Filing by National Securities Clearing Corporation
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

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

Section 806(e)(1) * Section 806(e)(2) *
✓            ✓

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

Increase the National Securities Clearing Corporation’s Minimum Required Fund Deposit

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 * James
Last Name * Nygard
Title * Director and Assistant General Counsel
E-mail * jnygard@dtcc.com
Telephone * (813) 470-1898
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.

Date 02/18/2020
By Nikki Poulos
Managing Director and Deputy General Counsel

(Name *)

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.
<table>
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<tr>
<th><strong>Form 19b-4 Information</strong></th>
<th>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.</th>
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<tr>
<td><strong>Exhibit 1 - Notice of Proposed Rule Change</strong></td>
<td>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).</td>
</tr>
<tr>
<td><strong>Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies</strong></td>
<td>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).</td>
</tr>
<tr>
<td><strong>Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Exhibit 3 - Form, Report, or Questionnaire</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Exhibit 4 - Marked Copies</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Exhibit 5 - Proposed Rule Text</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Partial Amendment</strong></td>
<td>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.</td>
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<td><strong>Exhibit Sent As Paper Document</strong></td>
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1. Text of the Advance Notice

(a) This advance notice of National Securities Clearing Corporation (“NSCC”) consists of modifications to NSCC’s Rules & Procedures (“Rules”), annexed hereto as Exhibit 5, in order to increase the minimum Required Fund Deposit for each Member.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change 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

Not applicable.

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

Not applicable.

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

NSCC conducted Member outreach with each Member that had an average Required Fund Deposit of less than $500,000 for the twelve-month period ending May 2019 to provide notice and an opportunity to discuss the proposed changes. One Member stated that it had an objection to the proposal to raise the minimum Required Fund Deposit from $10,000 to $250,000 and stated that (i) the proposed changes would solely burden the least active and lowest risk firms, (ii) the proposed changes do not have correlation with risk or any appropriate cost allocation at NSCC, (iii) the proposed changes are purely a tax on small firms and NSCC is intent on creating artificial barriers to entry through unjustified capital requirements and (iv) the current policies, procedures and standards are more than adequate to guard against risk at the small firm-level.

First, the proposed changes would not solely burden the least active and lowest risk firms. Members that maintain a minimum Required Fund Deposit of less than $250,000 do include


2 The letter sent by the Member also contained comments relating to another proposal that are not addressed herein.
smaller firms and firms that conduct infrequent activity, but they also consist of newer firms that are ramping up activity and firms that are winding down, regardless of size. Second, the backtesting results indicate that the Members that maintain a minimum Required Fund Deposit of less than $250,000 contributed to 30% of the total backtesting deficiencies which indicate a risk that Required Fund Deposit will be insufficient to manage risk in the event of such Members default. Third, the proposed increase to the Required Fund Deposit is not purely a tax on small firms and not intended as an artificial barrier to entry. While the proposed changes would be an added expense on certain smaller firms that currently have a Required Fund Deposit of less than $250,000, it would apply to all firms, regardless of size, that maintain a minimum Required Fund Deposit. In addition, as indicated above, although the proposed changes may be more of a burden on those Members that have lower operating margins, lower cash reserves or higher costs of capital compared to other Members, NSCC believes that the increase in Required Fund Deposit is necessary and appropriate as it would apply in direct relation to the specific risks presented by Members that currently maintain a Required Fund Deposit of less than $250,000. For that reason, the proposed changes are not an artificial barrier to entry but a necessary and appropriate change to address specific risk. Finally, as indicated by the backtesting results, NSCC believes that the current minimum Required Fund Deposit does indicate risk with respect to those Members that maintain a minimum Required Fund Deposit of less than $250,000 and the increase in the minimum Required Fund Deposit would reduce that risk. NSCC believes that increasing the minimum Required Fund Deposit to $250,000 would provide an appropriate balance of improving Member backtesting results and NSCC’s Clearing Fund coverage which will reduce risk for all Members, while minimizing the impact to Members by not raising the minimum Required Fund Deposit to a higher amount.

