

## OMB APPROVAL

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Required fields are shown with yellow backgrounds and asterisks.

Page 1 of \* 30

SECURITIES AND EXCHANGE COMMISSION  
 WASHINGTON, D.C. 20549  
 Form 19b-4

File No.\* SR - 2017 - \* 804

Amendment No. (req. for Amendments \*)

Filing by National Securities Clearing Corporation

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

|  |                          |                          |   |                          |                          |
|--|--------------------------|--------------------------|---|--------------------------|--------------------------|
| Initial *  | Amendment *              | Withdrawal               | Section 19(b)(2) *  | Section 19(b)(3)(A) *    | Section 19(b)(3)(B) *    |
| <input checked="" type="checkbox"/>  | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/>  | <input type="checkbox"/> | <input type="checkbox"/> |
| Pilot <input type="checkbox"/> Extension of Time Period for Commission Action * <input type="checkbox"/> Date Expires * <input type="text"/> |                          |                          | Rule<br><input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4)<br><input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5)<br><input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6) |                          |                          |

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

|                                     |                          |
|-------------------------------------|--------------------------|
| Section 806(e)(1) *                 | Section 806(e)(2) *      |
| <input checked="" type="checkbox"/> | <input type="checkbox"/> |

Section 3C(b)(2) \*

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Exhibit 2 Sent As Paper Document



Exhibit 3 Sent As Paper Document



### Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

To expand the application of the Family Issued Securities Charge

### Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

|              |  |             |       |
|--------------|--|-------------|-------|
| First Name * | Jacqueline                                       | Last Name * | Cezar |
| Title *      | Executive Director and Associate General Counsel |             |       |
| E-mail *     | jfarinella@dtcc.com                              |             |       |
| Telephone *  | (212) 855-3216                                   | Fax         |       |

### Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)

Date 07/10/2017

By Nikki Poulos

(Name \*)

Managing Director and Deputy General Counsel

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

npoulos@dtcc.com

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFT website.

**Form 19b-4 Information \***

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

Add Remove View

Exhibit Sent As Paper Document

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

Add Remove View

Exhibit Sent As Paper Document

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**1. Text of the Advance Notice**

(a) This advance notice is filed by National Securities Clearing Corporation (“NSCC”) in connection with proposed changes to NSCC’s Rules and Procedures (“Rules”)<sup>1</sup> in order to (i) expand the application of NSCC’s existing family-issued securities charge<sup>2</sup> to apply to all Members, as described below, and (ii) include a definition of “Family-Issued Security” as a security that was issued by a Member or by an affiliate of that Member.

(b) Not applicable.

(c) Not applicable.

**2. Procedures of the Self-Regulatory Organization**

The advance notice was approved by the Risk Committee of the Board of Directors on June 27, 2017.

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

Not applicable

**4. Self-Regulatory Organization’s Statement on Burden on Competition**

Not applicable.

**5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

NSCC has not received or solicited any written comments relating to this proposal. NSCC will notify the Commission of any written comments received by NSCC.

**6. Extension of Time Period for Commission Action**

NSCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Act for Commission action.

**7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

(a) Not applicable.

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<sup>1</sup> Terms not defined herein are defined in the Rules, available at [www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

<sup>2</sup> The family-issued securities charge is currently described in Procedure XV, Section I.(B)(1) of the Rules, supra note 1.

(b) Not applicable.

(c) Not applicable.

(d) Not applicable.

**8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act**

Not applicable.

**10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing, and Settlement Supervision Act**

*Description of Proposed Changes*

Currently, in calculating its Members' required deposits to the Clearing Fund, NSCC excludes positions in Family-Issued Securities of certain Members from its parametric volatility Clearing Fund component ("VaR Charge"), and instead charges an amount calculated by multiplying the absolute value of the long, net unsettled positions in that Member's Family-Issued Securities by a percentage that is no less than 40 percent ("FIS Charge"). The FIS Charge is currently only applied to Members that are rated 5, 6, or 7 on the Credit Risk Rating Matrix ("CRRM"). The proposed change would expand the application of the FIS Charge to the positions in Family-Issued Securities of all Members to help NSCC cover the specific wrong-way risk posed by Family-Issued Securities, as described further below.<sup>3</sup> Therefore, NSCC is proposing to amend (i) Rule 1 (Definitions and Descriptions) to add a definition of "Family-Issued Security," and (ii) Procedure XV (Clearing Fund Formula and Other Matters) to expand the application of the FIS Charge to all Members by moving the description of FIS Charge from Section I.(B)(1) to Sections I.(A)(1) and I.(A)(2) in order to make clear that the FIS Charge would be included as a component of the Clearing Fund formula calculated for all Members.

