

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75730; File No. SR-NSCC-2015-802)

August 19, 2015

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Amendment No. 1 and No Objection to Advance Notice Filing, as Modified by Amendment No. 1, to Establish a Prefunded Liquidity Program As Part of NSCC's Liquidity Risk Management

On June 26, 2015, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-NSCC-2015-802 ("Advance Notice") pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act")¹ and Rule 19b-4(n)(1)(i)² under the Securities Exchange Act of 1934 ("Exchange Act") to establish a "Prefunded Liquidity Program" through the private placement of unsecured debt. The Advance Notice was published for comment in the Federal Register on August 3, 2015.³ NSCC filed Amendment No. 1 to the Advance Notice on July 30, 2015.⁴ The Commission did not receive any comments on the Advance Notice. This publication serves as notice of filing Amendment No. 1 and of no objection to the Advance Notice, as modified by Amendment No. 1.

¹ 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated NSCC a systemically important financial market utility on July 18, 2012. See Financial Stability Oversight Council 2012 Annual Report, Appendix A, <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>. Therefore, NSCC is required to comply with the Clearing Supervision Act and file advance notices with the Commission. See 12 U.S.C. 5465(e).

² 17 CFR 240.19b-4(n)(1)(i).

³ See Securities Exchange Act Release No. 75541 (July 28, 2015), 80 FR 46072 (August 3, 2015) (File No. SR-NSCC-2015-802).

⁴ In Amendment No. 1, NSCC further specifies the proposed investment of the proceeds of the Prefunded Liquidity Program, as described below.

I. Description of the Advance Notice, As Modified by Amendment No. 1

As described by NSCC in its Advance Notice, as modified by Amendment No. 1, NSCC has proposed to establish the Prefunded Liquidity Program to raise prefunded liquidity and diversify its liquidity resources through the private placement of unsecured debt, consisting of a combination of short-term promissory notes (“Commercial Paper Notes”) and extendible-term promissory notes (“Extendible Notes,” together with the Commercial Paper Notes, “Notes”), to institutional investors in an aggregate amount not to exceed \$5 billion. The proceeds from the Prefunded Liquidity Program will supplement NSCC’s existing liquidity resources, which collectively provide NSCC with liquidity to complete end-of-day settlement in the event of the default of an NSCC Member.⁵

Terms of the Prefunded Liquidity Program. NSCC has engaged an issuing and paying agent, as well as certain placement agent dealers, to develop a program to issue the Notes. The Notes will be issued to institutional investors through a private placement and offered in reliance on an exemption from registration under Section 4(a)(2) of the Securities Act of 1933.⁶ NSCC will be party to certain transaction documents required to establish the Prefunded Liquidity Program, including an issuing and paying agent

⁵ Terms not defined herein are defined in NSCC’s Rules and Procedures (“Rules”) available at http://dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf. The events that constitute a Member default are specified in NSCC’s Rule 46 (Restrictions on Access to Services), which provides that NSCC’s Board of Directors may suspend a Member or prohibit or limit a Member’s access to NSCC’s services in enumerated circumstances; this includes default in delivering funds or securities to NSCC, or a Member’s experiencing such financial or operational difficulties that NSCC determines, in its discretion, that restriction on access to services is necessary for its protection and for the protection of its membership.

⁶ 15 U.S.C. 77d(a)(2).

agreement and a dealer agreement with each of the placement agent dealers. The dealer agreements each will be based on the standard form of dealer agreement for commercial paper programs, which is published by the Securities Industry and Financial Markets Association. The material terms and conditions of the Prefunded Liquidity Program are summarized below.

The Prefunded Liquidity Program will be established as a combination of both Commercial Paper Notes, which typically have shorter maturities, and Extendible Notes, which typically have longer maturities. NSCC intends to structure the Prefunded Liquidity Program such that the maturities of the issued Notes are staggered to avoid concentrations of maturing liabilities. The average maturity of the aggregate Notes outstanding issued under the Prefunded Liquidity Program is broadly estimated to range between three and six months. The Commercial Paper Notes and the Extendible Notes will be represented by one or more master notes issued in the name of The Depository Trust Company (“DTC”) or its nominee. The Notes will be issued only through the book-entry system of DTC and will not be certificated.