Finally, the Member stated that while it objected to raising the minimum Required Fund Deposit to $250,000, it would not object to an increase to $100,000. NSCC observed that the increased improvement of the Clearing Fund coverage by 0.13% overall, and the elimination of 12 additional backtesting deficiencies during the Impact Study Period (as defined below) provided by a minimum $250,000 Required Fund Deposit as compared to a minimum $100,000 Required Clearing Fund Deposit validates raising the minimum to $250,000. While an increase to a minimum Required Fund Deposit to $100,000 would also represent an improvement of the Clearing Fund coverage, the number of deficiencies mitigated or reduced would be fewer. If the minimum Required Fund Deposit were raised to $250,000, NSCC observed a 28% increase in the number of eliminated or reduced deficiencies during the Impact Study Period. As a result, NSCC believes that $250,000 is the appropriate minimum Required Fund Deposit amount that will minimize the financial impact to its Members while maximizing risk management of activity that is guaranteed at the point of validation or comparison by NSCC.

NSCC will notify the Securities and Exchange Commission (“Commission”) of any additional 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 Securities Exchange Act of 1934 (“Act”) for Commission action.
7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

   (a) Not applicable.

   (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**

    **Description of Proposed Changes**

    NSCC is proposing to increase the minimum Required Fund Deposit, as described in greater detail below.

    **The Minimum Required Fund Deposit**

    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.\(^3\) 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 liquidation of the Member’s portfolio in the event NSCC ceases to act for that Member (hereinafter referred to as a “default”).\(^4\) The aggregate of

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\(^3\) See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules (“Procedure XV”), 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).

\(^4\) 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
all Members’ Required Fund Deposits, together with certain other deposits required under the
Rules, constitutes the Clearing Fund of NSCC, which it would access, among other instances,
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.5 Currently, each Member is required to maintain a
minimum Required Fund Deposit amount of $10,000.6 If a Member’s Required Fund Deposit,
as calculated by Procedure XV, is less than $10,000 on a given day, NSCC requires a deposit to
bring the Member’s Required Fund Deposit up to $10,000. The first 40% of a Member’s
Required Fund Deposit, but no less than the minimum Required Fund Deposit amount of
$10,000, is required to be in cash.7

NSCC regularly assesses the market, liquidity and other risks that its margining
methodologies are designed to mitigate to evaluate whether margin levels are commensurate
with the particular risk attributes of each relevant product, portfolio, and market. In connection
with such regular reviews, NSCC has determined that there are circumstances where the current
minimum Required Fund Deposit amount is insufficient to manage NSCC’s risk in the event of
an abrupt or sudden increase in a Member’s activity.

NSCC employs daily backtesting to determine the adequacy of each Member’s Required
Fund Deposit.8 NSCC compares the Required Fund Deposit9 for each Member with the

 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.

5 Procedure XV, supra note 1.

6 Section 1 of Rule 4, supra note 1.

7 Section II.(A) of Procedure XV, supra note 1.

8 See Model Risk Management Framework (“Model Risk Management Framework”),
2017) (NSCC-2017-008) (sets forth the model risk management practices of NSCC and
states that Value at Risk (“VaR”) and Clearing Fund requirement coverage backtesting
would be performed on a daily basis or more frequently) and Securities Exchange Act
Release No. 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR-

9 Members may be required to post additional collateral to the Clearing Fund in addition to
their Required Fund Deposit amount. See e.g, Rule 15 (Assurance of Financial
Responsibility and Operational Capability), supra note 1 (providing that adequate
assurances of financial responsibility of a participant may be required, such as increased
simulated liquidation gains/losses using the actual positions in the Member’s portfolio, and the actual historical security returns. A backtesting deficiency occurs when NSCC determines that a Member’s Required Fund Deposit would not have been adequate to address the projected liquidation losses estimated from a Member’s settlement activity based on the backtesting results. NSCC investigates the cause(s) of any backtesting deficiencies. As a part of this investigation, NSCC pays particular attention to Members with backtesting deficiencies that bring the results for that Member below the 99% confidence target (i.e., greater than two backtesting deficiency days in a rolling twelve-month period) to determine if there is an identifiable cause of repeat backtesting deficiencies. NSCC also evaluates whether multiple Members may experience backtesting deficiencies for the same underlying reason. Backtesting deficiencies highlight exposure that could subject NSCC to potential losses under normal market conditions in the event that a Member defaults.

While multiple factors may contribute to a Member’s backtesting deficiency, NSCC has observed that some Members with position increases after the calculation of their Required Fund Deposit may incur backtesting deficiencies due to the additional exposure that is not mitigated until the collection of the Required Fund Deposit occurs intraday, or on the next business day. In addition, NSCC has determined that based on a review of backtesting deficiencies during the period from September 2017 to January 2018 (“Impact Study Period”), approximately 30% of backtesting deficiencies occurred with Members that maintained a Required Fund Deposit of less than $250,000. Approximately 90% of the deficiencies of those Members whose maintained a Required Fund Deposit of less than $250,000 would have been mitigated during that period if the Required Fund Deposit were $250,000 or higher.