As a central counterparty, NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions and thereby reducing the risk faced by participants and contributing to global financial stability. The effectiveness of a central counterparty's risk controls and the adequacy of its financial resources are critical to achieving these risk-reducing goals. In that context, NSCC continuously reviews its margining methodology in order to ensure the reliability of its margining in achieving the desired coverage. In order to be most effective, NSCC must take into consideration the risk characteristics specific to certain securities when margining those securities.

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<sup>3</sup> Members that do not trade in Family-Issued Securities would not be subject to the FIS Charge.

Among the various risks that NSCC considers when evaluating the effectiveness of its margining methodology are its counterparty risks and identification and mitigation of “wrong-way” risk, particularly specific wrong-way risk, defined as the risk that an exposure to a counterparty is highly likely to increase when the creditworthiness of that counterparty deteriorates.<sup>4</sup> NSCC has identified an exposure to specific wrong-way risk when it acts as central counterparty to a Member with respect to positions in Family-Issued Securities. In the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC.

In 2015, NSCC proposed to address its exposure to specific wrong-way risk in two ways.<sup>5</sup> First, NSCC proposed to apply the FIS Charge to its Members that are rated a 5, 6, or 7 on the CRRM (i.e., Members on the Watch List).<sup>6</sup> Today, following implementation of the FIS Phase 1 Rule Change, the FIS Charge is applied by excluding positions in Family-Issued Securities of those Members from NSCC’s VaR Charge, and instead charging an amount calculated by multiplying the absolute value of the long net unsettled positions in that Member’s Family-Issued Securities by a percentage.<sup>7</sup> That percentage is no less than 40 percent and up to 100 percent, and is determined by NSCC based on the Member’s rating on the CRRM and on the type of Family-Issued Securities submitted to NSCC. As such, under Procedure XV (1) fixed income securities that are Family-Issued Securities are charged a haircut rate of no less than 80 percent for Members that are rated 6 or 7 on the CRRM, and no less than 40 percent for Members rated 5 on the CRRM; and (2) equity securities that are Family-Issued Securities are charged a haircut rate of 100 percent for Members that are rated 6 or 7 on the CRRM, and no less than 50 percent for Members that are rated 5 on the CRRM. Members that have a rating on the

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<sup>4</sup> See Principles for financial market infrastructures, issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions 47 n.65 (April 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

<sup>5</sup> See Securities Exchange Act Release No. 76077 (October 5, 2015), 80 FR 61256 (October 9, 2015), (SR-NSCC-2015-003) (“FIS Phase 1 Rule Change”).

<sup>6</sup> As part of its ongoing monitoring of its membership, NSCC utilizes the CRRM to rate its risk exposures to its Members based on a scale from 1 (the strongest) to 7 (the weakest). Members that fall within the higher risk rating categories (i.e., 5, 6, and 7) are placed on NSCC’s “Watch List,” and may be subject to enhanced surveillance or additional margin charges, as permitted under the Rules. See Rule 2B, Section 4 and Procedure XV, Section I.(B)(1) of the Rules, supra note 1. See also Securities Exchange Act Release No. 80734 (May 19, 2017), 82 FR 24174 (May 25, 2017), (SR-DTC-2017-002, SR-FICC-2017-006, SR-NSCC-2017-002) (approving proposed changes to the CRRM methodology).

<sup>7</sup> Procedure XV (Clearing Fund Formula and Other Matters), Section I.(B)(1), supra note 1.

CRRM of 1 through 4 are not currently subject to the FIS Charge. As stated above, Family-Issued Securities present NSCC with specific wrong-way risk such that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. Therefore, the FIS Charge is applied to the unsettled long positions in Family-Issued Securities, which are the positions that NSCC would close out following a Member default, as opposed to the short positions in net unsettled securities. The haircut rates were calibrated based on historical corporate issue recovery rate data, and address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member's default.

The FIS Charge is currently applied only to Members on the Watch List because these Members present a heightened credit risk to NSCC or have demonstrated higher risk related to their ability to meet settlement, and, as such, at the time the FIS Phase 1 Rule Change was proposed, NSCC believed there was a clear and more urgent need to address NSCC's exposure to specific wrong-way risk presented by these Members' positions in Family-Issued Securities.

