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

File No.* SR - 2020 - * 016

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) *



Rule

Pilot

Extension of Time Period
for Commission Action *

Date Expires *



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) *



Section 3C(b)(2) *



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 *).

Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Risk Charge in the VaR 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 * Chezar

Title * Executive Director and Associate General Counsel

E-mail * jfarinella@dtcc.com

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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 07/30/2020

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 *

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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 *

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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 *

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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

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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

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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 Proposed Rule Change

(a) The proposed rule change of National Securities Clearing Corporation (“NSCC”) is annexed hereto as Exhibit 5 and consists of modifications to NSCC’s Rules & Procedures (“Rules”) to (1) introduce a new component of the Clearing Fund, the Margin Liquidity Adjustment (“MLA”) charge, and (2) enhance the calculation of the volatility component of the Clearing Fund formula that utilizes a parametric Value-at-Risk (“VaR”) model (defined for purposes of this filing as the “VaR Charge,” and described in more detail in Item 3(a)(i) below) by including a bid-ask spread risk charge, as described in greater detail below.¹

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposal to introduce an MLA charge was approved by the Risk Committee of the Board of Directors on September 12, 2017, October 16, 2018 and February 18, 2020, and the proposal to enhance the VaR Charge was approved by the Risk Committee of the Board of Directors on April 12, 2019.

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

(a) Purpose

NSCC is proposing to enhance its Clearing Fund methodology by (1) introducing a new component, the MLA charge, which would be calculated to address the risk presented to NSCC when a Member’s portfolio contains large Net Unsettled Positions² in a particular group of securities with a similar risk profile or in a particular asset type (referred to as “asset groups”), and (2) enhancing the calculation of the VaR Charge by including a bid-ask spread risk charge, as described in more detail below.³

¹ Capitalized terms not defined herein are defined in the Rules, available at http://dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf.

² “Net Unsettled Positions” and “Net Balance Order Unsettled Positions” refer to net positions that have not yet passed their settlement date or did not settle on their settlement date, and are referred to collectively in this filing as Net Unsettled Positions. See Procedure XV (Clearing Fund Formula and Other Matters) of the Rules, id.

³ The results of a study of the potential impact of adopting the proposed changes have been provided to the Securities and Exchange Commission (“Commission”) and are annexed hereto as Exhibit 3a.

(i) Overview of the Required Fund Deposit and NSCC's Clearing Fund

As part of its market risk management strategy, NSCC manages its credit exposure to Members by determining the appropriate Required Fund Deposits to the Clearing Fund and monitoring its sufficiency, as provided for in the Rules.⁴ The Required Fund Deposit serves as each Member's margin.

The objective of a Member's Required Fund Deposit is to mitigate potential losses to NSCC associated with liquidating a Member's portfolio in the event NSCC ceases to act for that Member (hereinafter referred to as a "default").⁵ The aggregate of all Members' Required Fund Deposits constitutes the Clearing Fund of NSCC. NSCC would access its Clearing Fund should a defaulting Member's own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that Member's portfolio.

Pursuant to the Rules, each Member's Required Fund Deposit amount consists of a number of applicable components, each of which is calculated to address specific risks faced by NSCC, as identified within Procedure XV of the Rules.⁶ The volatility component of each Member's Required Fund Deposit is designed to measure market price volatility and is calculated for Members' Net Unsettled Positions. The volatility component is designed to capture the market price risk associated with each Member's portfolio at a 99th percentile level of confidence. The VaR Charge is the volatility component applicable to most Net Unsettled Positions,⁷ and usually comprises the largest portion of a Member's Required Fund Deposit. Procedure XV of the Rules currently provides that the VaR Charge shall be calculated in accordance with a generally accepted portfolio volatility margin model utilizing assumptions

⁴ See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters), supra note 1. NSCC's market risk management strategy is designed to comply with Rule 17Ad-22(e)(4) under the Securities Exchange Act of 1934 ("Act"), where these risks are referred to as "credit risks." 17 CFR 240.17Ad-22(e)(4).

⁵ The Rules identify when NSCC may cease to act for a Member and the types of actions NSCC may take. For example, NSCC may suspend a firm's membership with NSCC or prohibit or limit a Member's access to NSCC's services in the event that Member defaults on a financial or other obligation to NSCC. See Rule 46 (Restrictions on Access to Services) of the Rules, supra note 1.

⁶ Supra note 1.

⁷ As described in Procedure XV, Section I(A)(1)(a)(ii), (iii) and (iv), and Section I(A)(2)(a)(ii), (iii) and (iv) of the Rules, Net Unsettled Positions in certain securities are excluded from the VaR Charge and instead charged a volatility component that is calculated by multiplying the absolute value of those Net Unsettled Positions by a percentage. Supra note 1.

based on historical data as NSCC deems reasonable and a volatility range that NSCC deems appropriate.⁸

NSCC regularly assesses market and liquidity risks as such risks relate to its margining methodologies to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market. The proposed changes to include the MLA charge to its Clearing Fund methodology and to enhance the VaR Charge by including a bid-ask spread risk charge, as described below, are the result of NSCC's regular review of the effectiveness of its margining methodology.

(ii) Overview of Liquidation Transaction Costs and Proposed Changes

Each of the proposed changes addresses a similar, but separate, risk that NSCC faces increased transaction costs when it liquidates the Net Unsettled Positions of a defaulted Member due to the unique characteristics of that Member's portfolio. The transaction costs to NSCC to liquidate a defaulted Member's portfolio include both market impact costs and fixed costs. Market impact costs are the costs due to the marketability of a security, and generally increase when a portfolio contains large Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type, as described more below. Fixed costs are the costs that generally do not fluctuate and may be caused by the bid-ask spread of a particular security. The bid-ask spread of a security accounts for the difference between the observed market price that a buyer is willing to pay for that security and the observed market price that a seller is willing to sell that security.

The transaction cost to liquidate a defaulted Member's portfolio is currently captured by the measurement of market risk through the calculation of the applicable volatility charge.⁹ The proposed changes would supplement and enhance the current measurement of this market risk to address situations where the characteristics of the defaulted Member's portfolio could cause these costs to be higher than the amount collected for the applicable volatility charge.

First, as described in more detail below, the MLA charge is designed to address the market impact costs of liquidating a defaulted Member's portfolio that may increase when that portfolio includes large Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type. These positions may be more difficult to liquidate because a large number of securities with similar risk profiles could reduce the marketability of

⁸ Procedure XV, Section I(A)(1)(a)(i) and Section I(A)(2)(a)(i) of the Rules, supra note 1.

⁹ The calculation of the VaR Charge and the haircut-based volatility charge are described in Sections I.(A)(1)(a) and I.(A)(2)(a) of Procedure XV of the Rules. Supra note 1. The methodologies for these calculations and how they are designed to address risks faced by NSCC have been described in recent proposed rule change and advance notice filings. See Securities Exchange Act Release Nos. 82780 (February 26, 2018), 82 FR 9035 (March 2, 2018) (File No. SR-NSCC-2017-808); 82781 (February 26, 2018), 82 FR 9042 (March 2, 2018) (File No. SR-NSCC-2017-020).

those large Net Unsettled Positions, increasing the market impact costs to NSCC. As described below, the MLA charge would supplement the applicable volatility charge.

Second, as described in more detail below, the bid-ask spread risk charge would address the risk that the transaction costs of liquidating a defaulted Member's Net Unsettled Positions may increase due to the fixed costs related to the bid-ask spread. As described below, this proposed change would be incorporated into, and, thereby, enhance the current measure of transaction costs through, the VaR Charge.

(iii) Proposed Margin Liquidity Adjustment Charge

In order to address the risks of an increased market impact cost presented by portfolios that contain large Net Unsettled Positions in the same asset group, NSCC is proposing to introduce a new component to the Clearing Fund formula, the MLA charge.

As noted above, a Member portfolio with large Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type may be more difficult to liquidate in the market in the event the Member defaults because a concentration in that group of securities or in an asset type could reduce the marketability of those large Net Unsettled Positions. Therefore, such portfolios create a risk that NSCC may face increased market impact cost to liquidate that portfolio in the assumed margin period of risk of three business days at market prices.

The proposed MLA charge would be calculated to address this increased market impact cost by assessing sufficient margin to mitigate this risk. As described below, the proposed MLA charge would be calculated for different asset groups, and subgroups for the equities asset group. Essentially, the calculation is designed to compare the total market value of a Net Unsettled Position in a particular asset group or subgroup, which NSCC would be required to liquidate in the event of a Member default, to the available trading volume of that asset group or equities subgroup in the market.¹⁰ If the market value of the Net Unsettled Position is large, as compared to the available trading volume of that asset group or subgroup, then there is an increased risk that NSCC would face additional market impact costs in liquidating that position in the event of a Member default. Therefore, the proposed calculation would provide NSCC with a measurement of the possible increased market impact cost that NSCC could face when it liquidates a large Net Unsettled Position in a particular asset group or subgroup.

