



NSSC SFT SPONSORED PROGRAM – DEFAULT SCENARIOS

The frequently asked questions (FAQs) below address what could happen, pursuant to the Rules and Procedures (the “Rules”) of the National Securities Clearing Corporation (“NSCC”), to a Sponsored Member’s Securities Financing Transaction (“SFT”) positions arising from Sponsored Member Transactions upon a default of NSCC, a Sponsoring Member, or a Sponsored Member.¹

The matters addressed in these FAQs are governed by the Rules, the current version of which is publicly available and may change from time to time.² In the event there is any conflict or inconsistency between the statements in these FAQs and the Rules, the Rules govern and control.

I. NSCC DEFAULT

Q. What would happen in the event of an NSCC default?

- **Termination of Outstanding Transactions**
 - Section 17 of Rule 56 would govern the treatment of outstanding SFTs upon an NSCC default and provides in such situation for the automatic termination of all SFTs, including all Sponsored Member Transactions, that have been novated to NSCC but have not yet settled.

¹ The information and examples provided in these FAQs are for general informational and indicative purposes only. Such information may not be relied on by any party for any purpose, as the actions taken in an actual default event could differ materially from expectations. Each situation regarding a defaulting firm (whether that firm is NSCC, a Sponsoring Member, or a Sponsored Member) is unique and the actions NSCC may take in an actual event will depend on the specific facts and circumstances, and will be governed by the facts, risks, laws, rules and regulations in effect at that time and that apply in the given situation. Accordingly, the assumptions, examples and scenarios discussed in this document reflect events and circumstances that may not arise, and the impact of these events and the actions taken by NSCC may differ depending on the actual circumstances. Any statements in these FAQs, like any statements regarding hypothetical scenarios, are subject to inherent uncertainties. NSCC does not undertake to update these FAQs to reflect changes or events that occur after the date of publication. The range of available actions described in this document and the discussion of actions that could be taken in certain future scenarios are hypothetical only and not binding on any parties in any forum, including but not limited to NSCC, any of its affiliates, a bankruptcy or other court, or any regulatory, resolution, or other governmental authority

² Capitalized terms used but not defined herein have the meanings given to them in the Rules, available at <https://www.dtcc.com/legal/rules-and-procedures>.

- **Market Action by SFT Members**
 - SFT Members, including Sponsored Members, would be permitted (but would not be obligated) to take market action to buy in or sell out the securities subject of the SFT that has been novated to NSCC.
 - The Rules do not generally limit an SFT Member’s ability to take market action in relation to the securities that are the subject of an SFT.

- **Calculation of Aggregate Net SFT Close-out Value**
 - Under Section 17 of Rule 56, following the termination of each SFT Member’s outstanding SFTs, the Board of Directors would determine a single net amount owed by or to each SFT Member, including each Sponsored Member, in respect of its SFT positions (the “Aggregate Net SFT Close-out Value”).
 - The Board of Directors would calculate the Aggregate Net SFT Close-out Value by aggregating and netting the close-out value of each of the SFT Member’s SFT positions.
 - The close-out value of each SFT position, in turn, would be calculated as follows:
 - For an SFT Long Position (i.e., the SFT Member is the securities lender under the SFT), the close-out value would be equal to the market value of the SFT Securities (i.e., the lent securities) that are the subject of the SFT that has been novated to NSCC minus the SFT Cash (i.e., the cash collateral) for the SFT.
 - For an SFT Short Position (i.e., the SFT Member is the securities borrower under the SFT), the close-out value would be equal to the amount of SFT Cash for the SFT minus the market value of the SFT Securities that are the subject of the SFT that has been novated to NSCC.
 - For such calculations, the market value of an SFT Security will be the closing price of such security on the business day following NSCC’s default.
 - An SFT Member’s market action or lack thereof would not affect the calculation of the close-out value.
 - Based on the Rules discussed above, the following is an example of how the Board of Directors may, depending on the given facts and circumstances, calculate the close-out value of an SFT position following an NSCC default:
 - Assume an SFT Member had lent 100 securities of CUSIP XXX against \$100 of SFT Cash.
 - Upon NSCC’s default, all the SFT Member’s SFT positions would automatically be terminated.
 - Following such termination, the Board would calculate the close-out value of each such SFT position.

- If the close-out value of CUSIP XXX (i.e., the closing price of the security on the business day following NSCC’s default) is \$1.20, then NSCC would owe a close-out value of \$20 to the SFT Member in respect of the SFT position (i.e., the market value of the 100 securities, \$120, minus the \$100 in SFT Cash).
 - If the close-out value of CUSIP XXX is \$0.80, then the SFT Member would owe a close-out value of \$20 to NSCC in respect of the SFT position (i.e., the market value of the 100 securities, \$80, minus the \$100 in SFT Cash).
- NSCC would then net all the close-out amounts owed by the SFT Member to NSCC against all close-out amounts owed by NSCC to the SFT Member to determine the Aggregate Net SFT Close-out Value owed by or to the SFT Member.
- NSCC would not net amounts NSCC owed to a Sponsored Member against amounts a Sponsoring Member owed to NSCC.
- NSCC may look to the Sponsored Member or the Sponsoring Member (including any Clearing Fund of the Sponsoring Member) to satisfy payment of any amounts owed by a Sponsored Member to NSCC.

