

and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its rules to make certain changes to the Risk Management Model Description, Stress Testing Framework, Liquidity Risk Management Framework, Back-Testing Framework, and Risk Parameter Setting and Review Policy in connection with the clearing of credit default index swaptions. The proposed rule change was published for comment in the **Federal Register** on January 31, 2020.<sup>3</sup> To date, the Commission has not received comments on the proposed rule change.

Section 19(b)(2) of the Act<sup>4</sup> provides that within 45 days of the publication of notice of the filing of a proposed rule change, or within such longer period up to 90 days as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved. The 45th day from the publication of notice of filing of this proposed rule change is March 16, 2020.

The Commission is extending the 45-day time period for Commission action on the proposed rule change, in which ICC would make the changes noted above. The Commission finds it is appropriate to designate a longer period within which to take action on the proposed rule change so that it has sufficient time to consider ICC’s proposed rule change.

Accordingly, pursuant to Section 19(b)(2)<sup>5</sup> of the Act, and for the reasons discussed above, the Commission designates April 30, 2020, as the date by which the Commission should either approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change (File No. SR-ICC-2020-002).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>6</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88382; File No. SR-FICC-2020-801]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of No Objection To Advance Notice To Amend the Mortgage-Backed Securities Division Stress Testing Methodology

March 13, 2020.

On January 21, 2020, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice SR-FICC-2020-801 (“Advance Notice”) pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”).<sup>2</sup> The Advance Notice describes modifications to the Mortgage-Backed Securities Division’s (“MBSD”) stress testing methodology, which is described in the Methodology Document—MBSD Market and Credit Risk Stress Test Models (“Stress Testing Methodology Document”).<sup>3</sup> The Advance Notice was published for public comment in the **Federal Register** on February 27, 2020,<sup>4</sup> and the Commission has received no comments regarding the changes proposed in the Advance Notice. This publication serves as notice of no objection to the Advance Notice.

#### I. The Advance Notice

##### A. Background

MBSD provides trade comparison, netting, risk management, settlement, and central counterparty services for U.S. mortgage-backed securities market. FICC manages its credit exposures to its

members by collecting an appropriate amount of margin from each member.<sup>5</sup> The aggregate of all MBSD members’ margin amounts (together with certain other deposits required under the MBSD Rules) constitutes MBSD’s Clearing Fund, which FICC would access should a member default with insufficient margin to satisfy any FICC losses caused by the liquidation of the defaulting member’s portfolio.<sup>6</sup>

FICC uses stress testing to test the sufficiency of its prefunded financial resources.<sup>7</sup> In contrast to FICC’s margin methodologies, which are designed to limit FICC’s credit exposures under normal market conditions,<sup>8</sup> FICC’s stress testing methodologies are designed to quantify FICC’s potential losses under extreme but plausible market conditions.<sup>9</sup> Therefore, stress testing is designed to help FICC identify credit risks beyond those contemplated by FICC’s margin methodologies, including credit exposures that might result from the realization of potential stress scenarios, such as extreme price changes, multiple defaults, or changes in other valuation inputs and assumptions.<sup>10</sup> As a result, stress testing helps FICC identify the amount of financial resources necessary to cover its credit exposure under stress scenarios in extreme but plausible market conditions.<sup>11</sup>

FICC’s stress testing methodologies have three key components.<sup>12</sup> First, FICC analyzes the securities and risk exposures in its members’ portfolios to identify the principal market risk drivers and capture the risk sensitivity of the portfolios under stressed market conditions.<sup>13</sup>

Second, FICC develops a comprehensive set of scenarios designed

<sup>5</sup> See Rule 4 (Clearing Fund and Loss Allocation) of the FICC MBSD Clearing Rules (“MBSD Rules”), available at [www.dtcc.com/legal/rules-and-procedures.aspx](http://www.dtcc.com/legal/rules-and-procedures.aspx).

<sup>6</sup> See *id.*

<sup>7</sup> On December 19, 2017, the Commission approved FICC’s adoption of the Clearing Agency Stress Testing Framework (Market Risk) (“Stress Testing Framework”), which among other things, sets forth the purpose of FICC’s stress testing and describes certain methodologies FICC uses in its stress testing. Securities Exchange Act Release No. 82368 (December 19, 2017), 82 FR 61082 (December 26, 2017) (SR-DTC-2017-005; SR-FICC-2017-009; SR-NSCC-2017-006) (“Stress Testing Framework Order”).