Rather than calculate the market impact cost for each CUSIP, NSCC's MLA charge would estimate market impact cost at the portfolio-level using aggregated CUSIP-level volume data. For example, as described in greater detail below, the calculation of market impact cost would include a measurement of the gross market value of the portfolio. Given the vast number of CUSIPs processed by NSCC, this approach is simpler and is expected to result in more predicable calculations of the MLA charge.

¹⁰ NSCC would determine average daily trading volume by reviewing data that is made publicly available by the Securities Industry and Financial Markets Association ("SIFMA"), at <https://www.sifma.org/resources/archive/research/statistics>.

To calculate the MLA charge, NSCC would categorize securities into separate asset groups, which have similar risk profiles – (1) equities¹¹ (excluding equities defined as Illiquid Securities pursuant to the Rules),¹² (2) Illiquid Securities, (3) unit investment trusts, or UITs, (4) municipal bonds (including municipal bond exchange-traded products, or “ETPs”), and (5) corporate bonds (including corporate bond ETPs). NSCC would then further segment the equities asset group into the following subgroups: (i) micro-capitalization equities, (ii) small capitalization equities, (iii) medium capitalization equities, (iv) large capitalization equities, (v) treasury ETPs, and (vi) all other ETPs.¹³

NSCC would first calculate a measurement of market impact cost for each asset group and equities subgroup for which a Member has Net Unsettled Positions in its portfolio. As described above, the calculation of an MLA charge is designed to measure the potential additional market impact cost to NSCC of closing out a large Net Unsettled Position in that particular asset group or equities subgroup.

Market Impact Cost Calculation for Market Capitalization Subgroups of Equities Asset Group

The market impact cost for each Net Unsettled Position in a market capitalization subgroup of the equities asset group would be calculated by multiplying four components: (1) an impact cost coefficient that is a multiple of the one-day market volatility of that subgroup and is designed to measure impact costs, (2) the gross market value of the Net Unsettled Position in that

¹¹ NSCC would exclude long positions in Family-Issued Securities, as defined in Rule 1 (Definitions) of the Rules, from the MLA charge. NSCC believes the margin charge applicable to long Net Unsettled Positions in Family-Issued Securities pursuant to Sections I.(A)(1)(a)(iv) and (2)(a)(iv) of Procedure XV of the Rules provides adequate mitigation of the risks presented by those Net Unsettled Positions, such that an MLA charge would not be triggered. Supra note 1.

¹² See Rule 1 (Definitions), supra note 1.

¹³ Initially, the market capitalization categorizations would be: (i) micro-capitalization equities would be less than \$300 million, (ii) small capitalization equities would be equal to or greater than \$300 million and less than \$2 billion, (iii) medium capitalization equities would be equal to or greater than \$2 billion and less than \$10 billion, and (iv) large capitalization equities would be equal to or greater than \$10 billion. In determining the range of these market capitalization categorizations, NSCC would consult publications issued by sources it deems appropriate. NSCC would review these categories annually and any changes that NSCC deems appropriate would be subject to NSCC’s model risk management governance procedures set forth in the Clearing Agency Model Risk Management Framework (“Model Risk Management Framework”). See Securities Exchange Act Release Nos. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File No. SR-NSCC-2017-008); 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR-NSCC-2018-009); 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File No. SR-NSCC-2020-008).

subgroup, (3) the square root of the gross market value of the Net Unsettled Position in that subgroup in the portfolio measured as a percentage of the average daily trading volume of that subgroup (as described in greater detail below), and (4) a measurement of the concentration of the Net Unsettled Position in that subgroup in the portfolio (as described in greater detail below).¹⁴

NSCC represents that its measurement of the gross market value of the Net Unsettled Position would be calculated using the gross market value of the portfolio, divided by the average daily trading volume of that subgroup multiplied by an assumed percentage of available market volume for that subgroup. NSCC also represents that its measurement of the concentration of the Net Unsettled Position in the portfolio would include aggregating the relative weight of each CUSIP in that Net Unsettled Position relative to the weight of that CUSIP in the subgroup, such that a portfolio with fewer positions in a subgroup would have a higher measure of concentration for that subgroup.¹⁵

Market Impact Cost Calculation for the Other Asset Groups and Equities Subgroups

The market impact cost for Net Unsettled Positions in the municipal bond, corporate bond, Illiquid Securities and UIT asset groups, and for Net Unsettled Positions in the treasury ETP and other ETP subgroups of the equities asset group would be calculated by multiplying three components: (1) an impact cost coefficient that is a multiple of the one-day market volatility of that asset group or subgroup, (2) the gross market value of the Net Unsettled Position in that asset group or subgroup, and (3) the square root of the gross market value of the Net Unsettled Position in that asset group or subgroup in the portfolio measured as a percentage of the average trading volume of that asset group or subgroup.¹⁶

As noted above, NSCC represents that the measurement of the market value of the Net Unsettled Position would be calculated using the gross market value of the portfolio, divided by the average daily trading volume of that asset group or subgroup multiplied by an assumed percentage of available market volume for that asset group or subgroup.

Total MLA Charge Calculation for Each Portfolio

For each asset group or subgroup, NSCC would compare the calculated market impact cost to a portion of the volatility charge that is allocated to Net Unsettled Positions in that asset group or subgroup (as determined by Sections I.(A)(1)(a) and I.(A)(2)(a) of Procedure XV of the Rules).¹⁷ If the ratio of the calculated market impact cost to the applicable 1-day volatility

¹⁴ See supra note 10.

¹⁵ The relative weight would be calculated by dividing the absolute market value of a single CUSIP in the Member's portfolio by the total absolute market value of that portfolio.

¹⁶ See supra note 10.

¹⁷ Supra note 1. NSCC's margining methodology uses a three-day assumed period of risk. For purposes of this calculation, NSCC would use a portion of the applicable volatility charge that is based on one-day assumed period of risk and calculated by applying a

charge is greater than a threshold, an MLA charge would be applied to that asset group or subgroup.¹⁸ If the ratio of these two amounts is equal to or less than this threshold, an MLA charge would not be applied to that asset group or subgroup. The threshold would be based on an estimate of the market impact cost that is incorporated into the calculation of the applicable 1-day volatility charge, such that an MLA charge would apply only when the calculated market impact cost exceeds this threshold.

For each Member portfolio, NSCC would add the MLA charges for Net Unsettled Positions in each of the subgroups of the equities asset group to determine an MLA charge for the Net Unsettled Positions in the equities asset group. NSCC would then add the MLA charge for Net Unsettled Positions in the equities asset group with each of the MLA charges for Net Unsettled Positions in the other asset groups to determine a total MLA charge for a Member.

The ratio of the calculated market impact cost to the 1-day volatility charge would also determine if NSCC would apply a downward adjustment, based on a scaling factor, to the total MLA charge, and the size of any adjustment. For Net Unsettled Positions that have a higher ratio of calculated market impact cost to the 1-day volatility charge, NSCC would apply a larger adjustment to the MLA charge by assuming that it would liquidate that position on a different timeframe than the assumed margin period of risk of three business days. For example, NSCC may be able to mitigate potential losses associated with liquidating a Member's portfolio by liquidating a Net Unsettled Position with a larger volatility charge over a longer timeframe. Therefore, when applicable, NSCC would apply a multiplier to the calculated MLA charge. When the ratio of calculated market impact cost to the 1-day volatility charge is lower, the multiplier would be one, and no adjustment would be applied; as the ratio gets higher the multiplier decreases and the MLA charge is adjusted downward.

The final MLA charge would be calculated daily and, when the charge is applicable, as described above, would be included as a component of Members' Required Fund Deposit.

Proposed Changes to NSCC Rules

The proposal described above would be implemented into Procedure XV of the NSCC Rules. Specifically, the proposed changes to Procedure XV would describe the calculation of the MLA charge in a new subsection (i) of Section I(A)(1) and a new subsection (g) of Section I(A)(2).

simple square-root of time scaling, referred to in this proposed rule change as "1-day volatility charge." Any changes that NSCC deems appropriate to this assumed period of risk would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. See supra note 13.

¹⁸ Initially, the threshold would be 0.4, because, currently, approximately 40 percent of the 1-day volatility charge addresses market impact costs. NSCC would review this threshold from time to time and any changes that NSCC deems appropriate would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. See id.

These new subsections would first identify each of the asset groups and subgroups. The proposed new subsections would then separately describe the two calculations of market impact cost for these asset groups and subgroups by identifying the components of these calculations. The new subsections would state that NSCC would compare the calculated market impact cost to a portion of that Member's volatility charge, to determine if an MLA charge would be applied to an asset group or subgroup. The new subsections would then state that NSCC would add each of the applicable MLA charges calculated for each asset group together. Finally, the new subsections would state that NSCC may apply a downward adjusting scaling factor to result in a final MLA charge.

NSCC would also amend Section I(B)(2) of Procedure VX, which describes the Excess Capital Premium charge, to add the MLA charge to the list of Clearing Fund components that are excluded from the calculation of the Excess Capital Premium charge.¹⁹ The Excess Capital Premium is imposed on a Member when the Member's Required Fund Deposit exceeds its excess net capital. NSCC believes that including the MLA charge in the calculation of the Excess Capital Premium could lead to more frequent and unnecessary Excess Capital Premium charges. This is not the intended purpose of the Excess Capital Premium charge and could place an unnecessary burden on Members.