Second, NSCC proposed to further evaluate its exposure to wrong-way risk presented by positions in Family-Issued Securities by reviewing the impact of expanding the application of the FIS Charge to positions in Family-Issued Securities of all Members.<sup>8</sup> Following its evaluation, NSCC has determined that the risk characteristics to be considered when margining Family-Issued Securities extend beyond Members' creditworthiness. More specifically, exposure to specific wrong-way risk is based on the correlation to the default of the issuer Member, and NSCC may face this risk with respect to positions in Family-Issued Securities of all of its Members, not only those Members on the Watch List. As such, in order to more effectively mitigate its exposure to specific wrong-way risk, NSCC is proposing to apply the FIS Charge to positions in Family-Issued Securities of all Members.

In order to implement this proposal, NSCC would amend Procedure XV to move the FIS Charge from Section I.(B)(1), where it is currently described as an additional deposit for Members on surveillance, to Sections I.(A)(1) and (2), to include the FIS Charge as a component of the Clearing Fund formula that is calculated for each Member.<sup>9</sup> Under the proposed change, the calculation of the FIS Charge would not change as applied to Members that are rated 5, 6, or 7 on the CRRM. NSCC is proposing to revise the description of the FIS Charge to include Members that are rated 1 through 4 on the CRRM.<sup>10</sup> Specifically, NSCC is proposing to amend the description of the FIS Charge in Procedure XV such that (1) fixed-income securities that are Family-Issued Securities would be charged a haircut rate of no less than 80 percent for Members that are rated 6 or 7 on the CRRM, and no less than 40 percent for Members that are rated 1 through 5 on the CRRM; and (2) equities that are Family-Issued Securities would be charged a

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<sup>8</sup> FIS Phase 1 Rule Change, supra note 5.

<sup>9</sup> Procedure XV, Sections I.(A)(1) and (2) and I.(B), supra note 1.

<sup>10</sup> Members that are not rated on the CRRM are not subject to the FIS Charge and would not be subject to the FIS Charge under the proposed change.

haircut rate of 100 percent for Members rated 6 or 7 on the CRRM, and no less than 50 percent for Members that are rated 1 through 5 on the CRRM.

The proposed change would also amend NSCC Rule 1 (Definitions and Descriptions) to include a definition of Family-Issued Securities in order to provide more clarity to the Rules. Under the proposed change, “Family-Issued Security” would be defined as a security that was issued by a Member or an affiliate of that Member.

*Expected Effect on and Management of Risk*

By expanding the application of the FIS Charge to all Members, the proposed change would more allow NSCC to more effectively mitigate its exposure to specific wrong-way risk as posed by Family-Issued Securities. As described above, Family-Issued Securities present NSCC with specific wrong-way risk such that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. The FIS Charge addresses this risk by using haircut rates that are calibrated based on historical corporate issue recovery rate data, and address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member’s default. Because NSCC may face specific wrong-way risk with respect to positions in Family-Issued Securities of all of its Members, the proposed change to expand the FIS Charge to all Members would reduce NSCC’s exposure to specific wrong-way risk.

By mitigating specific wrong-way risk for NSCC as described above, the proposed change would also mitigate risk for Members because lowering the risk profile for NSCC would in turn lower the risk exposure that Members may have with respect to NSCC in its role as a central counterparty.

*Consistency with the Clearing Supervision Act*

The stated purpose 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”) 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.<sup>11</sup> Section 805(a)(2) of the Clearing Supervision Act<sup>12</sup> also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like NSCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>13</sup> states that the objectives

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<sup>11</sup> 12 U.S.C. 5461(b).

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

<sup>13</sup> 12 U.S.C. 5464(b).

and principles for risk management standards prescribed under Section 805(a) shall be to, among other things, promote robust risk management.

NSCC believes that the proposed change is consistent with Section 805(b) of the Clearing Supervision Act because it is designed to promote robust risk management. By enhancing the margin methodology applied to Family-Issued Securities of all Members, the proposal would assist NSCC in collecting margin that more accurately reflects NSCC's exposure to a Member that clears Family-Issued Securities and would assist NSCC in its continuous efforts to improve the reliability and effectiveness of its risk-based margining methodology by taking into account specific wrong-way risk. By assisting NSCC in more effectively mitigating its exposure to specific wrong-way risk, the proposal is designed to promote robust risk management, consistent with Section 805(b) of the Clearing Supervision Act.<sup>14</sup>

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act<sup>15</sup> and Section 17A of the Securities Exchange Act of 1934 ("Act").<sup>16</sup> Rule 17Ad-22 requires 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.<sup>17</sup> For the reasons set forth below, NSCC believes the proposed change is consistent with Rules 17Ad-22(e)(4)(i), and (e)(6)(i) and (v), each promulgated under the Act.<sup>18</sup>

Rule 17Ad-22(e)(4)(i) under the Act requires, in part, that each covered clearing agency 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, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>19</sup> The specific wrong-way risk presented by Family-Issued Securities is the risk that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. The haircut rates of the FIS Charge more accurately reflect this risk because they were calibrated based on historical corporate issue recovery rate data, and, therefore, address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member's default. In this way, NSCC has determined that the margining methodology used in calculating the FIS Charge more accurately reflects the

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<sup>14</sup> Id.