Typical examples where Members may be maintaining a minimum Required Fund Deposit amount of $10,000 include (1) when a new Member has activated its clearing accounts at NSCC but is growing its business; (2) when a Member generally has limited or infrequent transaction activity; and (3) when a Member is winding down its business and is in the process of retiring its NSCC membership. In each of these circumstances, an abrupt increase in clearing activity following a period of low or no clearing activity could cause NSCC to be under-margined with respect to the Member and may result in backtesting deficiencies. Therefore, NSCC is proposing to increase the minimum Required Fund Deposit amount of $10,000 to address the risk that NSCC becomes under-margined in circumstances when a Member is subject to the current minimum Required Fund Deposit amount.

Clearing Fund deposits). For backtesting comparisons, NSCC uses the Required Fund Deposit amount, without regard to the actual, total collateral posted by the Member to the Clearing Fund.

The 99% confidence target is consistent with Rule17Ad-22(e)(6)(iii) which requires NSCC to calculate margin to cover its “potential future exposure” which is defined in Rule 17Ad-22(a)(13) to mean the “maximum exposure estimated to occur at a future point in time with an established single-tailed confidence level of at least 99 percent with respect to the estimated distribution of future exposure.” 17 CFR 240.17Ad-22(a)(13), (e)(6)(iii).
In determining the appropriate minimum Required Fund Deposit amount, NSCC reviewed varying minimum Required Fund Deposit amounts to determine the anticipated effects of increasing the minimum Required Fund Deposits on Clearing Fund coverage and on backtesting results. NSCC also conducted a review of minimum deposit requirements of registered clearing agencies and foreign central counterparty clearing houses (“CCPs”) to compare NSCC’s minimum Required Fund Deposit with the deposits required by registered clearing agencies and foreign CCPs. As discussed below, based on the results of the reviews and the comparison of other registered clearing agencies and foreign CCPs, NSCC believes that a proposed minimum Required Fund Deposit amount of $250,000 would provide an appropriate balance of improving Member backtesting results and NSCC’s Clearing Fund coverage, while minimizing the impact to Members.

NSCC conducted a review of backtesting deficiencies during the Impact Study Period to determine the anticipated backtesting coverage using $250,000 as the minimum Required Fund Deposit amount and amounts lower and higher than $250,000. The results of the reviews indicated that using $250,000 as its minimum Required Fund Deposit amount would improve NSCC’s rolling twelve-month Clearing Fund coverage and reduce the number of Members with backtesting coverage below 99%. The reviews indicated that the proposed changes would reduce backtesting deficiencies for Members who maintain a minimum Required Fund Deposit of less than $250,000 by approximately 90%. The review of backtesting deficiencies during the Impact Study Period also indicated that raising the minimum Required Fund Deposit to $250,000 would decrease backtesting deficiencies to a greater extent than raising it to a lower amount such as $100,000 and would increase the Clearing Fund coverage to a greater extent.

NSCC’s review of the requirements of other clearing agencies and foreign CCPs indicated that NSCC’s minimum Required Fund Deposit requirement of $10,000 was significantly lower than minimum deposits or equivalent required by such other entities. While

Backtesting percentages indicate the risk that a minimum Required Fund Deposit will be sufficient to manage risk in the event of a Member’s default. A backtesting coverage that is below the 99% confidence target for a Member means that the Member has more than two backtesting deficiency days in a rolling twelve-month period. As indicated above, consistent with Rule 17Ad-22(e)(6)(iii), NSCC pays particular attention to Members with backtesting deficiencies that bring the results for that Member below the 99% confidence target to determine if there is an identifiable cause of repeat backtesting deficiencies. See supra note 10.

Over the Impact Study Period, if the minimum Required Fund Deposit had been set to $250,000 compared to $100,000, there would have been 12 more backtesting deficiencies eliminated; overall increasing the 12-month backtesting coverage percentage by 0.13%.

For example, the minimum initial contribution for The Options Clearing Corporation (“OCC”) is $500,000. See Rule 1002(d) of the OCC Rules, available at https://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_rules.pdf. The minimum Required Fund Deposit for both the Government Securities Division (“GSD”)
the minimum required fund deposits of such other entities is not dispositive as to the risk borne by NSCC or the proper fund deposit amounts to offset such risk, it is indicative of the amounts that users of other similarly situated entities can expect to pay as a minimum required fund deposit to use the services of the clearing agencies and foreign CCPs and the impact to such users. The comparison shows that entities using other clearing agencies and foreign CCPs pay significantly more in minimum fund deposits to use similar services than the minimum Required Fund Deposit amount at NSCC.