(iv) Proposed Bid-Ask Spread Risk Charge

NSCC has identified potential risk that its margining methodologies do not account for the transaction costs related to bid-ask spread in the market that could be incurred when liquidating a portfolio. Bid-ask spreads account for the difference between the observed market price that a buyer is willing to pay for a security and the observed market price that a seller is willing to sell that security. Therefore, NSCC is proposing to include a bid-ask spread risk charge in the VaR Charge to address this risk.

In order to calculate this charge, NSCC would segment Member's portfolios into four bid-ask spread risk classes: (i) large and medium capitalization equities, (ii) small capitalization equities, (iii) micro-capitalization equities, and (iv) ETPs.²⁰

Each risk class would be assigned a specific bid-ask spread haircut rate in the form of a basis point charge that would be applied to the gross market value in that particular risk class. The applicable bid-ask spread risk charge would be the product of the gross market value in a particular risk class in the Member's portfolio and the applicable basis point charge. The bid-ask spread risk charge would be calculated at the portfolio level, such that NSCC would aggregate the bid-ask spread risk charges of the applicable risk classes for the Member's portfolio.

NSCC proposes to review the haircut rates annually based on either the analysis of liquidation transaction costs related to the bid-ask spread that is conducted in connection with its annual simulation of a Member default or market data that is sourced from a third-party data vendor. Based on the analyses from recent years' simulation exercises, NSCC does not

¹⁹ See Section I.(B)(2) of Procedure XV of the Rules. Supra note 1.

²⁰ See supra note 13.

anticipate that these haircut rates would change significantly year over year. NSCC may also adjust the haircut rates following its annual model validation review, to the extent the results of that review indicate the current haircut rates are not adequate to address the risk presented by transaction costs from a bid-ask spread.²¹

The proposed initial haircuts are based on the analysis from the most recent annual default simulation and market data sourced from a third-party data vendor, and are listed in the table below:

Class	Haircut (bps)
Large and Medium Capitalization Equities	5.0
Small Capitalization Equities	12.3
Micro-Capitalization Equities	23.1
ETPs	1.5

Proposed Changes to NSCC Rules

The proposal described above would be implemented into Procedure XV of the NSCC Rules. Specifically, NSCC would amend subsection (a)(i)(I) of Sections I(A)(1) and I(A)(2) of Procedure XV by stating that the calculations of the estimations of volatility described in these Sections shall include an additional bid-ask spread risk charge measured by multiplying the gross market value of each Net Unsettled Position by a basis point charge. The proposed change to this subsection would also state that the basis point charge would be based on four risk classes and would identify those risk classes.

(v) *Implementation Timeframe*

NSCC would implement the proposed changes no later than 10 Business Days after the later of the approval of the proposed rule change and no objection to the related advance notice²²

²¹ All proposed changes to the haircuts would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. See id.

²² NSCC filed this proposed rule change as an advance notice (File No. SR-NSCC-2020-804) with the Commission 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, 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) under the Act, 17 CFR 240.19b-4(n)(1)(i). A copy of the advance notice is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

by the Commission. NSCC would announce the effective date of the proposed changes by Important Notice posted to its website.

(b) Statutory Basis

NSCC believes that the proposed changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, NSCC believes the proposed changes are consistent with Section 17A(b)(3)(F) of the Act,²³ and Rules 17Ad-22(e)(4)(i) and (e)(6)(i), each promulgated under the Act,²⁴ for the reasons described below.

Section 17A(b)(3)(F) of the Act requires that the rules of NSCC be designed to, among other things, assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.²⁵ NSCC believes the proposed change to implement the MLA charge is designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible because it is designed to address the market impact costs to NSCC of liquidating a Member's portfolio in the event of that Member's default. Specifically, the proposed MLA charge would allow NSCC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type that are not captured by the VaR Charge.

The Clearing Fund is a key tool that NSCC uses to mitigate potential losses to NSCC associated with liquidating a Member's portfolio in the event of Member default. Therefore, the proposed change to include the MLA charge among the Clearing Fund components, when applicable, would enable NSCC to better address the increased market impact costs of liquidating Net Unsettled Positions in a particular group of securities with a similar risk profile, such that, in the event of Member default, NSCC's operations would not be disrupted and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the proposed rule change to implement the MLA charge is designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible, consistent with Section 17A(b)(3)(F) of the Act.²⁶

Additionally, NSCC believes that the proposed change to amend the VaR Charge to include bid-ask spread risk charge within Members' final VaR Charge would be designed to assure the safeguarding of securities and funds that are in the custody or control of NSCC or for which it is responsible because the proposed change would enable NSCC to better limit its exposure to increased transaction costs due to the bid-ask spread in the market when liquidating the a defaulted Member's portfolio. NSCC believes that including the above-described bid-ask

²³ 15 U.S.C. 78q-1(b)(3)(F).

²⁴ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

²⁵ 15 U.S.C. 78q-1(b)(3)(F).

²⁶ Id.

spread risk charge within the VaR Charges would better ensure that NSCC calculates and collects sufficient margin and, thereby, better enable NSCC to limit its exposure to these transaction costs. By enabling NSCC to limit its exposure to Members in this way, the proposed change is designed to better ensure that, in the event of a Member default, NSCC would have adequate margin from the defaulting Member and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the proposed change to include the bid-ask spread risk charge within the calculation of the final VaR Charge would be designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible and therefore consistent with Section 17A(b)(3)(F) of the Act.²⁷

Rule 17Ad-22(e)(4)(i) under the Act requires, in part, that NSCC 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.²⁸

As described above, NSCC believes that both of the proposed changes would enable it to better identify, measure, monitor, and, through the collection of Members' Required Fund Deposits, manage its credit exposures to Members by maintaining sufficient resources to cover those credit exposures fully with a high degree of confidence.

Specifically, NSCC believes that the proposed MLA charge would effectively mitigate the risks related to large Net Unsettled Positions of securities in the same asset group within a portfolio and would address the potential increased risks NSCC may face related to its ability to liquidate such positions in the event of a Member default.

Therefore, NSCC believes that the proposal would enhance NSCC's ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. As such, NSCC believes the proposed changes are consistent with Rule 17Ad-22(e)(4)(i) under the Act.²⁹

Additionally, NSCC believes that the proposed bid-ask spread risk charge would enhance NSCC's ability to identify, measure, monitor and manage its credit exposures to Members and those exposures arising from its payment, clearing, and settlement processes because the proposed changes would better ensure that NSCC maintains sufficient financial resources to cover its credit exposure to each Member with a high degree of confidence. NSCC believes that the proposed change would enable NSCC to more effectively identify, measure, monitor and manage its exposures to risks related to market price, and enable it to better limit its exposure to potential losses from Member defaults by providing a more effective measure of the risks related to market price. As described above, due to the bid-ask spread in the market, there is an

²⁷ Id.

²⁸ 17 CFR 240.17Ad-22(e)(4)(i).

²⁹ Id.

observable transaction cost to liquidate a portfolio. The proposed bid-ask spread risk charge is designed to manage the risk related to this transaction cost in the event a Member's portfolio is liquidated. As such, NSCC believes that the proposed change would better address the potential risks that NSCC may face that are related to its ability to liquidate a Member's Net Unsettled Positions in the event of that firm's default, and thereby enhance NSCC's ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In this way, NSCC believes this proposed change is also consistent with Rule 17Ad-22(e)(4)(i) under the Act.³⁰

Rule 17Ad-22(e)(6)(i) under the Act requires, in part, that NSCC 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.³¹

The Required Fund Deposits are made up of risk-based components (as margin) that are calculated and assessed daily to limit NSCC's credit exposures to Members, including the VaR Charge. NSCC's proposed change to introduce an MLA charge is designed to more effectively address the risks presented by large Net Unsettled Positions in the same asset group. NSCC believes the addition of the MLA charge would enable NSCC to assess a more appropriate level of margin that accounts for these risks. This proposed change is designed to assist NSCC in maintaining a risk-based margin system that considers, and produces margin levels commensurate with, the risks and particular attributes of portfolios that contain large Net Unsettled Positions in the same asset group and may be more difficult to liquidate in the event of a Member default. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(i) under the Act.³²

Furthermore, NSCC believes that including the bid-ask spread risk charge within the calculation of the final VaR Charge would provide NSCC with a better assessment of its risks related to market price. This proposed change would enable NSCC to assess a more appropriate level of margin that accounts for this risk at the portfolio level. As such, each Member portfolio would be subject to a risk-based margining system that, at minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market, consistent with Rule 17Ad-22(e)(6)(i) under the Act.³³

³⁰ Id.

³¹ 17 CFR 240.17Ad-22(e)(6)(i).

³² Id.

³³ Id.

4. Self-Regulatory Organization's Statement on Burden on Competition

NSCC believes that the proposed changes could have an impact on competition. Specifically, NSCC believes the proposed changes could burden competition because they would result in larger Required Fund Deposit amounts for Members when the additional charges are applicable and result in a Required Fund Deposit that is greater than the amount calculated pursuant to the current formula.