<sup>15</sup> 12 U.S.C. 5464(a)(2).

<sup>16</sup> 17 CFR 240.17Ad-22 ("Rule 17Ad-22").

<sup>17</sup> Id.

<sup>18</sup> 17 CFR 240.17Ad-22(e)(4) and (e)(6).

<sup>19</sup> 17 CFR 240.17Ad-22(e)(4)(i).



risk characteristics of Family-Issued Securities than applying its VaR Charge, and would permit NSCC to more accurately identify, measure, monitor and manage its credit exposures to those Members with positions in Family-Issued Securities. Further, by expanding the application of the FIS Charge to all Members, the proposed change would assist NSCC in collecting and maintaining financial resources that reflect its credit exposures to those Members. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(4)(i).

Rule 17Ad-22(e)(6)(i) under the Act requires, in part, that each covered clearing agency that provides central counterparty services establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.<sup>20</sup> Rule 17Ad-22(e)(6)(v) under the Act requires, in part, that each covered clearing agency that provides central counterparty services establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.<sup>21</sup>

As stated above, Family-Issued Securities present NSCC with specific wrong-way risk that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. Therefore, the haircut rates were calibrated based on historical corporate issue recovery rate data, and address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member's default, and would more accurately reflect the risk characteristics of Family-Issued Securities than applying its VaR Charge. In this way, the proposal would assist NSCC in maintaining a risk-based margin system that considers, and produces margin levels commensurate with, the risks and particular attributes of Family-Issued Securities. Additionally, NSCC believes application of the FIS Charge to positions in Family-Issued Securities of all Members is an appropriate method for measuring its credit exposures, because the FIS Charge accounts for the risk factors presented by these securities, i.e. the risk that these securities would be devalued in the event of a Member default. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(i) and (v).

## **11. Exhibits**

Exhibit 1 – Not applicable.

Exhibit 1A – Notice of proposed change for publication in the Federal Register.

Exhibit 2 – Not applicable.

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<sup>20</sup> 17 CFR 240.17Ad-22(e)(6)(i).

<sup>21</sup> 17 CFR 240.17Ad-22(e)(6)(v).

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the Rules.

**EXHIBIT 1A**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-[\_\_\_\_]; File No. SR-NSCC-2017-804)

[DATE]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of a Advance Notice to Expand the Application of the Family-Issued Securities Charge

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> notice is hereby given that on July \_\_, 2017, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice SR-NSCC-2017-804 (“Advance Notice”) as described in Items I, II and III below, which Items have been prepared by the clearing agency.<sup>3</sup> The Commission is publishing this notice to solicit comments on the Advance Notice from interested persons.

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

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

<sup>3</sup> On July \_\_, 2017, NSCC filed this Advance Notice as a proposed rule change (SR-NSCC-2017-010) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4, 17 CFR 240.19b-4. A copy of the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

The Advance Notice consists of amendments to the NSCC Rules and Procedures ("Rules")<sup>4</sup> in order to (i) expand the application of NSCC's existing family-issued securities charge<sup>5</sup> to apply to all Members, as described below, and (ii) include a definition of "Family-Issued Security" as a security that was issued by a Member or by an affiliate of that Member, as described in greater detail below.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

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

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

NSCC has not received or solicited any written comments relating to this proposal. NSCC will notify the Commission of any written comments received by NSCC.

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<sup>4</sup> Terms not defined herein are defined in the Rules, available at [www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

<sup>5</sup> The family-issued securities charge is currently described in Procedure XV, Section I.(B)(1) of the Rules, supra note 4.

(B) Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing, and Settlement Supervision Act

Description of Proposed Changes

Currently, in calculating its Members' required deposits to the Clearing Fund, NSCC excludes positions in Family-Issued Securities of certain Members from its parametric volatility Clearing Fund component ("VaR Charge"), and instead charges an amount calculated by multiplying the absolute value of the long, net unsettled positions in that Member's Family-Issued Securities by a percentage that is no less than 40 percent ("FIS Charge"). The FIS Charge is currently only applied to Members that are rated 5, 6, or 7 on the Credit Risk Rating Matrix ("CRRM"). The proposed change would expand the application of the FIS Charge to the positions in Family-Issued Securities of all Members to help NSCC cover the specific wrong-way risk posed by Family-Issued Securities, as described further below.<sup>6</sup> Therefore, NSCC is proposing to amend (i) Rule 1 (Definitions and Descriptions) to add a definition of "Family-Issued Security," and (ii) Procedure XV (Clearing Fund Formula and Other Matters) to expand the application of the FIS Charge to all Members by moving the description of FIS Charge from Section I.(B)(1) to Sections I.(A)(1) and I.(A)(2) in order to make clear that the FIS Charge would be included as a component of the Clearing Fund formula calculated for all Members.