II. SPONSORING MEMBER DEFAULT

Q. What happens when NSCC ceases to act for a Sponsoring Member in its capacity as a Sponsoring Member?

- **No Processing of New Trades**
 - As provided under Rule 2C, Section 10(c), if NSCC ceases to act for a Sponsoring Member, NSCC would no longer novate new Sponsored Member Transactions submitted by that Sponsoring Member.
 - However, the Rules provide that NSCC will continue to process new Sponsored Member Transactions submitted by other Sponsoring Members.
- **Settlement or Close-out of Existing Trades**
 - NSCC would either settle or close-out the Sponsored Member Transactions that were novated to NSCC before NSCC ceased to act for the Sponsoring Member.
 - Rule 2C, Section 12(b) provides that, if NSCC ceases to act for a Sponsoring Member, NSCC shall determine whether to close-out the affected Sponsored Member Transactions and/or permit the Sponsored Members to complete their settlement.
 - *Settlement*
 - If the Sponsoring Member is subject to insolvency proceedings, NSCC may need the permission of the relevant bankruptcy trustee or receiver for the Sponsoring Member (e.g., the Securities Investor Protection

Corporation or Federal Deposit Insurance Corporation) in order to settle the Sponsored Member Transactions that were novated to NSCC before NSCC ceased to act for the Sponsoring Member.

- If NSCC has such permission and elects to settle a Sponsored Member Transaction, settlement would occur as though no default had occurred and in accordance with the Rules.
 - NSCC, the Sponsored Member, and the Sponsoring Member (acting through its bankruptcy trustee or receiver, if applicable) would be required to transfer or cause to be transferred the relevant cash and securities on the books and records of the Sponsoring Member in accordance with Section 5 of Rule 2C and Section 7 of Rule 56.
- *Close-out*
 - If NSCC closes out the novated Sponsored Member Transactions submitted by a defaulted Sponsoring Member, NSCC would close-out these trades by (i) taking market action to buy in or sell out the relevant securities, (ii) deeming itself to have bought in or sold out the relevant securities at the bid or ask price from a generally recognized source or at such price or prices as NSCC is able to purchase or sell such securities, or (iii) otherwise liquidating the Sponsored Member Transactions.
 - Sponsored Members would be permitted (but would not be obligated) to take market action to buy in or sell out the securities subject of the SFT that has been novated to NSCC.
 - The Rules generally do not limit an SFT Member’s ability to take market action in relation to the securities that are the subject of an SFT.
 - Pursuant to the Rules cited discussed above, the following is an example of how the amount owed by or to a Sponsored Member in relation to the Sponsored Member’s SFT positions in a particular security may, depending on the given facts and circumstances, be calculated by NSCC:
 - Assume a Sponsored Member had lent 100 securities of CUSIP XXX against \$100 of SFT Cash.
 - If NSCC opted not to settle the Sponsored Member Transaction, it would close-out the SFT position.
 - If NSCC calculates the liquidation value of CUSIP XXX to be \$1.20, then NSCC would owe \$20 to the Sponsored Member in respect of the SFT position (i.e., the liquidation value of the 100 securities, \$120, minus the \$100 in SFT Cash).
 - If NSCC calculates the liquidation value of CUSIP XXX to be \$0.80, then the Sponsored Member would owe \$20 to NSCC in

respect of the SFT position (i.e., the liquidation value of the 100 securities, \$80, minus the \$100 in SFT Cash).

- A Sponsored Member’s market action, or lack thereof, would not affect the foregoing calculations.
- NSCC would then net all the close-out amounts owed by the Sponsored Member to NSCC against all close-out amounts owed by NSCC to the Sponsored Member to determine the net amount owed by or to the SFT Member in respect of the closed-out Sponsored Member Transactions.
- However, NSCC would not net amounts NSCC owed to a Sponsored Member against amounts a Sponsoring Member owed to NSCC.
- NSCC would pay any amount owing to a Sponsored Member to the relevant Sponsoring Member in the Sponsoring Member’s capacity as paying agent (or as otherwise directed by the Sponsoring Member’s bankruptcy trustee or receiver, if applicable).
- NSCC may look to the Sponsored Member or the Sponsoring Member (including any clearing fund of the Sponsoring Member) to collect payment of any amounts owed by a Sponsored Member to NSCC.

III. SPONSORED MEMBER DEFAULT

Q. What happens when NSCC ceases to act for a Sponsored Member?

- Section 14 of Rule 2C would generally govern the liquidation of a Sponsored Member’s SFT positions in the event NSCC ceased to act for the Sponsored Member and the Sponsoring Member has not performed the obligations of the Sponsored Member in respect of all SFT positions guaranteed by the Sponsoring Member.
- Section 14 provides for the Sponsoring Member to liquidate and value all, but not fewer than all, of the Sponsored Member’s SFT positions and to calculate any amount owing by or to the Sponsored Member in relation thereto. The Sponsoring Member would be solely responsible for paying or collecting any such amount.
- The Rules do not dictate how a Sponsoring Member must calculate the value of a Sponsored Member’s SFT positions. Accordingly, the Sponsoring Member and Sponsored Member may agree in their bilateral documentation as to the manner in which the Sponsoring Member will make such calculations. However, NSCC is not responsible for such calculations or for paying any amount owed to the Sponsored Member in the event Section 14 of Rule 2C applies.