When the proposal results in a larger Required Fund Deposit, the proposed change could burden competition for Members that have lower operating margins or higher costs of capital compared to other Members. However, the increase in Required Fund Deposit would be in direct relation to the specific risks presented by each Member's Net Unsettled Positions, and each Member's Required Fund Deposit would continue to be calculated with the same parameters and at the same confidence level for each Member. Therefore, Members that present similar Net Unsettled Positions, regardless of the type of Member, would have similar impacts on their Required Fund Deposit amounts. As such NSCC believes that any burden on competition imposed by the proposed changes would not be significant and, further, would be both necessary and appropriate in furtherance of NSCC's efforts to mitigate risks and meet the requirements of the Act, as described in this filing and further below.

NSCC believes the above described burden on competition that may be created by the proposed MLA charge and the bid-ask spread risk charge would be necessary in furtherance of the Act, specifically Section 17A(b)(3)(F) of the Act.³⁴ As stated above, the proposed MLA charge is designed to address the market impact costs to NSCC of liquidating a Member portfolio in the event of the Member's default. Specifically, the proposed MLA charge would allow NSCC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating net unsettled positions that are not captured by the VaR Charge. Likewise, the proposed bid-ask spread risk charge is designed to help limit NSCC's exposures to the increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a Member portfolio in the event of a Member default. Therefore, NSCC believes this proposed change is consistent with the requirements of Section 17A(b)(3)(F) of the Act, which requires that the Rules be designed to assure the safeguarding of securities and funds that are in NSCC's custody or control or which it is responsible.³⁵

NSCC believes these proposed changes would also support NSCC's compliance with Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act, which require NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to (x) 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; and (y) cover its credit exposures to its participants by establishing a risk-

³⁴ 15 U.S.C. 78q-1(b)(3)(F).

³⁵ Id.

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.³⁶

As described above, NSCC believes the introduction of the MLA charge would allow NSCC to employ a risk-based methodology that would address the increased market impact costs that NSCC could face when liquidating Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type. Similarly, the proposed change to include the bid-ask spread risk charge within the VaR Charge would allow NSCC to employ a risk-based methodology that would better measure the transaction costs that could be incurred in liquidating a defaulted Member's portfolio. Therefore, the proposed changes would better limit NSCC's credit exposures to Members, consistent with the requirements of Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act.³⁷

NSCC believes that the above described burden on competition that could be created by the proposed changes would be appropriate in furtherance of the Act because such changes have been appropriately designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible, as described in detail above. The proposed MLA charge and the proposed bid-ask spread risk charge would also enable NSCC to produce margin levels more commensurate with the risks and particular attributes of each Member's portfolio.

The proposed MLA charge would do this by measuring the increased market impact costs that NSCC may face when liquidating a defaulted Member's portfolio that includes Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type. With respect to the proposed bid-ask spread risk charge, a haircut (in the form of a basis point charge that would be applied to the gross market value) would be applied to separate risk classes in the portfolio. As described above, for purposes of calculating this charge, the portfolio would be segmented into four separate risk classes, by product type and market capitalization, and a haircut would be applied to the gross market value of each group. Therefore, because the proposed changes are designed to provide NSCC with an appropriate measure of the risks (*i.e.*, risks related to both market impact costs and transaction costs) presented by Members' portfolios, NSCC believes the proposal is appropriately designed to meet its risk management goals and its regulatory obligations.

NSCC believes that it has designed the proposed changes in an appropriate way in order to meet compliance with its obligations under the Act. Specifically, the proposals would improve the risk-based margining methodology that NSCC employs to set margin requirements and better limit NSCC's credit exposures to its Members. Therefore, as described above, NSCC believes the proposed changes are necessary and appropriate in furtherance of NSCC's

³⁶ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

³⁷ Id.

obligations under the Act, specifically Section 17A(b)(3)(F) of the Act³⁸ and Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act.³⁹

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 Act⁴⁰ 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.
- (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 of 2010

Not applicable.

³⁸ 15 U.S.C. 78q-1(b)(3)(F).

³⁹ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

⁴⁰ 15 U.S.C. 78s(b)(2).

11. Exhibits

Exhibit 1 – Not applicable.

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

Exhibit 2 – Not applicable.

Exhibit 3a – Impact Study Data. **Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3a pursuant to 17 CFR 240.24b-2 being requested.**

Exhibit 3b – NSCC Methodology Document, NSCC Margin Liquidity Adjustment. **Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3b pursuant to 17 CFR 240.24b-2 being requested.**

Exhibit 3c – NSCC Methodology Document, Bid-Ask Spread Risk Charge. **Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3c pursuant to 17 CFR 240.24b-2 being requested.**

Exhibit 3d – Responses to SEC Information Requests. **Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3d pursuant to 17 CFR 240.24b-2 being requested.**

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the Rules.

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[____]; File No. SR-NSCC-2020-016)

[DATE]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Risk Charge in the VaR Charge

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on July __, 2020, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency.³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of modifications to NSCC’s Rules & Procedures (“Rules”) to (1) introduce a new component of the Clearing Fund, the Margin Liquidity Adjustment (“MLA”) charge, and (2) enhance the calculation of the volatility component of the Clearing Fund formula that utilizes a parametric Value-at-Risk

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On July __, 2020, NSCC filed this proposed rule change as an advance notice (SR-NSCC-2020-804) with the Commission 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, 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) under the Act, 17 CFR 240.19b-4(n)(1)(i). A copy of the advance notice is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

(“VaR”) model (defined for purposes of this filing as the “VaR Charge,” and described in more detail in Item II(A)1(i) below) by including a bid-ask spread risk charge, as described in greater detail below.⁴

II. Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. 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 of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

NSCC is proposing to enhance its Clearing Fund methodology by (1) introducing a new component, the MLA charge, which would be calculated to address the risk presented to NSCC when a Member’s portfolio contains large Net Unsettled Positions⁵ in a particular group of securities with a similar risk profile or in a particular asset type

⁴ Capitalized terms not defined herein are defined in the Rules, available at http://dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf.

⁵ “Net Unsettled Positions” and “Net Balance Order Unsettled Positions” refer to net positions that have not yet passed their settlement date or did not settle on their settlement date, and are referred to collectively in this filing as Net Unsettled Positions. See Procedure XV (Clearing Fund Formula and Other Matters) of the Rules, id.

(referred to as “asset groups”), and (2) enhancing the calculation of the VaR Charge by including a bid-ask spread risk charge, as described in more detail below.⁶

(i) *Overview of the Required Fund Deposit and NSCC’s Clearing Fund*

As part of its market risk management strategy, NSCC manages its credit exposure to Members by determining the appropriate Required Fund Deposits to the Clearing Fund and monitoring its sufficiency, as provided for in the Rules.⁷ The Required Fund Deposit serves as each Member’s margin.

The objective of a Member’s Required Fund Deposit is to mitigate potential losses to NSCC associated with liquidating a Member’s portfolio in the event NSCC ceases to act for that Member (hereinafter referred to as a “default”).⁸ The aggregate of all Members’ Required Fund Deposits constitutes the Clearing Fund of NSCC. NSCC would access its Clearing Fund should a defaulting Member’s own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that Member’s portfolio.

⁶ The results of a study of the potential impact of adopting the proposed changes have been provided to the Commission.

⁷ See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters), supra note 4. NSCC’s market risk management strategy is designed to comply with Rule 17Ad-22(e)(4) under the Act, where these risks are referred to as “credit risks.” 17 CFR 240.17Ad-22(e)(4).

⁸ The Rules identify when NSCC may cease to act for a Member and the types of actions NSCC may take. For example, NSCC may suspend a firm’s membership with NSCC or prohibit or limit a Member’s access to NSCC’s services in the event that Member defaults on a financial or other obligation to NSCC. See Rule 46 (Restrictions on Access to Services) of the Rules, supra note 4.

Pursuant to the Rules, each Member's Required Fund Deposit amount consists of a number of applicable components, each of which is calculated to address specific risks faced by NSCC, as identified within Procedure XV of the Rules.⁹ The volatility component of each Member's Required Fund Deposit is designed to measure market price volatility and is calculated for Members' Net Unsettled Positions. The volatility component is designed to capture the market price risk associated with each Member's portfolio at a 99th percentile level of confidence. The VaR Charge is the volatility component applicable to most Net Unsettled Positions,¹⁰ and usually comprises the largest portion of a Member's Required Fund Deposit. Procedure XV of the Rules currently provides that the VaR Charge shall be calculated in accordance with a generally accepted portfolio volatility margin model utilizing assumptions based on historical data as NSCC deems reasonable and a volatility range that NSCC deems appropriate.¹¹

NSCC regularly assesses market and liquidity risks as such risks relate to its margining methodologies to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market. The proposed changes to include the MLA charge to its Clearing Fund methodology and to enhance the

⁹ Supra note 4.