As a central counterparty, NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions and thereby reducing the risk faced by participants and contributing to global financial

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<sup>6</sup> Members that do not trade in Family-Issued Securities would not be subject to the FIS Charge.

stability. The effectiveness of a central counterparty's risk controls and the adequacy of its financial resources are critical to achieving these risk-reducing goals. In that context, NSCC continuously reviews its margining methodology in order to ensure the reliability of its margining in achieving the desired coverage. In order to be most effective, NSCC must take into consideration the risk characteristics specific to certain securities when margining those securities.

Among the various risks that NSCC considers when evaluating the effectiveness of its margining methodology are its counterparty risks and identification and mitigation of "wrong-way" risk, particularly specific wrong-way risk, defined as the risk that an exposure to a counterparty is highly likely to increase when the creditworthiness of that counterparty deteriorates.<sup>7</sup> NSCC has identified an exposure to specific wrong-way risk when it acts as central counterparty to a Member with respect to positions in Family-Issued Securities. In the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC.

In 2015, NSCC proposed to address its exposure to specific wrong-way risk in two ways.<sup>8</sup> First, NSCC proposed to apply the FIS Charge to its Members that are rated a 5, 6, or 7 on the CRRM (i.e., Members on the Watch List).<sup>9</sup> Today, following

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<sup>7</sup> See Principles for financial market infrastructures, issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions 47 n.65 (April 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

<sup>8</sup> See Securities Exchange Act Release No. 76077 (October 5, 2015), 80 FR 61256 (October 9, 2015), (SR-NSCC-2015-003) ("FIS Phase 1 Rule Change").

<sup>9</sup> As part of its ongoing monitoring of its membership, NSCC utilizes the CRRM to rate its risk exposures to its Members based on a scale from 1 (the strongest) to 7

implementation of the FIS Phase 1 Rule Change, the FIS Charge is applied by excluding positions in Family-Issued Securities of those Members from NSCC's VaR Charge, and instead charging an amount calculated by multiplying the absolute value of the long net unsettled positions in that Member's Family-Issued Securities by a percentage.<sup>10</sup> That percentage is no less than 40 percent and up to 100 percent, and is determined by NSCC based on the Member's rating on the CRRM and on the type of Family-Issued Securities submitted to NSCC. As such, under Procedure XV (1) fixed income securities that are Family-Issued Securities are charged a haircut rate of no less than 80 percent for Members that are rated 6 or 7 on the CRRM, and no less than 40 percent for Members rated 5 on the CRRM; and (2) equity securities that are Family-Issued Securities are charged a haircut rate of 100 percent for Members that are rated 6 or 7 on the CRRM, and no less than 50 percent for Members that are rated 5 on the CRRM. Members that have a rating on the CRRM of 1 through 4 are not currently subject to the FIS Charge. As stated above, Family-Issued Securities present NSCC with specific wrong-way risk such that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. Therefore, the FIS Charge is applied to the unsettled long positions in Family-Issued Securities, which are the

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(the weakest). Members that fall within the higher risk rating categories (i.e., 5, 6, and 7) are placed on NSCC's "Watch List," and may be subject to enhanced surveillance or additional margin charges, as permitted under the Rules. See Rule 2B, Section 4 and Procedure XV, Section I.(B)(1) of the Rules, supra note 4. See also Securities Exchange Act Release No. 80734 (May 19, 2017), 82 FR 24174 (May 25, 2017), (SR-DTC-2017-002, SR-FICC-2017-006, SR-NSCC-2017-002) (approving proposed changes to the CRRM methodology).

<sup>10</sup> Procedure XV (Clearing Fund Formula and Other Matters), Section I.(B)(1), supra note 4.

positions that NSCC would close out following a Member default, as opposed to the short positions in net unsettled securities. The haircut rates were calibrated based on historical corporate issue recovery rate data, and address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member's default.

The FIS Charge is currently applied only to Members on the Watch List because these Members present a heightened credit risk to NSCC or have demonstrated higher risk related to their ability to meet settlement, and, as such, at the time the FIS Phase 1 Rule Change was proposed, NSCC believed there was a clear and more urgent need to address NSCC's exposure to specific wrong-way risk presented by these Members' positions in Family-Issued Securities.