<sup>8</sup> See *e.g.*, Securities Exchange Act Release No. 80253 (March 15, 2017), 82 FR 14581, 14582 (March 21, 2017) (SR-FICC-2017-004).

<sup>9</sup> See Stress Testing Framework Order, *supra* note 7, 82 FR at 61083; Notice of Filing, *supra* note 4 at 11413.

<sup>10</sup> See *id.*; 17 CFR 240.17Ad-22(a)(17).

<sup>11</sup> See Stress Testing Framework Order, *supra* note 7, 82 FR at 61083; Notice of Filing, *supra* note 4 at 11413.

<sup>12</sup> See *id.*

<sup>13</sup> See *id.*

<sup>6</sup> 17 CFR 200.30-3(a)(31).

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

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

<sup>3</sup> As part of the Advance Notice, FICC filed Exhibit 3a—Methodology Document—MBSD Market and Credit Risk Stress Models. Pursuant to 17 CFR 240.24b-2, FICC requested confidential treatment of Exhibit 3a.

<sup>4</sup> Securities Exchange Act Release No. 34-88266 (February 24, 2020), 85 FR 11413 (February 27, 2020) (SR-FICC-2020-801) (“Notice of Filing”).

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

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

<sup>3</sup> Securities Exchange Act Release No. 88047 (Jan. 27, 2020), 85 FR 5756 (Jan. 31, 2020) (SR-ICC-2020-002).

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> 15 U.S.C. 78s(b)(2).

to test whether FICC's prefunded financial resources are sufficient to cover losses sustained by member portfolios in such scenarios.<sup>14</sup> Specifically, FICC assesses the impact on member portfolios under both historical scenarios and hypothetical scenarios.<sup>15</sup> Historical scenarios are based on stressed market conditions as they have occurred on specific dates in the past.<sup>16</sup> In order to select historical stress scenarios, MBS's stress testing model selects dates from the past that represent stressed market conditions based on the largest historical changes of the selected risk factors. Hypothetical scenarios represent theoretical market conditions that may not actually have occurred, but could conceivably occur.<sup>17</sup> In order to select hypothetical stress scenarios, MBS considers potential future events and their perceived impact to portfolio market risk factors.

In developing historical scenarios for MBS's stress testing purposes, FICC currently examines historical data to identify the largest historical changes of two risk factors that influence the pricing of mortgage-backed securities ("MBS"). Specifically, FICC examines historical data to determine the sensitivity of MBS prices to changes in interest rates and mortgage option adjusted spreads ("OAS").<sup>18</sup> FICC currently uses its own internally-developed risk factor historical data. FICC examines the historical data during a rolling 10-year look-back period, with dates falling outside the 10-year period eliminated quarterly.<sup>19</sup>

Third, to measure and aggregate the applicable risks, FICC applies the historical and hypothetical scenarios described above to MBS's member portfolios (1) to analyze the potential losses on each portfolio in relation to margin amounts collected, and (2) to analyze the effects that potential losses on member portfolios during stress scenarios might have on FICC's

prefunded financial resources. Specifically, FICC calculates the stress profits-and-losses under each stress scenario and determines the loss amount exceeding a member's margin for each scenario ("Member Deficiency"). FICC further combines the Member Deficiencies of the member and the member's affiliated family (that are also MBS's members) ("Affiliated Family Deficiency"). FICC calculates the ratio of an Affiliated Family Deficiency over the total value of the MBS's Clearing Fund excluding the sum value of the applicable affiliated family's margin.<sup>20</sup>

Currently, in determining the potential losses to a member's portfolio under a stress scenario, FICC applies a profit-and-loss calculation that multiplies a set of risk factor stress movements by the sensitivity (*i.e.*, the percentage value change in response to the stress movements) of the securities in the portfolio. FICC estimates MBS risk sensitivities based on two interest rate risk factors and an OAS risk factor by using a regression model with a two-month look-back period.<sup>21</sup>