¹⁰ As described in Procedure XV, Section I(A)(1)(a)(ii), (iii) and (iv), and Section I(A)(2)(a)(ii), (iii) and (iv) of the Rules, Net Unsettled Positions in certain securities are excluded from the VaR Charge and instead charged a volatility component that is calculated by multiplying the absolute value of those Net Unsettled Positions by a percentage. Supra note 4.

¹¹ Procedure XV, Section I(A)(1)(a)(i) and Section I(A)(2)(a)(i) of the Rules, supra note 4.

VaR Charge by including a bid-ask spread risk charge, as described below, are the result of NSCC's regular review of the effectiveness of its margining methodology.

(ii) *Overview of Liquidation Transaction Costs and Proposed Changes*

Each of the proposed changes addresses a similar, but separate, risk that NSCC faces increased transaction costs when it liquidates the Net Unsettled Positions of a defaulted Member due to the unique characteristics of that Member's portfolio. The transaction costs to NSCC to liquidate a defaulted Member's portfolio include both market impact costs and fixed costs. Market impact costs are the costs due to the marketability of a security, and generally increase when a portfolio contains large Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type, as described more below. Fixed costs are the costs that generally do not fluctuate and may be caused by the bid-ask spread of a particular security. The bid-ask spread of a security accounts for the difference between the observed market price that a buyer is willing to pay for that security and the observed market price that a seller is willing to sell that security.

The transaction cost to liquidate a defaulted Member's portfolio is currently captured by the measurement of market risk through the calculation of the applicable volatility charge.¹² The proposed changes would supplement and enhance the current

¹² The calculation of the VaR Charge and the haircut-based volatility charge are described in Sections I.(A)(1)(a) and I.(A)(2)(a) of Procedure XV of the Rules. Supra note 4. The methodologies for these calculations and how they are designed to address risks faced by NSCC have been described in recent proposed rule change and advance notice filings. See Securities Exchange Act Release Nos. 82780 (February 26, 2018), 82 FR 9035 (March 2, 2018) (File No. SR-NSCC-2017-808); 82781 (February 26, 2018), 82 FR 9042 (March 2, 2018) (File No. SR-NSCC-2017-020).

measurement of this market risk to address situations where the characteristics of the defaulted Member's portfolio could cause these costs to be higher than the amount collected for the applicable volatility charge.

First, as described in more detail below, the MLA charge is designed to address the market impact costs of liquidating a defaulted Member's portfolio that may increase when that portfolio includes large Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type. These positions may be more difficult to liquidate because a large number of securities with similar risk profiles could reduce the marketability of those large Net Unsettled Positions, increasing the market impact costs to NSCC. As described below, the MLA charge would supplement the applicable volatility charge.

Second, as described in more detail below, the bid-ask spread risk charge would address the risk that the transaction costs of liquidating a defaulted Member's Net Unsettled Positions may increase due to the fixed costs related to the bid-ask spread. As described below, this proposed change would be incorporated into, and, thereby, enhance the current measure of transaction costs through, the VaR Charge.

(iii) Proposed Margin Liquidity Adjustment Charge

In order to address the risks of an increased market impact cost presented by portfolios that contain large Net Unsettled Positions in the same asset group, NSCC is proposing to introduce a new component to the Clearing Fund formula, the MLA charge.

As noted above, a Member portfolio with large Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type may be more difficult to liquidate in the market in the event the Member defaults because a

concentration in that group of securities or in an asset type could reduce the marketability of those large Net Unsettled Positions. Therefore, such portfolios create a risk that NSCC may face increased market impact cost to liquidate that portfolio in the assumed margin period of risk of three business days at market prices.

The proposed MLA charge would be calculated to address this increased market impact cost by assessing sufficient margin to mitigate this risk. As described below, the proposed MLA charge would be calculated for different asset groups, and subgroups for the equities asset group. Essentially, the calculation is designed to compare the total market value of a Net Unsettled Position in a particular asset group or subgroup, which NSCC would be required to liquidate in the event of a Member default, to the available trading volume of that asset group or equities subgroup in the market.¹³ If the market value of the Net Unsettled Position is large, as compared to the available trading volume of that asset group or subgroup, then there is an increased risk that NSCC would face additional market impact costs in liquidating that position in the event of a Member default. Therefore, the proposed calculation would provide NSCC with a measurement of the possible increased market impact cost that NSCC could face when it liquidates a large Net Unsettled Position in a particular asset group or subgroup.

Rather than calculate the market impact cost for each CUSIP, NSCC's MLA charge would estimate market impact cost at the portfolio-level using aggregated CUSIP-level volume data. For example, as described in greater detail below, the calculation of

¹³ NSCC would determine average daily trading volume by reviewing data that is made publicly available by the Securities Industry and Financial Markets Association ("SIFMA"), at <https://www.sifma.org/resources/archive/research/statistics>.

market impact cost would include a measurement of the gross market value of the portfolio. Given the vast number of CUSIPs processed by NSCC, this approach is simpler and is expected to result in more predictable calculations of the MLA charge.

To calculate the MLA charge, NSCC would categorize securities into separate asset groups, which have similar risk profiles – (1) equities¹⁴ (excluding equities defined as Illiquid Securities pursuant to the Rules),¹⁵ (2) Illiquid Securities, (3) unit investment trusts, or UITs, (4) municipal bonds (including municipal bond exchange-traded products, or “ETPs”), and (5) corporate bonds (including corporate bond ETPs). NSCC would then further segment the equities asset group into the following subgroups: (i) micro-capitalization equities, (ii) small capitalization equities, (iii) medium capitalization equities, (iv) large capitalization equities, (v) treasury ETPs, and (vi) all other ETPs.¹⁶

¹⁴ NSCC would exclude long positions in Family-Issued Securities, as defined in Rule 1 (Definitions) of the Rules, from the MLA charge. NSCC believes the margin charge applicable to long Net Unsettled Positions in Family-Issued Securities pursuant to Sections I.(A)(1)(a)(iv) and (2)(a)(iv) of Procedure XV of the Rules provides adequate mitigation of the risks presented by those Net Unsettled Positions, such that an MLA charge would not be triggered. Supra note 4.

¹⁵ See Rule 1 (Definitions), supra note 4.

¹⁶ Initially, the market capitalization categorizations would be: (i) micro-capitalization equities would be less than \$300 million, (ii) small capitalization equities would be equal to or greater than \$300 million and less than \$2 billion, (iii) medium capitalization equities would be equal to or greater than \$2 billion and less than \$10 billion, and (iv) large capitalization equities would be equal to or greater than \$10 billion. In determining the range of these market capitalization categorizations, NSCC would consult publications issued by sources it deems appropriate. NSCC would review these categories annually and any changes that NSCC deems appropriate would be subject to NSCC’s model risk management governance procedures set forth in the Clearing Agency Model Risk Management Framework (“Model Risk Management Framework”). See Securities Exchange Act Release Nos. 81485 (August 25, 2017), 82 FR 41433

NSCC would first calculate a measurement of market impact cost for each asset group and equities subgroup for which a Member has Net Unsettled Positions in its portfolio. As described above, the calculation of an MLA charge is designed to measure the potential additional market impact cost to NSCC of closing out a large Net Unsettled Position in that particular asset group or equities subgroup.

Market Impact Cost Calculation for Market Capitalization Subgroups of Equities Asset Group

The market impact cost for each Net Unsettled Position in a market capitalization subgroup of the equities asset group would be calculated by multiplying four components: (1) an impact cost coefficient that is a multiple of the one-day market volatility of that subgroup and is designed to measure impact costs, (2) the gross market value of the Net Unsettled Position in that subgroup, (3) the square root of the gross market value of the Net Unsettled Position in that subgroup in the portfolio measured as a percentage of the average daily trading volume of that subgroup (as described in greater detail below), and (4) a measurement of the concentration of the Net Unsettled Position in that subgroup in the portfolio (as described in greater detail below).¹⁷

NSCC represents that its measurement of the gross market value of the Net Unsettled Position would be calculated using the gross market value of the portfolio, divided by the average daily trading volume of that subgroup multiplied by an assumed percentage of available market volume for that subgroup. NSCC also represents that its

(August 31, 2017) (File No. SR-NSCC-2017-008); 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR-NSCC-2018-009); 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File No. SR-NSCC-2020-008).

¹⁷ See supra note 13.

measurement of the concentration of the Net Unsettled Position in the portfolio would include aggregating the relative weight of each CUSIP in that Net Unsettled Position relative to the weight of that CUSIP in the subgroup, such that a portfolio with fewer positions in a subgroup would have a higher measure of concentration for that subgroup.¹⁸

Market Impact Cost Calculation for the Other Asset Groups and Equities Subgroups

The market impact cost for Net Unsettled Positions in the municipal bond, corporate bond, Illiquid Securities and UIT asset groups, and for Net Unsettled Positions in the treasury ETP and other ETP subgroups of the equities asset group would be calculated by multiplying three components: (1) an impact cost coefficient that is a multiple of the one-day market volatility of that asset group or subgroup, (2) the gross market value of the Net Unsettled Position in that asset group or subgroup, and (3) the square root of the gross market value of the Net Unsettled Position in that asset group or subgroup in the portfolio measured as a percentage of the average trading volume of that asset group or subgroup.¹⁹

As noted above, NSCC represents that the measurement of the market value of the Net Unsettled Position would be calculated using the gross market value of the portfolio, divided by the average daily trading volume of that asset group or subgroup multiplied by an assumed percentage of available market volume for that asset group or subgroup.