Based on the backtesting results discussed above and the impact to Members of raising the minimum Required Fund Deposit amount to $250,000, NSCC believes that raising it to $250,000 is the appropriate minimum Required Fund Deposit amount that will minimize the financial impact to its Members while maximizing risk management of activity that is guaranteed at the point of validation or comparison by NSCC.

As is currently provided for in the Rules, NSCC is proposing to continue to require that Members deposit an amount equal to the minimum Required Fund Deposit in cash. NSCC permits Members to satisfy their Required Fund Deposit obligations through a combination of cash and open account indebtedness secured by Eligible Clearing Fund Securities. Cash deposits are fungible. NSCC would be therefore be further strengthening its liquidity resources by requiring each Member to deposit a baseline of $250,000 in cash to the Clearing Fund.

**Proposed Rule Changes**

In order to implement the proposed increase in the minimum Required Fund Deposit amount to $250,000, Section 1 of Rule 4 would be revised to state that the minimum Required Fund Deposit for each Member shall be $250,000. In addition, Section II.(A) of Procedure XV would be revised to replace the minimum contribution amount from $10,000 to $250,000. Section II.(A) of Procedure XV currently provides that no less than $10,000, the minimum Required Fund Deposit, of a Member’s Required Fund Deposit must be in cash. To reflect the increase in the minimum Required Fund Deposit, NSCC would also increase the minimum cash requirement to $250,000 to match the proposed increased minimum Required Fund Deposit amount.


14 Section II.(A) of Procedure XV, supra note 1.

15 Rule 4, Section 1, supra note 1.

16 Section II.(A) of Procedure XV, supra note 1.
Expected Effect on and Management of Risk

NSCC believes that the proposed changes to increase the minimum Required Fund Deposit amount would enable NSCC to better limit its risk exposures to Members that would otherwise maintain a Required Fund Deposit of less than $250,000. By increasing the minimum required fund deposit to $250,000, the proposed change addresses exposure that could subject NSCC to potential losses in the event that a Member defaults. Specifically, the proposed rule change seeks to remedy potential situations that are described above where NSCC could be under-marginied, such as when a Member has an abrupt increase in clearing activity following a period of low or no clearing activity, by increasing the minimum margin requirements. Therefore, by enabling NSCC to collect margin that more accurately reflects the risk characteristics of its Members, the proposal would enhance NSCC’s risk management capabilities.

By providing NSCC with a more effective limit on its exposures, as described above, the proposed change would also mitigate risk for Members because lowering the risk profile for NSCC would in turn lower the risk exposure that Members may have with respect to NSCC in its role as a central counterparty. Further, the proposal is designed to meet NSCC’s risk management goals and its regulatory obligations, as described below.

Consistency with the Clearing Supervision Act

Although Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”) does not specify a standard of review for an advance notice, its stated purpose is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.

NSCC believes that the proposal is consistent with the Clearing Supervision Act, specifically with the risk management objectives and principles of Section 805(b), and with certain of the risk management standards adopted by the Commission pursuant to Section 805(a)(2), for the reasons described below.

17 12 U.S.C. 5461 et. seq.
19 12 U.S.C. 5464(a)(2) and (b).
(i) **Consistency with Section 805(b) of the Clearing Supervision Act**

For the reasons described below, NSCC believes that the proposed changes in this advance notice are consistent with the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision.

As discussed above, NSCC is proposing to increase the minimum Required Fund Deposit to be paid by Members and to require that such minimum Required Fund Deposit be paid in cash. Required Fund Deposits are 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. NSCC believes the proposed changes are consistent with promoting robust risk management because they are designed to enable NSCC to better limit its exposure to Members in the event of a Member default. Specifically, as a review of backtesting deficiencies during the Impact Study Period has indicated, raising the minimum Required Fund Deposit to $250,000 would decrease the number of backtesting deficiencies and ensure that NSCC maintains the coverage of credit exposures for more Members at a confidence level of at least 99%.