The Commercial Paper Notes either will be interest bearing or sold at a discount from their face amount, and the Extendible Notes will be interest bearing. Interest payable on the Notes will be at market rates customary for such type of debt and reflective of the creditworthiness of NSCC. The Commercial Paper Notes will have a maturity not to exceed 397 calendar days from the date of issue and will not be redeemable by NSCC prior to maturity, nor will they contain any provision for extension, renewal, automatic rollover or voluntary prepayment. The Extendible Notes will have an initial maturity of 397 calendar days from the date of issue. However, each month

following the date of issue, the holder of an Extendible Note will be permitted to elect to extend the maturity of all or a portion of the principal amount of such Extendible Note for an additional 30 calendar days. A holder of an Extendible Note will be permitted to continue to extend its Extendible Note up to the final maturity date, which is expected to be a maximum of six years from the date of issue. If a holder of an Extendible Note fails to exercise its right to extend the maturity of all or a portion of the Extendible Note, such portion of the Extendible Note would be deemed to be represented by a new note (“Non-Extended Note”), and NSCC would have the option to redeem any Non-Extended Note in whole, but not in part, at any time prior to the maturity date of that Non-Extended Note, which would be 12 months from the date on which they opted not to extend.

NSCC will hold the proceeds from the issuance of the Notes in a cash deposit account at the Federal Reserve Bank of New York (“FRBNY”)⁷ and invest the proceeds in the same manner it invests Clearing Fund deposits in accordance with the DTCC Investment Policy.⁸ Pending the establishment of NSCC’s account at the FRBNY, such proceeds will be maintained in accounts with creditworthy financial institutions and invested in the same manner as NSCC invests Clearing Fund deposits in accordance with

⁷ Pursuant to Section 806(a) under the Payment, Clearing and Settlement Supervision Act, and Section 234.6 of the Federal Reserve Regulation HH promulgated thereunder, NSCC, as a designated systemically important financial market utility under the Payment, Clearing and Settlement Supervision Act, has applied for a cash deposit account at the FRBNY, as well as subscription to ancillary FRBNY services that would facilitate the use of the requested cash deposit account. See 12 U.S.C. 5465(a); 12 CFR 234.6. The application is pending with the FRBNY as of the date of this notice.

⁸ NSCC will submit a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Exchange Act, and the rules thereunder, which specify how NSCC will invest the proceeds of the Notes under the DTCC Investment Policy. See 15 U.S.C. 78s(b)(1).

the DTCC Investment Policy. Acceptable investments for Clearing Fund deposits under DTCC's Investment Policy include reverse repurchase agreements, money market mutual fund investments, bank deposits and commercial paper bank sweep deposits. In all cases, amounts will be available to draw to complete settlement as needed.

NSCC Liquidity Risk Management. As described by NSCC, as a central counterparty ("CCP"), NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions, thereby reducing the risk faced by its Members and contributing to global financial stability. NSCC's liquidity risk management framework plays an integral part in NSCC's ability to perform this role and is designed to ensure that NSCC maintains sufficient liquid resources to timely meet its payment (principally settlement) obligations with a high degree of confidence.

NSCC's liquidity needs are driven by the requirement to complete end-of-day settlement, on an ongoing basis, in the event of Member default. If an NSCC Member defaults, as a CCP for the cash markets, NSCC would need to complete settlement of guaranteed transactions on the failing Member's behalf from the date of default through the remainder of the settlement cycle (currently three days for securities that settle on a regular way basis in the U.S. equities markets).

NSCC measures and manages its liquidity risk by performing daily simulations that measure the amount of liquidity NSCC would require in a number of scenarios, including amounts required over the settlement cycle in the event that the Member or Member family to which NSCC has the largest aggregate liquidity exposure defaults. NSCC seeks to maintain qualified liquidity resources in an amount sufficient to meet this

requirement. NSCC's existing liquidity resources include: (1) the cash in NSCC's Clearing Fund; (2) the cash that would be obtained by drawing upon NSCC's committed 364-day credit facility with a consortium of banks ("Line of Credit"); and (3) additional cash deposits, known as "Supplemental Liquidity Deposits," designed to cover the heightened liquidity exposure arising around monthly option expiry periods, required from those Members whose activity would pose the largest liquidity exposure to NSCC.⁹ The proceeds from the Prefunded Liquidity Program will supplement these liquidity resources. Further, NSCC will consider the proceeds from the Prefunded Liquidity Program to be qualifying liquidity resources under NSCC's Rule 4A.