¹⁸ The relative weight would be calculated by dividing the absolute market value of a single CUSIP in the Member's portfolio by the total absolute market value of that portfolio.

¹⁹ See supra note 13.

Total MLA Charge Calculation for Each Portfolio

For each asset group or subgroup, NSCC would compare the calculated market impact cost to a portion of the volatility charge that is allocated to Net Unsettled Positions in that asset group or subgroup (as determined by Sections I.(A)(1)(a) and I.(A)(2)(a) of Procedure XV of the Rules).²⁰ If the ratio of the calculated market impact cost to the applicable 1-day volatility charge is greater than a threshold, an MLA charge would be applied to that asset group or subgroup.²¹ If the ratio of these two amounts is equal to or less than this threshold, an MLA charge would not be applied to that asset group or subgroup. The threshold would be based on an estimate of the market impact cost that is incorporated into the calculation of the applicable 1-day volatility charge, such that an MLA charge would apply only when the calculated market impact cost exceeds this threshold.

For each Member portfolio, NSCC would add the MLA charges for Net Unsettled Positions in each of the subgroups of the equities asset group to determine an MLA charge for the Net Unsettled Positions in the equities asset group. NSCC would then add

²⁰ Supra note 4. NSCC's margining methodology uses a three-day assumed period of risk. For purposes of this calculation, NSCC would use a portion of the applicable volatility charge that is based on one-day assumed period of risk and calculated by applying a simple square-root of time scaling, referred to in this proposed rule change as "1-day volatility charge." Any changes that NSCC deems appropriate to this assumed period of risk would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. See supra note 16.

²¹ Initially, the threshold would be 0.4, because, currently, approximately 40 percent of the 1-day volatility charge addresses market impact costs. NSCC would review this threshold from time to time and any changes that NSCC deems appropriate would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. See id.

the MLA charge for Net Unsettled Positions in the equities asset group with each of the MLA charges for Net Unsettled Positions in the other asset groups to determine a total MLA charge for a Member.

The ratio of the calculated market impact cost to the 1-day volatility charge would also determine if NSCC would apply a downward adjustment, based on a scaling factor, to the total MLA charge, and the size of any adjustment. For Net Unsettled Positions that have a higher ratio of calculated market impact cost to the 1-day volatility charge, NSCC would apply a larger adjustment to the MLA charge by assuming that it would liquidate that position on a different timeframe than the assumed margin period of risk of three business days. For example, NSCC may be able to mitigate potential losses associated with liquidating a Member's portfolio by liquidating a Net Unsettled Position with a larger volatility charge over a longer timeframe. Therefore, when applicable, NSCC would apply a multiplier to the calculated MLA charge. When the ratio of calculated market impact cost to the 1-day volatility charge is lower, the multiplier would be one, and no adjustment would be applied; as the ratio gets higher the multiplier decreases and the MLA charge is adjusted downward.

The final MLA charge would be calculated daily and, when the charge is applicable, as described above, would be included as a component of Members' Required Fund Deposit.

Proposed Changes to NSCC Rules

The proposal described above would be implemented into Procedure XV of the NSCC Rules. Specifically, the proposed changes to Procedure XV would describe the

calculation of the MLA charge in a new subsection (i) of Section I(A)(1) and a new subsection (g) of Section I(A)(2).

These new subsections would first identify each of the asset groups and subgroups. The proposed new subsections would then separately describe the two calculations of market impact cost for these asset groups and subgroups by identifying the components of these calculations. The new subsections would state that NSCC would compare the calculated market impact cost to a portion of that Member's volatility charge, to determine if an MLA charge would be applied to an asset group or subgroup. The new subsections would then state that NSCC would add each of the applicable MLA charges calculated for each asset group together. Finally, the new subsections would state that NSCC may apply a downward adjusting scaling factor to result in a final MLA charge.

NSCC would also amend Section I(B)(2) of Procedure VX, which describes the Excess Capital Premium charge, to add the MLA charge to the list of Clearing Fund components that are excluded from the calculation of the Excess Capital Premium charge.²² The Excess Capital Premium is imposed on a Member when the Member's Required Fund Deposit exceeds its excess net capital. NSCC believes that including the MLA charge in the calculation of the Excess Capital Premium could lead to more frequent and unnecessary Excess Capital Premium charges. This is not the intended purpose of the Excess Capital Premium charge and could place an unnecessary burden on Members.

²² See Section I.(B)(2) of Procedure XV of the Rules. Supra note 4.

(iv) Proposed Bid-Ask Spread Risk Charge

NSCC has identified potential risk that its margining methodologies do not account for the transaction costs related to bid-ask spread in the market that could be incurred when liquidating a portfolio. Bid-ask spreads account for the difference between the observed market price that a buyer is willing to pay for a security and the observed market price that a seller is willing to sell that security. Therefore, NSCC is proposing to include a bid-ask spread risk charge in the VaR Charge to address this risk.

In order to calculate this charge, NSCC would segment Member's portfolios into four bid-ask spread risk classes: (i) large and medium capitalization equities, (ii) small capitalization equities, (iii) micro-capitalization equities, and (iv) ETPs.²³

Each risk class would be assigned a specific bid-ask spread haircut rate in the form of a basis point charge that would be applied to the gross market value in that particular risk class. The applicable bid-ask spread risk charge would be the product of the gross market value in a particular risk class in the Member's portfolio and the applicable basis point charge. The bid-ask spread risk charge would be calculated at the portfolio level, such that NSCC would aggregate the bid-ask spread risk charges of the applicable risk classes for the Member's portfolio.

NSCC proposes to review the haircut rates annually based on either the analysis of liquidation transaction costs related to the bid-ask spread that is conducted in connection with its annual simulation of a Member default or market data that is sourced from a third-party data vendor. Based on the analyses from recent years' simulation exercises, NSCC does not anticipate that these haircut rates would change significantly

²³ See supra note 16.

year over year. NSCC may also adjust the haircut rates following its annual model validation review, to the extent the results of that review indicate the current haircut rates are not adequate to address the risk presented by transaction costs from a bid-ask spread.²⁴

The proposed initial haircuts are based on the analysis from the most recent annual default simulation and market data sourced from a third-party data vendor, and are listed in the table below:

Class	Haircut (bps)
Large and Medium Capitalization Equities	5.0
Small Capitalization Equities	12.3
Micro-Capitalization Equities	23.1
ETPs	1.5

Proposed Changes to NSCC Rules

The proposal described above would be implemented into Procedure XV of the NSCC Rules. Specifically, NSCC would amend subsection (a)(i)(I) of Sections I(A)(1) and I(A)(2) of Procedure XV by stating that the calculations of the estimations of volatility described in these Sections shall include an additional bid-ask spread risk charge measured by multiplying the gross market value of each Net Unsettled Position by a basis point charge. The proposed change to this subsection would also state that the

²⁴ All proposed changes to the haircuts would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. See id.

basis point charge would be based on four risk classes and would identify those risk classes.

(v) *Implementation Timeframe*

NSCC would implement the proposed changes no later than 10 Business Days after the later of the approval of the proposed rule change and no objection to the related advance notice²⁵ by the Commission. NSCC would announce the effective date of the proposed changes by Important Notice posted to its website.

2. Statutory Basis

NSCC believes that the proposed changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, NSCC believes the proposed changes are consistent with Section 17A(b)(3)(F) of the Act,²⁶ and Rules 17Ad-22(e)(4)(i) and (e)(6)(i), each promulgated under the Act,²⁷ for the reasons described below.

Section 17A(b)(3)(F) of the Act requires that the rules of NSCC be designed to, among other things, assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.²⁸ NSCC believes the proposed change to implement the MLA charge is designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible because it is designed to address the market impact costs to NSCC of

²⁵ Supra note 3.

²⁶ 15 U.S.C. 78q-1(b)(3)(F).

²⁷ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

²⁸ 15 U.S.C. 78q-1(b)(3)(F).

liquidating a Member's portfolio in the event of that Member's default. Specifically, the proposed MLA charge would allow NSCC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type that are not captured by the VaR Charge.