Second, NSCC proposed to further evaluate its exposure to wrong-way risk presented by positions in Family-Issued Securities by reviewing the impact of expanding the application of the FIS Charge to positions in Family-Issued Securities of all Members.<sup>11</sup> Following its evaluation, NSCC has determined that the risk characteristics to be considered when margining Family-Issued Securities extend beyond Members' creditworthiness. More specifically, exposure to specific wrong-way risk is based on the correlation to the default of the issuer Member, and NSCC may face this risk with respect to positions in Family-Issued Securities of all of its Members, not only those Members on the Watch List. As such, in order to more effectively mitigate its exposure to specific wrong-way risk, NSCC is proposing to apply the FIS Charge to positions in Family-Issued Securities of all Members.

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<sup>11</sup> FIS Phase 1 Rule Change, supra note 8.



In order to implement this proposal, NSCC would amend Procedure XV to move the FIS Charge from Section I.(B)(1), where it is currently described as an additional deposit for Members on surveillance, to Sections I.(A)(1) and (2), to include the FIS Charge as a component of the Clearing Fund formula that is calculated for each Member.<sup>12</sup> Under the proposed change, the calculation of the FIS Charge would not change as applied to Members that are rated 5, 6, or 7 on the CRRM. NSCC is proposing to revise the description of the FIS Charge to include Members that are rated 1 through 4 on the CRRM.<sup>13</sup> Specifically, NSCC is proposing to amend the description of the FIS Charge in Procedure XV such that (1) fixed-income securities that are Family-Issued Securities would be charged a haircut rate of no less than 80 percent for Members that are rated 6 or 7 on the CRRM, and no less than 40 percent for Members that are rated 1 through 5 on the CRRM; and (2) equities that are Family-Issued Securities would be charged a haircut rate of 100 percent for Members rated 6 or 7 on the CRRM, and no less than 50 percent for Members that are rated 1 through 5 on the CRRM.

The proposed change would also amend NSCC Rule 1 (Definitions and Descriptions) to include a definition of Family-Issued Securities in order to provide more clarity to the Rules. Under the proposed change, “Family-Issued Security” would be defined as a security that was issued by a Member or an affiliate of that Member.

*Expected Effect on and Management of Risk*

By expanding the application of the FIS Charge to all Members, the proposed change would more allow NSCC to more effectively mitigate its exposure to specific

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<sup>12</sup> Procedure XV, Sections I.(A)(1) and (2) and I.(B), supra note 4.

<sup>13</sup> Members that are not rated on the CRRM are not subject to the FIS Charge and would not be subject to the FIS Charge under the proposed change.

wrong-way risk as posed by Family-Issued Securities. As described above, Family-Issued Securities present NSCC with specific wrong-way risk such that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. The FIS Charge addresses this risk by using haircut rates that are calibrated based on historical corporate issue recovery rate data, and address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member's default. Because NSCC may face specific wrong-way risk with respect to positions in Family-Issued Securities of all of its Members, the proposed change to expand the FIS Charge to all Members would reduce NSCC's exposure to specific wrong-way risk.

By mitigating specific wrong-way risk for NSCC as described above, the proposed change would also mitigate risk for Members because lowering the risk profile for NSCC would in turn lower the risk exposure that Members may have with respect to NSCC in its role as a central counterparty.

*Consistency with the Clearing Supervision Act*

The stated purpose of Title VIII of the Clearing 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.<sup>14</sup> Section 805(a)(2) of the Clearing Supervision Act<sup>15</sup> also

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<sup>14</sup> 12 U.S.C. 5461(b).

<sup>15</sup> 12 U.S.C. 5464(a)(2).

authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like NSCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>16</sup> states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to, among other things, promote robust risk management.

NSCC believes that the proposed change is consistent with Section 805(b) of the Clearing Supervision Act because it is designed to promote robust risk management. By enhancing the margin methodology applied to Family-Issued Securities of all Members, the proposal would assist NSCC in collecting margin that more accurately reflects NSCC's exposure to a Member that clears Family-Issued Securities and would assist NSCC in its continuous efforts to improve the reliability and effectiveness of its risk-based margining methodology by taking into account specific wrong-way risk. By assisting NSCC in more effectively mitigating its exposure to specific wrong-way risk, the proposal is designed to promote robust risk management, consistent with Section 805(b) of the Clearing Supervision Act.<sup>17</sup>

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act<sup>18</sup> and Section 17A of the Act.<sup>19</sup> Rule 17Ad-22 requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum

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<sup>16</sup> 12 U.S.C. 5464(b).

