for conflict of interests between FICC and DTCC (including its other affiliates) that could adversely affect the Permitted Clearing Services or the effectiveness of FICC's risk management policies, controls and standards.

FILING REQUIREMENTS

Proposed Rule Changes Filed with the SEC

7. FICC will promptly provide to staff of the Commission a copy of the proposed rule changes filed with the SEC or its successor regarding the following:
 - (a) material changes to its by-laws or the rules of GSD or MBSD where such changes would impact the Permitted Clearing Services used by Ontario residents (whether as a Member or otherwise);
 - (b) new services or clearing of new types of products to be offered to Ontario Members or services or products that will no longer be available to Ontario Members; and
 - (c) a new category of membership not listed in representation 1.13 of FICC's representations set out above in this order if FICC expects that category of membership would be available to Ontario Members;

Other SEC Filings

8. FICC will promptly provide to staff of the Commission a copy of the following information, to the extent that FICC is required to provide such information to, or file such information with, the SEC or its successor:
 - (a) details of any material legal proceeding instituted against FICC;

- (b) notification that FICC has failed to comply with an undisputed obligation to pay money or deliver property to a Member (including an Ontario Member) for a period of 30 days after receiving notice from the Member of FICC's past due obligation;
- (c) notification that FICC has instituted a petition for a judgment of bankruptcy or insolvency or similar relief or to wind up or liquidate FICC, or has a proceeding for any such petition instituted against it;
- (d) notification that FICC has initiated the Recovery Plan (as defined in the rules of the Divisions);
- (e) the appointment of a receiver or the making of any general assignment for the benefit of creditors;
- (f) the entering of FICC into any resolution regime or the placing of FICC into resolution by a resolution authority; and
- (g) a notification or report that FICC files under Reg SCI.

Prompt Notice

9. FICC will promptly notify staff of the Commission of any of the following:
- (a) a material change to its business or operations;
 - (b) a material problem with the clearance and settlement of transactions that could materially affect the safety and soundness of FICC;
 - (c) a material change or proposed material change in FICC's status as a clearing agency or to the regulatory oversight of FICC by the SEC or any successor or to the regulatory oversight by the Board of Governors of the Federal Reserve System or any successor;
 - (d) an Ontario Member being treated by FICC as insolvent or FICC ceasing to act for an Ontario Member or limiting or excluding an Ontario Member's utilization of Permitted Clearing Services; and
 - (e) the admission of any new Ontario Member..

Quarterly Reporting

10. FICC will maintain and submit the following information to the Commission in a manner and form acceptable to the Commission on a quarterly basis within 30 days of the end of each calendar quarter, and at any time promptly upon the request of staff of the Commission:
- (a) a current list of all Ontario Members with their corresponding legal entity identifier (LEI), if any;
 - (b) a list of all Ontario Members against whom disciplinary or legal action has been taken in the quarter by FICC with respect to activities at FICC or, if notified to FICC by an Ontario Member pursuant to the GSD Rules or MBSD Rules, by any other authority that has or may have jurisdiction with respect to the Ontario Member's activities at FICC;
 - (c) a list of all current proceedings by FICC in the quarter relating to Ontario Members that may result in disciplinary or legal action by FICC against such Ontario Members;
 - (d) a list of all applicants who have been denied member status in GSD or MBSD in the quarter who would have been Ontario Members had they become Members;
 - (e) quantitative information in respect of the Permitted Clearing Services used by Ontario Members, as applicable¹, including in particular the following:
 - (i) as at the end of the quarter, the level, maximum and average of outstanding positions and daily volume of trades matched (based on trade sides and U.S. dollar value for GSD and trade sides and par value for MBSD) during the quarter for each Ontario Member of GSD and MBSD, respectively, by product type;

¹ Funds-Only Settling Bank Members do not have outstanding positions and/or Clearing Fund requirements, and CCIT Members, Comparison-Only Members and Sponsored Members are not required to post Clearing Fund.

- (ii) the portion of the end of quarter level and average of outstanding positions and daily volume of trades matched (based on trade sides and U.S. dollar value for GSD and trade sides and par value for MBSD) during the quarter for all GSD and MBSD members, respectively, that represents the end of quarter level and average of outstanding positions and daily volume of trades matched (based on trade sides and U.S. dollar value for GSD and trade sides and par value for MBSD) during the quarter for each Ontario Member of GSD and MBSD, respectively, by product type;
- (iii) the aggregate total Clearing Fund amount required by GSD and MBSD, respectively, ending on the last trading day during the quarter for each Ontario Member of GSD and MBSD, respectively;
- (f) the portion of the total Clearing Fund required by GSD and MBSD, respectively, ending on the last trading day of the quarter for all GSD and MBSD members, respectively, that represents the total Clearing Fund required during the quarter for each Ontario Member of GSD and MBSD, respectively;
- (g) a summary of risk management analysis related to the adequacy of the Clearing Fund requirement, including but not limited to stress testing and backtesting results;
- (h) if known to FICC, for each Member (identified by LEI), including an Ontario Member, clearing on behalf of an Executing Firm (as defined in the GSD Rules) resident in Ontario that uses the Permitted Clearing Services, (i) the identities of such Executing Firms (including LEI, if any) and (ii) the aggregate volume of trades matched (based on trade sides and U.S. dollar value) for such Executing Firms during the quarter; and
- (i) copies of the rules of the Divisions that show cumulative changes made during the quarter.

INFORMATION SHARING

11. FICC will promptly provide such information as may be requested from time to time by, and otherwise cooperate with, the Commission or its staff, subject to any applicable privacy or other laws that would prevent the sharing of such information and subject to the application of solicitor-client privilege.
12. Unless otherwise prohibited under applicable law, FICC will share information relating to regulatory and enforcement matters and otherwise cooperate with other recognized and exempt clearing agencies on such matters, as appropriate.