#### *B. Proposed Changes to MBS's Stress Testing Methodology*

##### 1. Changes to the Scenario Selection Process

As proposed in the Advance Notice, FICC would continue to examine historical risk factor data on interest rates and OAS. However, FICC proposes to add two new risk factors—interest rate volatility<sup>22</sup> and mortgage basis<sup>23</sup>—

<sup>14</sup> See *id.*  
<sup>15</sup> See *id.*  
<sup>16</sup> See *id.*  
<sup>17</sup> See *id.*  
<sup>18</sup> OAS is the yield spread added to a yield curve necessary to match the discounted present value of an MBS's cash flows to its market price. The OAS reflects a credit premium and the option-like characteristic of an MBS in that it incorporates prepayment. See Notice of Filing, *supra* note 4 at 11413–14.  
<sup>19</sup> FICC retains and applies certain historical scenarios beyond the 10-year data range because such events have had a significant impact on the financial markets, including, for example, May 29, 1994 (when the Federal Reserve significantly raised rates), October 5, 1998 (when the Long-Term Capital Management crisis occurred), and September 11, 2001. See Notice of Filing, *supra* note 4 at 11415.

<sup>20</sup> 17 CFR 240.17Ad–22(e)(4) requires a covered clearing agency, such as FICC, to establish, implement, maintain and enforce written policies and procedures reasonably designed to monitor and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient prefunded financial resources at a minimum to enable the clearing agency to cover the default of the member (including relevant affiliates) that would potentially cause the largest aggregate credit exposure for the clearing agency in extreme but plausible conditions ("Cover 1 Requirement").

<sup>21</sup> Regression is a statistical approach that FICC uses to determine the coefficient range used in the stress profit-and-loss calculation. See Notice of Filing, *supra* note 4 at 11415.  
<sup>22</sup> Interest rate volatility reflects the market view of fluctuations in interest rates. A high degree of interest rate volatility will affect the price sensitivity of a security. Identifying historical dates with high degrees of interest rate volatility provides additional historical stress shocks.

<sup>23</sup> Mortgage basis captures the difference between the prevailing mortgage rate and a blended U.S. Treasury rate, which impacts borrowers' refinance incentives and the model prepayment assumptions. The smaller the mortgage basis, the greater the incentive for mortgage borrowers to refinance their loans and prepay their existing mortgage, thus increasing prepayment speeds. Changes in prepayment speeds affect the value of MBS securities. Identifying historical dates of changes in

and to obtain all of the historical risk factor data from a vendor.<sup>24</sup> FICC states that the vendor-sourced data would be more comprehensive than FICC's currently internally-sourced data.<sup>25</sup> As such, FICC states that the proposed change would enable FICC to better understand market price changes of MBS cleared by FICC and would enhance FICC's ability to identify risk exposures under broader and more varied market conditions.<sup>26</sup> FICC also states that using the vendor-sourced data could prove beneficial for its members.<sup>27</sup> Specifically, FICC states that its use of the vendor-sourced data would enable its members to align their stress testing analyses with FICC's analyses, because its members use similar data and analysis for their own internal stress testing methodologies.<sup>28</sup>

In addition, as proposed in the Advance Notice, FICC would change the look-back period for identifying historical stress scenarios by anchoring the starting date of the look-back period to May 29, 2002<sup>29</sup> and not eliminating any time period after that date.<sup>30</sup> FICC states that expanding the look-back period beyond the 10-year rolling window would enable FICC to include a broader range of extreme but plausible market conditions in the stress testing methodology.

the mortgage basis provides additional historical stress shocks.

<sup>24</sup> FICC currently receives the historical risk-factor data from the vendor for use in MBS's value-at-risk ("VaR") model, which calculates the VaR Charge component of each member's margin. See MBS's Rule 1, Definitions—VaR Charge, *supra* note 5. See also Securities Exchange Act Release No. 79843 (January 19, 2017), 82 FR 8555, 8556 (January 26, 2017) (SR–FICC–2016–801); Securities Exchange Act Release No. 79868 (January 24, 2017), 82 FR 8780, 8781 (January 30, 2017) (SR–FICC–2016–007). As proposed in the Advance Notice, FICC would use the same data set for MBS's stress testing purposes.