NSCC states that by providing NSCC with additional, prefunded, and readily available liquidity resources to be used to complete end-of-day settlement as needed in the event of a Member default, the proposed Prefunded Liquidity Program will provide additional certainty, stability, and safety to NSCC, its Members, and the U.S. equities market that it serves. The Prefunded Liquidity Program also is designed to reduce NSCC's concentration risk with respect to its liquidity resources because it is anticipated that many of the potential institutional investors who would be purchasers of the Notes are not currently providing liquidity resources to NSCC.

The Prefunded Liquidity Program was developed in coordination with a standing advisory group, the Clearing Agency Liquidity Council ("CALC"), which includes representatives of NSCC's Members and participants of NSCC's affiliate, the Fixed Income Clearing Corporation. The CALC was established in 2013 to facilitate dialogue between these clearing agencies and their participants regarding liquidity initiatives.

⁹ Supplemental Liquidity Deposits are described in NSCC Rule 4A.

II. Discussion and Commission Findings

Although the Payment, Clearing and Settlement Supervision Act does not specify a standard of review for an advance notice, the Commission believes that the stated purpose of the Payment, Clearing and Settlement Supervision Act is instructive.¹⁰ The stated purpose of the Payment, Clearing and Settlement Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.¹¹

Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act¹² authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the supervisory agency or the appropriate financial regulator. Section 805(b) of the Payment, Clearing and Settlement Supervision Act¹³ states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and

¹⁰ See 12 U.S.C. 5461(b).

¹¹ Id.

¹² 12 U.S.C. 5464(a)(2).

¹³ 12 U.S.C. 5464(b).

- support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act (“Clearing Agency Standards”) and the Exchange Act.¹⁴ The Clearing Agency Standards became effective on January 2, 2013, and require registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.¹⁵ As such, it is appropriate for the Commission to review advance notices against these Clearing Agency Standards, and the objectives and principles of these risk management standards as described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act.¹⁶

The Commission believes the proposal in the Advance Notice is consistent with the objectives and principles described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act,¹⁷ and the Clearing Agency Standards, in particular, Rule 17Ad-22(b)(3)¹⁸ under the Exchange Act, as described in detail below.

¹⁴ 17 CFR 240.17Ad-22.

¹⁵ The Clearing Agency Standards are substantially similar to the risk management standards established by the Board of Governors of the Federal Reserve System governing the operations of designated financial market utilities that are not clearing entities and financial institutions engaged in designated activities for which the Commission or the Commodity Futures Trading Commission is the Supervisory Agency. See Financial Market Utilities, 77 FR 45907 (August 2, 2012).

¹⁶ 12 U.S.C. 5464(b).

¹⁷ Id.

¹⁸ 17 CFR 240.17Ad-22(b)(3).

The objectives and principles of Section 805(b) of the Payment, Clearing and Settlement Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.¹⁹ By diversifying the type and source of NSCC’s liquidity, the Commission believes that the Prefunded Liquidity Program will reduce NSCC’s overall liquidity risk consistent with prudent risk-management practices. Given that NSCC has been designated as a systemically important financial market utility,²⁰ NSCC’s ability to provide its clearing services upon a member default contributes to safety, soundness, and reduces systemic risks, all of which supports the stability of the broader financial system. Therefore, the Commission believes the proposal is consistent with the objectives and principles described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act.

Rule 17Ad-22(b)(3)²¹ under the Exchange Act requires a CCP, such as NSCC, to “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [m]aintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions” NSCC’s proposal to establish a Prefunded Liquidity Program will diversify NSCC’s liquidity resources, further reduce NSCC’s overall

¹⁹ 12 U.S.C. 5464(b).

²⁰ Financial Stability Oversight Council, 2012 Annual Report, Appendix A, p. 110 and Appendix A, available at <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Appendix%20A%20Designation%20of%20Systemically%20Important%20Market%20Utilities.pdf>.

²¹ 17 CFR 240.17Ad-22(b)(3).

liquidity risk, and, thus, help it maintain sufficient financial resources to withstand, at a minimum, a default by an NSCC member to which NSCC has the largest exposure. As such, the Commission believes that the proposal is consistent with Rule 17Ad-22(b)(3).

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Payment, Clearing and Settlement Supervision Act,²² that the Commission DOES NOT OBJECT to Advance Notice, as modified by Amendment No. 1, and that NSCC is AUTHORIZED to implement the proposal.

By the Commission.

Jill M. Peterson
Assistant Secretary

²² 12 U.S.C. 5465(e)(1)(I).