The Clearing Fund is a key tool that NSCC uses to mitigate potential losses to NSCC associated with liquidating a Member's portfolio in the event of Member default. Therefore, the proposed change to include the MLA charge among the Clearing Fund components, when applicable, would enable NSCC to better address the increased market impact costs of liquidating Net Unsettled Positions in a particular group of securities with a similar risk profile, such that, in the event of Member default, NSCC's operations would not be disrupted and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the proposed rule change to implement the MLA charge is designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible, consistent with Section 17A(b)(3)(F) of the Act.²⁹

Additionally, NSCC believes that the proposed change to amend the VaR Charge to include bid-ask spread risk charge within Members' final VaR Charge would be designed to assure the safeguarding of securities and funds that are in the custody or control of NSCC or for which it is responsible because the proposed change would enable NSCC to better limit its exposure to increased transaction costs due to the bid-ask spread in the market when liquidating the a defaulted Member's portfolio. NSCC believes that

²⁹ Id.

including the above-described bid-ask spread risk charge within the VaR Charges would better ensure that NSCC calculates and collects sufficient margin and, thereby, better enable NSCC to limit its exposure to these transaction costs. By enabling NSCC to limit its exposure to Members in this way, the proposed change is designed to better ensure that, in the event of a Member default, NSCC would have adequate margin from the defaulting Member and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the proposed change to include the bid-ask spread risk charge within the calculation of the final VaR Charge would be designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible and therefore consistent with Section 17A(b)(3)(F) of the Act.³⁰

Rule 17Ad-22(e)(4)(i) under the Act requires, in part, that NSCC 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.³¹

As described above, NSCC believes that both of the proposed changes would enable it to better identify, measure, monitor, and, through the collection of Members' Required Fund Deposits, manage its credit exposures to Members by maintaining

³⁰ Id.

³¹ 17 CFR 240.17Ad-22(e)(4)(i).

sufficient resources to cover those credit exposures fully with a high degree of confidence.

Specifically, NSCC believes that the proposed MLA charge would effectively mitigate the risks related to large Net Unsettled Positions of securities in the same asset group within a portfolio and would address the potential increased risks NSCC may face related to its ability to liquidate such positions in the event of a Member default.

Therefore, NSCC believes that the proposal would enhance NSCC's ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. As such, NSCC believes the proposed changes are consistent with Rule 17Ad-22(e)(4)(i) under the Act.³²

Additionally, NSCC believes that the proposed bid-ask spread risk charge would enhance NSCC's ability to identify, measure, monitor and manage its credit exposures to Members and those exposures arising from its payment, clearing, and settlement processes because the proposed changes would better ensure that NSCC maintains sufficient financial resources to cover its credit exposure to each Member with a high degree of confidence. NSCC believes that the proposed change would enable NSCC to more effectively identify, measure, monitor and manage its exposures to risks related to market price, and enable it to better limit its exposure to potential losses from Member defaults by providing a more effective measure of the risks related to market price. As described above, due to the bid-ask spread in the market, there is an observable transaction cost to liquidate a portfolio. The proposed bid-ask spread risk charge is

³²

Id.

designed to manage the risk related to this transaction cost in the event a Member's portfolio is liquidated. As such, NSCC believes that the proposed change would better address the potential risks that NSCC may face that are related to its ability liquidate a Member's Net Unsettled Positions in the event of that firm's default, and thereby enhance NSCC's ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In this way, NSCC believes this proposed change is also consistent with Rule 17Ad-22(e)(4)(i) under the Act.³³

Rule 17Ad-22(e)(6)(i) under the Act requires, in part, that NSCC 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.³⁴

The Required Fund Deposits are made up of risk-based components (as margin) that are calculated and assessed daily to limit NSCC's credit exposures to Members, including the VaR Charge. NSCC's proposed change to introduce an MLA charge is designed to more effectively address the risks presented by large Net Unsettled Positions in the same asset group. NSCC believes the addition of the MLA charge would enable NSCC to assess a more appropriate level of margin that accounts for these risks. This proposed change is designed to assist NSCC in maintaining a risk-based margin system

³³ Id.

³⁴ 17 CFR 240.17Ad-22(e)(6)(i).

that considers, and produces margin levels commensurate with, the risks and particular attributes of portfolios that contain large Net Unsettled Positions in the same asset group and may be more difficult to liquidate in the event of a Member default. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(i) under the Act.³⁵

Furthermore, NSCC believes that including the bid-ask spread risk charge within the calculation of the final VaR Charge would provide NSCC with a better assessment of its risks related to market price. This proposed change would enable NSCC to assess a more appropriate level of margin that accounts for this risk at the portfolio level. As such, each Member portfolio would be subject to a risk-based margining system that, at minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market, consistent with Rule 17Ad-22(e)(6)(i) under the Act.³⁶

(B) Clearing Agency's Statement on Burden on Competition

NSCC believes that the proposed changes could have an impact on competition. Specifically, NSCC believes the proposed changes could burden competition because they would result in larger Required Fund Deposit amounts for Members when the additional charges are applicable and result in a Required Fund Deposit that is greater than the amount calculated pursuant to the current formula.

When the proposal results in a larger Required Fund Deposit, the proposed change could burden competition for Members that have lower operating margins or

³⁵ Id.

³⁶ Id.

higher costs of capital compared to other Members. However, the increase in Required Fund Deposit would be in direct relation to the specific risks presented by each Member's Net Unsettled Positions, and each Member's Required Fund Deposit would continue to be calculated with the same parameters and at the same confidence level for each Member. Therefore, Members that present similar Net Unsettled Positions, regardless of the type of Member, would have similar impacts on their Required Fund Deposit amounts. As such NSCC believes that any burden on competition imposed by the proposed changes would not be significant and, further, would be both necessary and appropriate in furtherance of NSCC's efforts to mitigate risks and meet the requirements of the Act, as described in this filing and further below.

NSCC believes the above described burden on competition that may be created by the proposed MLA charge and the bid-ask spread risk charge would be necessary in furtherance of the Act, specifically Section 17A(b)(3)(F) of the Act.³⁷ As stated above, the proposed MLA charge is designed to address the market impact costs to NSCC of liquidating a Member portfolio in the event of the Member's default. Specifically, the proposed MLA charge would allow NSCC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating net unsettled positions that are not captured by the VaR Charge. Likewise, the proposed bid-ask spread risk charge is designed to help limit NSCC's exposures to the increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a Member portfolio in the event of a Member default. Therefore, NSCC believes this proposed change is consistent with the requirements of Section 17A(b)(3)(F)

³⁷ 15 U.S.C. 78q-1(b)(3)(F).

of the Act, which requires that the Rules be designed to assure the safeguarding of securities and funds that are in NSCC's custody or control or which it is responsible.³⁸

NSCC believes these proposed changes would also support NSCC's compliance with Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act, which require NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to (x) 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; and (y) 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.³⁹

As described above, NSCC believes the introduction of the MLA charge would allow NSCC to employ a risk-based methodology that would address the increased market impact costs that NSCC could face when liquidating Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type. Similarly, the proposed change to include the bid-ask spread risk charge within the VaR Charge would allow NSCC to employ a risk-based methodology that would better measure the transaction costs that could be incurred in liquidating a defaulted Member's portfolio. Therefore, the proposed changes would better limit NSCC's credit exposures

³⁸ Id.

³⁹ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

to Members, consistent with the requirements of Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act.⁴⁰

NSCC believes that the above described burden on competition that could be created by the proposed changes would be appropriate in furtherance of the Act because such changes have been appropriately designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible, as described in detail above. The proposed MLA charge and the proposed bid-ask spread risk charge would also enable NSCC to produce margin levels more commensurate with the risks and particular attributes of each Member's portfolio.

The proposed MLA charge would do this by measuring the increased market impact costs that NSCC may face when liquidating a defaulted Member's portfolio that includes Net Unsettled Positions in a particular group of securities with a similar risk profile or in a particular asset type. With respect to the proposed bid-ask spread risk charge, a haircut (in the form of a basis point charge that would be applied to the gross market value) would be applied to separate risk classes in the portfolio. As described above, for purposes of calculating this charge, the portfolio would be segmented into four separate risk classes, by product type and market capitalization, and a haircut would be applied to the gross market value of each group. Therefore, because the proposed changes are designed to provide NSCC with an appropriate measure of the risks (*i.e.*, risks related to both market impact costs and transaction costs) presented by Members' portfolios, NSCC believes the proposal is appropriately designed to meet its risk management goals and its regulatory obligations.

⁴⁰

Id.

NSCC believes that it has designed the proposed changes in an appropriate way in order to meet compliance with its obligations under the Act. Specifically, the proposals would improve the risk-based margining methodology that NSCC employs to set margin requirements and better limit NSCC's credit exposures to its Members. Therefore, as described above, NSCC believes the proposed changes are necessary and appropriate in furtherance of NSCC's obligations under the Act, specifically Section 17A(b)(3)(F) of the Act⁴¹ and Rules 17Ad-22(e)(4)(i) and Rule 17Ad-22(e)(6)(i) under the Act.⁴²

(C) Clearing Agency'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.

III. Date of Effectiveness of the Proposed Rule Change, and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

⁴¹ 15 U.S.C. 78q-1(b)(3)(F).

⁴² 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

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 proposed rule change 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. Please include File Number SR-NSCC-2020-016 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-2020-016. 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 proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSCC-2020-016 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴³

Secretary

⁴³ 17 CFR 200.30-3(a)(12).

EXHIBIT 3

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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.

PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS¹

Changes to this Procedure XV, as amended by File Nos. SR-NSCC-2020-016 and SR-NSCC-2020-804, are available at dtcc.com/~media/Files/Downloads/legal/rule-filings/2020/NSCC/SR-NSCC-2020-016.pdf and dtcc.com/~media/Files/Downloads/legal/rule-filings/2020/NSCC/SR-NSCC-2020-804.pdf, respectively. These changes have been approved by the Securities and Exchange Commission but have not yet been implemented. By no later than [insert date within 10 Business Days after the later of the approval of SR-NSCC-2020-016 and no objection to SR-NSCC-2020-804 by the Securities and Exchange Commission], these changes will be implemented, and this legend will automatically be removed from this Procedure XV.

I.(A) Clearing Fund Formula for Members

Each Member of the Corporation, except as otherwise provided in this Procedure, is required to contribute to the Clearing Fund maintained by the Corporation an amount calculated by the Corporation equal to:

(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, which shall be the highest resultant value among the following:

- I. an estimation of volatility calculated 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 (1) 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; and
- (2) each of the following estimations:
 - A. an exponentially-weighted moving average volatility estimation using a decay factor of less than 1, and
 - B. an evenly-weighted volatility estimation using a look-back period of not less than 253 days.

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

The higher of the two estimations described in (A) and (B) above, shall be the “Core Parametric Estimation”.

In calculating these estimations of volatility, the Corporation shall include an additional bid-ask spread risk charge measured by multiplying the gross market value of each Net Unsettled Position by a basis point charge, where the applicable basis point charge shall be reviewed at least annually and shall be based on the following groups: (i) large and medium capitalization equities, (ii) small capitalization equities, (iii) micro-capitalization equities, and (iv) exchange traded products (“ETPs”).

plus

(i) A Margin Liquidity Adjustment (“MLA”) charge shall apply to a Member’s Net Unsettled Positions, other than long Net Unsettled Positions in Family-Issued Securities.

For purposes of calculating this charge, Net Unsettled Positions shall be categorized into the following asset groups: (1) equities (excluding Illiquid Securities), (2) Illiquid Securities, (3) unit investment trusts (“UITs”), (4) municipal bonds (including municipal bond ETPs), and (5) corporate bonds (including corporate bond ETPs). The equities asset group shall be further segmented into the following subgroups: (i) micro-capitalization equities, (ii) small capitalization equities, (iii) medium capitalization equities, (iv) large capitalization equities, (v) treasury ETPs, and (vi) all other ETPs.

The Corporation shall first calculate a measurement of market impact cost for Net Unsettled Positions in each of the asset groups or subgroups, as described below.

- i. For Net Unsettled Positions in the market capitalization subgroups of the equities asset group, by multiplying four components:
 1. an impact cost coefficient that is a multiple of the one-day market volatility of that subgroup,
 2. the gross market value of the Net Unsettled Position in that subgroup,
 3. the square root of the gross market value of the Net Unsettled Position in that subgroup in the portfolio

measured as a percentage of the average trading volume of that subgroup, and

4. a measurement of the concentration of each Net Unsettled Position in that subgroup.
- ii. For Net Unsettled Positions in the Illiquid Securities, UIT, municipal bond, and corporate bond asset groups and for Net Unsettled Positions in the treasury ETP and other ETP subgroups of the equities asset group, by multiplying three components:
1. an impact cost coefficient that is a multiple of the one-day market volatility of that asset group or subgroup,
 2. the gross market value of the Net Unsettled Position in that asset group or subgroup, and
 3. the square root of the gross market value of the Net Unsettled Position in that asset group or subgroup in the portfolio measured as a percentage of the average trading volume of that asset group or subgroup.

For each asset group and equities subgroup, the calculated market impact cost shall be compared to a portion of the volatility charge applicable to Net Unsettled Positions (as determined by Section I.(A)(1)(a) of this Procedure XV). If the ratio of the calculated market impact cost to the portion of the volatility charge is greater than a threshold, to be determined by the Corporation from time to time, an MLA charge will be applicable to that asset group or subgroup. If the ratio of these two amounts is equal to or less than the threshold, an MLA charge will not be applicable to that asset group or subgroup.

All MLA charges for each of the equities subgroups shall be added together to result in one MLA charge for the equities subgroup. All MLA charges for each of the asset groups shall be added together to result in a total MLA charge.

The Corporation may apply a downward adjusting scaling factor to the total MLA charge based on the ratio of calculated market impact cost to a portion of the applicable volatility charge, where a higher ratio would trigger a larger downward adjustment of the MLA charge and a lower ratio would trigger no downward adjustment of the MLA charge.

(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, which shall be the highest resultant value among the following:

- I. an estimation of volatility calculated 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 (1) 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 and (2) each of the following estimations:
 - A. an exponentially-weighted moving average volatility estimation using a decay factor of less than 1, and
 - B. an evenly-weighted volatility estimation using a look-back period of not less than 253 days.

The higher of the two estimations described in (A) and (B) above, shall be the "Core Parametric Estimation".

In calculating these estimations of volatility, the Corporation shall include an additional bid-ask spread risk charge measured by multiplying the gross market value of each Net Balance Order Unsettled Position by a basis point charge, where the applicable basis point charge shall be reviewed at least annually and shall be based on the following risk groups: (i) large and medium capitalization equities, (ii) small capitalization equities, (iii) micro-capitalization equities, and (iv) ETPs.

plus

(g) An MLA charge shall apply to a Member's Net Balance Order Unsettled Positions, other than long Net Balance Order Unsettled Positions in Family-Issued Securities.

For purposes of calculating this charge, Net Balance Order Unsettled Positions shall be categorized into the following asset groups: (1) equities (excluding Illiquid Securities), (2) Illiquid Securities, (3) UITs, (4) municipal bonds (including municipal bond ETPs), and (5) corporate bonds (including corporate bond ETPs). The equities asset group shall be further segmented into the following subgroups: (i) micro-capitalization equities, (ii) small capitalization equities, (iii) medium capitalization equities, (iv) large capitalization equities, (v) treasury ETPs, and (vi) all other ETPs.

The Corporation shall first calculate a measurement of market impact cost for Net Balance Order Unsettled Positions in each of the asset groups or subgroups, as described below.

- i. For Net Balance Order Unsettled Positions in the market capitalization subgroups of the equities asset group, by multiplying four components:
 1. an impact cost coefficient that is a multiple of the one-day market volatility of that subgroup,
 2. the gross market value of the Net Balance Order Unsettled Position in that subgroup,
 3. the square root of the gross market value of the Net Balance Order Unsettled Position in that subgroup in the portfolio measured as a percentage of the average trading volume of that subgroup, and
 4. a measurement of the concentration of each Net Balance Order Unsettled Position in that subgroup.
- ii. For Net Balance Order Unsettled Positions in the Illiquid Securities, UIT, municipal bond, and corporate bond asset groups and for Net Balance Order Unsettled Positions in the treasury ETP and other ETP subgroups of the equities asset group, by multiplying three components:
 1. an impact cost coefficient that is a multiple of the one-day market volatility of that asset group or subgroup,
 2. the gross market value of the Net Balance Order Unsettled Position in that asset group or subgroup, and
 3. the square root of the gross market value of the Net Balance Order Unsettled Position in that asset group or subgroup in the portfolio measured as a percentage of the average trading volume of that asset group or subgroup.

For each asset group and equities subgroup, the calculated market impact cost shall be compared to a portion of the volatility charge applicable to Net Balance Order Unsettled Positions (as determined by Section I.(A)(2)(a) of this Procedure XV). If the ratio of the calculated market impact cost to the portion of the volatility charge is greater than a threshold, to be determined by the Corporation from time to time, an MLA charge will be applicable to that asset group or subgroup. If the ratio of these two

amounts is equal to or less than the threshold, an MLA charge will not be applicable to that asset group or subgroup.

All MLA charges for each of the equities subgroups shall be added together to result in one MLA charge for the equities subgroup. All MLA charges for each of the asset groups shall be added together to result in a total MLA charge.

The Corporation may apply a downward adjusting scaling factor to the total MLA charge based on the ratio of calculated market impact cost to a portion of the applicable volatility charge, where a higher ratio would trigger a larger downward adjustment of the MLA charge and a lower ratio would trigger no downward adjustment of the MLA charge.

I.(B) Additional Clearing Fund Formula

(2) Excess Capital Premium

If a Member's contribution to the Clearing Fund, as computed pursuant to Section I.(A) of this Procedure (but excluding any charges as set forth in Subsections I.(A)(1)(d), (f), ~~and (g)~~, and (i); and I.(A)(2)(c), (d), ~~and (e)~~, and (g) of this Procedure), plus any amount collected pursuant to 1.(B)(1) above or Rule 15 (such aggregate amount referred to as the "Calculated Amount"), when divided by its excess net capital or capital (as applicable), as defined in the membership standards set forth in Addendum B, is greater than 1.0 (the "Excess Capital Ratio"), then the Corporation may require such Member to deposit, within such timeframe as the Corporation may require, an additional amount (the "Excess Capital Premium") to the Clearing Fund equal to the product of: (a) the amount by which the Calculated Amount exceeds its excess net capital or capital (as applicable), as defined in the membership standards set forth in Addendum B, multiplied by (b) its Excess Capital Ratio.