<sup>25</sup> For example, FICC's current methodology uses four tenors for the interest rate factor and two individual factors for the OAS factor. The vendor-supplied data would include 11 tenors for the interest rate factor and approximately 32 individual factors for the OAS factor, which would enable FICC's analysis to differentiate between various agency mortgage programs, underlying collateral maturities, and other MBS features. See Notice of Filing, *supra* note 4 at 11414–16.

<sup>26</sup> See Notice of Filing, *supra* note 4 at 11416.

<sup>27</sup> See Notice of Filing, *supra* note 4 at 11414–15.

<sup>28</sup> See *id.*

<sup>29</sup> FICC states that it chose May 29, 2002 as the fixed starting point of the look-back period based on FICC's assessment of the accuracy and consistency of the vendor's historical data. See Notice of Filing, *supra* note 4 at 11415.

<sup>30</sup> FICC would continue to include events prior to the May 29, 2002 date range that FICC identifies as important periods of historical stress. See *id.*

## 2. Changes to the Risk Measurement and Aggregation Process

As proposed in the Advance Notice, FICC would replace the regression-based profit-and-loss calculation with a financial profit-and-loss calculation using vendor-sourced data. The vendor-sourced data would expand the set of risk factors available to FICC for calculating the potential losses generated by the liquidation of a member's portfolio during stress scenarios. FICC believes that the vendor-sourced data would improve the accuracy of FICC's stress testing methodology by generating profit-and-loss calculations that are closer to the actual MBS price changes during the large market moves that are typical in stress testing scenarios.<sup>31</sup>

## 3. Back-Up Calculation

Finally, FICC proposes to implement a back-up calculation that it would use in the event the vendor fails to provide FICC with the vendor-sourced data described above. Specifically, if the vendor fails to provide any data or a significant portion of the data in accordance with the timeframes to which FICC and the vendor agreed, FICC would use the most recently available data on the first day that such disruption occurs. If FICC and the vendor expect that the vendor would resume providing data within five business days, FICC would determine whether to calculate the daily stress testing calculation using the most recently available data or a back-up calculation, described below. If FICC and the vendor expect that the data disruption would extend beyond five days, FICC would utilize the back-up calculation.

The proposed back-up calculation would be as follows: FICC would (1) calculate each member's portfolio net exposures in four securitization programs,<sup>32</sup> (2) calculate the stress return for each securitization program as the three-day price return for each securitization program for each scenario date, and (3) calculate each member's stress profit-and-loss as the sum of the products of the net exposure of each category and the stress return value for each category. The proposed back-up calculation would use publicly available

indices as the data source for the stress return calculations.

## II. Discussion

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs and strengthening the liquidity of SIFMUs.<sup>33</sup>

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe regulations containing risk management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency.<sup>34</sup> Section 805(b) of the Clearing Supervision Act provides the following objectives and principles for the Commission's risk-management standards prescribed under Section 805(a):<sup>35</sup>

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

Section 805(c) provides, in addition, that the Commission's risk management standards may address such areas as risk management and default policies and procedures, among others areas.<sup>36</sup>

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the "Clearing Agency Rules").<sup>37</sup> The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk management practices on an ongoing basis.<sup>38</sup> As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described

in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the proposal in the Advance Notice is consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,<sup>39</sup> and in the Clearing Agency Rules, in particular Rules 17Ad-22(e)(4).<sup>40</sup>

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

For the reasons discussed below, the Commission believes that the Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act.<sup>41</sup>

#### 1. Changes to the Scenario Selection Process

As described above in Section I.A., in developing historical scenarios for MBS stress testing purposes, FICC currently (1) examines historical data to identify the largest historical changes of two risk factors that influence MBS pricing (*i.e.*, interest rates and OAS), (2) relies on its own internally-developed risk factor historical data, and (3) considers the historical data during a rolling 10-year look-back period, with dates falling outside the 10-year period eliminated quarterly. As proposed in the Advance Notice, FICC would replace the internally-generated historical data with more comprehensive vendor-sourced data designed to enhance FICC's ability to identify risk exposures under broader and more varied market conditions. Additionally, FICC proposes to expand the look-back period for identifying historical stress scenarios from a rolling 10-year period to one that starts on May 29, 2002 and continues forward without eliminating time periods. Expanding the look-back period beyond the 10-year rolling window would include a broader range of extreme but plausible market conditions in FICC's stress testing methodology.