<sup>17</sup> Id.

<sup>18</sup> 12 U.S.C. 5464(a)(2).

<sup>19</sup> 17 CFR 240.17Ad-22 ("Rule 17Ad-22").

requirements for their operations and risk management practices on an ongoing basis.<sup>20</sup>

For the reasons set forth below, NSCC believes the proposed change is consistent with Rules 17Ad-22(e)(4)(i), and (e)(6)(i) and (v), each promulgated under the Act.<sup>21</sup>

Rule 17Ad-22(e)(4)(i) under the Act requires, in part, that each covered clearing agency 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, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>22</sup> The specific wrong-way risk presented by Family-Issued Securities is the risk that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. The haircut rates of the FIS Charge more accurately reflect this risk because they were calibrated based on historical corporate issue recovery rate data, and, therefore, address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member's default. In this way, NSCC has determined that the margining methodology used in calculating the FIS Charge more accurately reflects the risk characteristics of Family-Issued Securities than applying its VaR Charge, and would permit NSCC to more accurately identify, measure, monitor and manage its credit exposures to those Members with positions in Family-

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<sup>20</sup> Id.

<sup>21</sup> 17 CFR 240.17Ad-22(e)(4) and (e)(6).

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

Issued Securities. Further, by expanding the application of the FIS Charge to all Members, the proposed change would assist NSCC in collecting and maintaining financial resources that reflect its credit exposures to those Members. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(4)(i).

Rule 17Ad-22(e)(6)(i) under the Act requires, in part, that each covered clearing agency that provides central counterparty services establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.<sup>23</sup> Rule 17Ad-22(e)(6)(v) under the Act requires, in part, that each covered clearing agency that provides central counterparty services establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.<sup>24</sup>

As stated above, Family-Issued Securities present NSCC with specific wrong-way risk that, in the event that a Member with unsettled long positions in Family-Issued Securities defaults, NSCC would close out those positions following a likely drop in the credit-worthiness of the issuer, possibly resulting in a loss to NSCC. Therefore, the haircut rates were calibrated based on historical corporate issue recovery rate data, and

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<sup>23</sup> 17 CFR 240.17Ad-22(e)(6)(i).

<sup>24</sup> 17 CFR 240.17Ad-22(e)(6)(v).

address the risk that the Family-Issued Securities of a Member would be devalued in the event of that Member's default, and would more accurately reflect the risk characteristics of Family-Issued Securities than applying its VaR Charge. In this way, the proposal would assist NSCC in maintaining a risk-based margin system that considers, and produces margin levels commensurate with, the risks and particular attributes of Family-Issued Securities. Additionally, NSCC believes application of the FIS Charge to positions in Family-Issued Securities of all Members is an appropriate method for measuring its credit exposures, because the FIS Charge accounts for the risk factors presented by these securities, i.e. the risk that these securities would be devalued in the event of a Member default. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(i) and (v).

### III. Date of Effectiveness of the Advance Notice, and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and

authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

#### IV. Solicitation of Comments

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

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2017-804 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-NSCC-2017-804. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent

amendments, all written statements with respect to the Advance Notice that are filed with the Commission, and all written communications relating to the Advance Notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSCC-2017-804 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary



**EXHIBIT 5**



**NATIONAL  
SECURITIES  
CLEARING  
CORPORATION**

**RULES & PROCEDURES**

TEXT OF PROPOSED RULE CHANGE

**Bold and underlined text** indicates proposed added language

**~~Bold and strikethrough text~~** indicates proposed deleted language

RULE 1. DEFINITIONS AND DESCRIPTIONS.

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**Family-Issued Security**

**The term “Family-Issued Security” means a security that was issued by a Member or an affiliate of that Member.**

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## PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS<sup>1</sup>

### I.(A) Clearing Fund Formula for Members

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#### (1) For CNS Transactions

(a)(i) The volatility of such Member's net of unsettled Regular Way, When-Issued and When-Distributed pending positions (i.e., net positions that have not yet passed Settlement Date) and fail positions (i.e., net positions that did not settle on Settlement Date), hereinafter collectively referred to as Net Unsettled Positions. Such calculation shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

(ii) The Corporation shall have the discretion to exclude from the calculations in subsection (i) above Net Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, other than municipal and corporate bonds. The amount of Clearing Fund required with respect to such Net Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the positions covered by subsection y of this paragraph. The Corporation shall exclude from the calculations in subsection (i) above **(A) municipal and corporate bonds, which are addressed in subsection (iii) below, and (B) Family-Issued Securities, which are addressed in subsection (iv) below.**

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**(iv) The Corporation shall exclude from the calculations in subsection (i) above long Net Unsettled Positions in Family-Issued Securities. The amount of Clearing Fund required with respect to long Net Unsettled Positions in Family-Issued Securities shall be determined by multiplying**

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<sup>1</sup> All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

**the absolute value of such positions by a percentage designated by the Corporation; such percentage shall be no less than 40% and up to 100%, and shall be determined, from time to time, in the sole discretion of the Corporation, within parameters described below, based on the Member's rating on the Credit Risk Rating Matrix and the type of Family-Issued Securities submitted to the Corporation:**

**(A) Fixed income securities that are Family-Issued Securities shall be charged a haircut rate of no less than 80% for firms that are rated 6 or 7 on the Credit Risk Rating Matrix, and no less than 40% for firms that are rated 1 through 5 on the Credit Risk Rating Matrix.**

**(B) Equity securities that are Family-Issued Securities shall be charged a haircut rate of 100% for firms that are rated 6 or 7 on the Credit Risk Rating Matrix, and no less than 50% for firms that are rated 1 through 5 on the Credit Risk Rating Matrix;**

plus

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**(2) For Balance Order Transactions**

(a)(i) The volatility of such Member's net of unsettled Regular Way, When-Issued and When-Distributed positions that have not yet passed Settlement Date, hereinafter collectively referred to as Net Balance Order Unsettled Positions. Such calculation shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

(ii) The Corporation shall have the discretion to exclude from the calculations in subsection (i) above Net Balance Order Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, other than municipal and corporate bonds. The amount of Clearing Fund required with respect to such Net Balance Order Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the

positions covered by subsection y of this paragraph. The Corporation shall exclude from the calculations in subsection (i) above (A) municipal and corporate bonds, which are addressed in subsection (iii) below, and (B) Family-Issued Securities, which are addressed in subsection (iv) below.

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(iv) The Corporation shall exclude from the calculations in subsection (i) above long Net Balance Order Unsettled Positions in Family-Issued Securities. The amount of Clearing Fund required with respect to long Net Balance Order Unsettled Positions in Family-Issued Securities shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation; such percentage shall be no less than 40% and up to 100%, and shall be determined, from time to time, in the sole discretion of the Corporation, within parameters described below, based on the Member's rating on the Credit Risk Rating Matrix and the type of Family-Issued Securities submitted to the Corporation:

(A) Fixed income securities that are Family-Issued Securities shall be charged a haircut rate of no less than 80% for firms that are rated 6 or 7 on the Credit Risk Rating Matrix, and no less than 40% for firms that are rated 1 through 5 on the Credit Risk Rating Matrix.

(B) Equity securities that are Family-Issued Securities shall be charged a haircut rate of 100% for firms that are rated 6 or 7 on the Credit Risk Rating Matrix, and no less than 50% for firms that are rated 1 through 5 on the Credit Risk Rating Matrix;

plus

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#### I.(B) Additional Clearing Fund Formula

##### (1) Additional Deposits for Members on the Watch List

Any Member or Limited Member who is placed on the Watch List shall be required to make such additional Clearing Fund deposits as determined by the Corporation on the same day as requested by the Corporation within such timeframe as required by the Corporation from time to time.

##### ~~(2) Family-Issued Securities~~

~~The Corporation shall require Members who are rated 5, 6, or 7 on the Credit Risk Rating Matrix to contribute to the Clearing Fund an amount determined by multiplying the absolute value of any long Net Unsettled Positions in classes of "family-issued securities" (defined as securities that were issued by either that~~

~~Member or by an affiliate of that Member) by a percentage designated by the Corporation; such percentage, to be no less than 40% and up to 100%, shall be determined, from time to time, in the sole discretion of the Corporation, within the parameters described as follows, based on the Member's rating on the Credit Risk Rating Matrix and on the type of family-issued securities submitted to the Corporation.~~

~~Fixed income securities that are family-issued securities shall be charged a haircut rate of no less than 80% for firms that are rated 6 or 7 on the Credit Risk Rating Matrix, and no less than 40% for firms that are rated 5 on the Credit Risk Rating Matrix; and equity securities that are family-issued securities shall be charged a haircut rate of 100% for firms that are rated 6 or 7 on Credit Risk Rating Matrix, and no less than 50% for firms that are rated 5 on the Credit Risk Rating Matrix.~~

~~The Corporation shall exclude long Net Unsettled Positions in such family-issued securities of Members who are rated 5, 6, or 7 on the Credit Risk Rating Matrix from the calculations describe in Subsections I.(A)(1)(a)(i) and (ii) and I.(A)(2)(a)(i) and (ii).~~

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