Taken together, these changes should allow FICC to identify and analyze risk exposures under a broader and more varied range of stressed market conditions covering a longer time period, which should, in turn, help FICC identify the amount of financial resources necessary to cover its credit exposure under stress scenarios in extreme but plausible market conditions. The Commission, therefore, believes that the proposed methodology would be consistent with the promotion

<sup>33</sup> See 12 U.S.C. 5461(b).

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

<sup>35</sup> 12 U.S.C. 5464(b).

<sup>36</sup> 12 U.S.C. 5464(c).

<sup>37</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11). See also Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) ("Covered Clearing Agency Standards"). FICC is a "covered clearing agency" as defined in Rule 17Ad-22(a)(5).

<sup>38</sup> 17 CFR 240.17Ad-22.

<sup>39</sup> 12 U.S.C. 5464(b).

<sup>40</sup> 17 CFR 240.17Ad-22(e)(4).

<sup>41</sup> 12 U.S.C. 5464(b).

<sup>31</sup> See Notice of Filing, *supra* note 4 at 11416-17.

<sup>32</sup> The securitization programs are as follows: (1) FNMA and Freddie Mac ("FHLMC") conventional 30-year mortgage-backed securities, (2) GNMA 30-year mortgage-backed securities, (3) FNMA and FHLMC conventional 15-year mortgage-backed securities, and (4) GNMA 15-year mortgage-backed securities.

of robust risk management as well as safety and soundness at FICC.

Further, the proposed methodology would provide FICC with more information to address potential deficiencies in its prefunded financial resources than the current methodology because more comprehensive data and the expanded look-back period would allow FICC to identify and analyze additional risk exposures under a broader range of stressed market conditions than under the current methodology. Addressing potential deficiencies should help FICC ensure that it is collecting adequate prefunded financial resources to cover its potential losses resulting from the default of a clearing member and its affiliated family under multiple extreme but plausible market conditions, thereby improving FICC's ability to meet its Cover 1 Requirement and to limit its exposures in the event of such a default. Accordingly, the Commission believes the proposed methodology would be consistent with reducing systemic risks and supporting the stability of the broader financial system.

## 2. Changes in Risk Measurement and Aggregation Process

As described above in Section I.A., FICC's stress testing methodology uses a regression model with a two-month look-back period to determine the potential losses to a member's portfolio under a stress scenario, estimating each member's MBS sensitivity to two interest rate risk factors and an OAS risk factor. As proposed in the Advance Notice, FICC would replace the regression-based calculation with a financial profit-and-loss calculation using more comprehensive vendor-sourced data. The vendor-sourced data would expand the set of risk factors available to FICC for calculating the potential losses generated by the liquidation of a member's portfolio during stress scenarios.

The proposed methodology's profit-and-loss calculation using more comprehensive vendor-sourced data should enable FICC to perform a more robust assessment of Member Deficiencies and Affiliated Member Deficiencies and to identify potential additional risk exposures that it may not have captured before. Accordingly, the Commission believes that the proposed methodology would be consistent with promoting robust risk management and safety and soundness. Moreover, because using the profit-and-loss calculation based on more comprehensive vendor-sourced data should better enable FICC to identify and address potential risks with respect

to specific members and their affiliates, it should help FICC ensure that it is collecting adequate prefunded financial resources to cover its potential losses resulting from the default of clearing members and their affiliates under multiple extreme but plausible market conditions, thereby improving FICC's ability to meet its Cover 1 Requirement and to limit its exposures in the event of such a default. Accordingly, the Commission believes the proposed methodology would be consistent with reducing systemic risks and supporting the stability of the broader financial system.

## 3. Back-Up Calculation

As described above in Section I.B., FICC proposes to implement a back-up calculation that it would utilize in the event of an interruption in the vendor-sourced data feed. The back-up calculation should provide FICC with a reasonable alternative method for calculating stress profits-and-losses in the event of an interruption in the vendor-sourced data feed. Accordingly, the Commission believes the proposed back-up calculation would be consistent with promoting robust risk management because it would help ensure that FICC has the ability to execute its stress tests with a reasonable alternative in the event of a vendor data disruption.

Further, by providing FICC with a reasonable alternative method for conducting stress testing, the proposed back-up calculation would help FICC avoid gaps in assessing the sufficiency of its prefunded financial resources with respect to meeting FICC's Cover 1 Requirement during a vendor data disruption. Accordingly, the Commission believes the proposed back-up calculation would be consistent with promoting safety and soundness at FICC, which in turn is consistent with reducing systemic risks and supporting the stability of the broader financial system.

### B. Consistency With Rule 17Ad-22(e)(4)(iii) and (vi)

Rule 17Ad-22(e)(4)(iii) requires, in part, each covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, by maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the participant family that would potentially cause the

largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions.<sup>42</sup> Rule 17Ad-22(e)(4)(vi) requires, in part, each covered clearing agency to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, by testing the sufficiency of its total financial resources available by conducting stress testing of its total financial resources once each day using standard predetermined parameters and assumptions.<sup>43</sup>

As described above in Section I.B., FICC proposes to change its stress testing methodology to: (1) Enhance the scenario selection process by replacing its internally-generated historical data with more comprehensive vendor-sourced data and expanding the look-back period for identifying historical stress scenarios from a rolling 10-year period to one that starts on May 29, 2002 and continues forward without eliminating time periods; (2) replace the regression-based calculation with a financial profit-and-loss calculation using more comprehensive vendor-sourced data; and (3) implement a back-up calculation that it would utilize in the event of an interruption in the vendor-sourced data feed. Taken together, these changes should allow FICC to identify and analyze risk exposures under a broader range of stressed market conditions covering a longer time period, which should, in turn, help FICC identify the amount of financial resources necessary to cover its credit exposure under stress scenarios in extreme but plausible market conditions.

Accordingly, the Commission believes that FICC's proposed stress testing methodology is consistent with Rule 17Ad-22(e)(4)(iii) because it should better enable FICC to assess its ability to maintain sufficient financial resources to cover a wide range of foreseeable stress scenarios that include the default of the member (including relevant affiliates) that would potentially cause FICC's largest aggregate credit exposure in extreme but plausible conditions.<sup>44</sup> Additionally, the Commission believes FICC's proposed stress testing methodology is consistent with Rule 17Ad-22(e)(4)(vi) because it should enable FICC to test the sufficiency of its minimum financial resources by conducting stress testing using standard

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

<sup>43</sup> 17 CFR 240.17Ad-22(e)(4)(vi).

<sup>44</sup> See 17 CFR 240.17Ad-22(e)(4)(iii).

predetermined parameters and assumptions.<sup>45</sup>

### III. Conclusion

It is therefore noticed, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission does not object to this advance notice proposal (SR-FICC-2020-801) and that FICC is authorized to implement the proposal as of the date of this notice.

By the Commission.

**J. Matthew DeLesDernier,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88378; File No. SR-NYSEArca-2019-77]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To List and Trade Shares of the AdvisorShares Pure US Cannabis ETF Under NYSE Arca Rule 8.600-E

March 13, 2020.

On December 13, 2019, NYSE Arca, Inc. (“NYSE Arca” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade shares (“Shares”) of the AdvisorShares Pure US Cannabis ETF (“Fund”) under NYSE Arca Rule 8.600-E. The proposed rule change was published for comment in the **Federal Register** on December 26, 2019.<sup>3</sup> On January 28, 2020, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.<sup>5</sup> The Commission has received no comment letters on the proposal. The Commission is publishing this order to

institute proceedings under Section 19(b)(2)(B) of the Act<sup>6</sup> to determine whether to approve or disapprove the proposed rule change.

### I. Exchange’s Description of the Proposal<sup>7</sup>

The Exchange proposes to list and trade Shares of the Fund under Commentary .01 to NYSE Arca Rule 8.600-E, which governs the listing and trading of Managed Fund Shares<sup>8</sup> on the Exchange.

AdvisorShares Investments, LLC (“Adviser”) is the investment adviser for the Fund.<sup>9</sup> AdvisorShares Trust (“Trust”) and the Adviser manage the Fund’s investments, subject to the oversight and supervision by the Board of Trustees of the Trust.<sup>10</sup> Foreside Fund Services, LLC, a registered broker-dealer, will act as the distributor for the Fund’s Shares. The Bank of New York Mellon will serve as the administrator, custodian, and transfer agent for the Fund.

#### A. Principal Investments of the Fund

According to the Exchange, the investment objective of the Fund is to

<sup>6</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>7</sup> The Commission notes that additional information regarding, among other things, the Shares, Fund, investment objective, permitted investments, investment strategies and methodology, investment restrictions, investment adviser, creation and redemption procedures, availability of information, trading rules and halts, and surveillance procedures, can be found in the Notice (*see supra* note Error! Bookmark not defined.) and the Registration Statement (*see infra* note 9), as applicable.

<sup>8</sup> A Managed Fund Share is a security that represents an interest in an investment company registered under the Investment Company Act of 1940 (“1940 Act”) organized as an open-end investment company or similar entity that invests in a portfolio of securities selected by its investment adviser consistent with its investment objectives and policies.

<sup>9</sup> The Exchange represents that the Adviser is not registered as a broker-dealer, and the Adviser is not affiliated with any broker-dealers. In the event (a) the Adviser becomes registered as a broker-dealer or newly affiliated with a broker-dealer, or (b) any new adviser is a registered broker-dealer or becomes affiliated with a broker-dealer, it will implement and maintain a “fire wall” with respect to its relevant personnel or broker-dealer affiliate regarding access to information concerning the composition of, and/or changes to, the portfolio, and will be subject to procedures, each designed to prevent the use and dissemination of material non-public information regarding the portfolio.

<sup>10</sup> The Exchange represents that the Trust is registered under the 1940 Act. On August 19, 2019, the Trust filed with the Commission Post-Effective Amendment No. 145 to the Trust’s registration statement on Form N-1A under the Securities Act of 1933 (15 U.S.C. 77a) and under the 1940 Act relating to the Fund (File Nos. 333-157876 and 811-22110) (“Registration Statement”). In addition, the Exchange represents that the Commission has issued an order granting certain exemptive relief to the Trust under the 1940 Act. *See* Investment Company Act Release No. 29291 (May 28, 2010) (File No. 812-13677).

seek long-term capital appreciation. The Fund will seek to achieve its investment objective by investing, under normal market conditions,<sup>11</sup> at least 80% of its net assets in securities of companies that derive at least 50% of their net revenue from the marijuana and hemp business in the United States and in derivatives that have economic characteristics similar to such securities.<sup>12</sup>

In addition to its investment in securities of companies that derive a significant portion of their revenue from the marijuana and hemp business, and in derivatives providing exposure to such securities, the Fund may invest in securities of companies that, in the opinion of the Adviser, may have current or future revenues from cannabis-related business or that are registered with the United States Drug Enforcement Agency (DEA) specifically for the purpose of handling marijuana for lawful research and development of cannabis or cannabinoid-related products.

According to the Exchange, the Fund will not invest directly in or hold ownership in any companies that engage in cannabis-related business unless permitted by national and local laws of the relevant jurisdiction, including U.S. federal and state laws. The Fund has represented that this restriction does not apply to the Fund’s investment in derivatives instruments. All of the Fund’s investments, including derivatives instruments, would be made in accordance with all applicable laws, including U.S. federal and state laws. The Fund will concentrate at least 25% of its investments in the pharmaceuticals, biotechnology and life sciences industry group within the health care sector.

The Fund primarily may invest in U.S. and foreign exchange-listed equity securities and in derivative instruments, as further described in this section, intended to provide exposure to such securities.

The Fund may invest in the following types of U.S. and foreign exchange-listed equity securities: common stock; preferred stock; warrants; Real Estate Investment Trusts (REITs); and rights. The Fund may also invest in U.S. exchange-listed exchange-traded funds

<sup>11</sup> The term “normal market conditions” is defined in NYSE Arca Rule 8.600-E(c)(5).

<sup>12</sup> The Fund’s investments in derivatives will include investments in both listed derivatives and over-the-counter (“OTC”) derivatives, as those terms are defined in Commentary .01(d) and (e) to NYSE Arca Rule 8.600-E.

<sup>45</sup> See 17 CFR 240.17Ad-22(e)(4)(vi).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 87791 (December 18, 2019), 84 FR 71057 (“Notice”).

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 88066, 85 FR 6009 (February 3, 2020). The Commission designated March 25, 2020, as the date by which it should approve, disapprove, or institute proceedings to determine whether to approve or disapprove the proposed rule change.