Furthermore, NSCC believes that the changes proposed in this advance notice are consistent with promoting safety and soundness, which, in turn, is consistent with reducing systemic risks and supporting the stability of the broader financial system, consistent with Section 805(b) of the Clearing Supervision Act. The proposed changes are designed to better limit NSCC’s exposures to Members in the event of Member default. As discussed above, the proposed changes would allow NSCC to limit its exposure to Members that would otherwise have a Required Fund Deposit of less than $250,000. The proposed increase in the minimum Required Fund Deposit would allow NSCC to collect margin at levels that reflect the risk presented by Members and would help NSCC limit its exposures to Members that have an abrupt or sudden increase in clearing activity following a period of low or no clearing activity. In addition, by continuing to require that Members pay an amount equal to the minimum Required Fund Deposit amount in cash, NSCC would be making available additional collateral that is easier for NSCC to access upon a Member’s default, further limiting the credit exposure to its Members.

By better limiting NSCC’s exposures to Members in the event of a Member default, the proposed changes are consistent with promoting safety and soundness, which, in turn, is consistent with reducing systemic risks and supporting the stability of the broader financial system.

(ii) **Consistency with Section 805(a)(2) of the Clearing Supervision Act**

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like NSCC, and financial institutions engaged in designated activities for which the Commission is the supervisory agency or the appropriate financial

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The Commission has accordingly adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (“Covered Clearing Agency Standards”).

The Covered Clearing Agency Standards require registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis. NSCC believes that the proposed changes are consistent with Rule 17Ad-22(e)(4)(i) and (e)(6)(iii), each promulgated under the Act.

Rule 17Ad-22(e)(4)(i) under the Act requires 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.

As described above, NSCC believes that 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. More specifically, as a review of backtesting deficiencies during the Impact Study Period has indicated, raising the minimum Required Fund Deposit amount to $250,000 would decrease the number of backtesting deficiencies and help ensure that NSCC maintains the coverage of credit exposures for more Members at a confidence level of at least 99%. In addition, by requiring that Members pay an amount equal to the minimum Required Fund Deposit amount in cash, NSCC would be making available collateral that is easier to access when Members default further reducing the risk of losses, which would require using non-defaulting Members’ securities or funds, or NSCC funds. Therefore, NSCC believes that the proposed changes would enhance NSCC’s ability to effectively identify, measure, monitor and manage 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.

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22 17 CFR 240.17Ad-22(e).
23 Id.
24 17 CFR 240.17Ad-22(e)(4)(i) and (e)(6)(iii).
26 Id.
Rule 17Ad-22(e)(6)(iii) under the Act requires 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, calculates margin sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. NSCC employs daily backtesting to determine the adequacy of each Member’s Required Fund Deposit paying particular attention to Members that have backtesting deficiencies below the 99% confidence target. Such backtesting deficiencies highlight exposure that could subject NSCC to potential losses if a Member defaults. As discussed above, NSCC has determined that approximately 30% of all backtesting deficiencies occur for those Members that maintain a Required Fund Deposit of less than $250,000 and that approximately 90% of the deficiencies of those Members would have been mitigated during the Impact Study Period if the Required Fund Deposit were $250,000 or higher. By raising the minimum Required Fund Deposit amount to $250,000, NSCC believes it can decrease the backtesting deficiencies by Members, and thus decrease exposure to such Members in the event of a default. NSCC believes that the increase in margin for those Members that currently maintain a Required Fund Deposit of less than $250,000 would improve the probabilities that the margin maintained by such Members is sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(iii) under the Act.

11. Exhibits

Exhibit 1 – Not applicable.

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

Exhibit 2 – Comments on the Proposed Rule Change Received from Members, Participants, or Others.


Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the Rules.

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Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Advance Notice to Increase the National Securities Clearing Corporation’s Minimum Required Fund Deposit

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")\(^1\) and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 ("Act"),\(^2\) notice is hereby given that on February __, 2020, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the advance notice SR-NSCC-2020-803 ("Advance Notice") 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 Advance Notice from interested persons.

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

This Advance Notice consists of modifications to NSCC’s Rules & Procedures

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\(^1\) 12 U.S.C. 5465(e)(1).


(“Rules”)

in order to increase the minimum Required Fund Deposit for each Member.

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

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

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

NSCC conducted Member outreach with each Member that had an average Required Fund Deposit of less than $500,000 for the twelve-month period ending May 2019 to provide notice and an opportunity to discuss the proposed changes. One Member stated that it had an objection to the proposal to raise the minimum Required Fund Deposit from $10,000 to $250,000 and stated that (i) the proposed changes would solely burden the least active and lowest risk firms, (ii) the proposed changes do not have correlation with risk or any appropriate cost allocation at NSCC, (iii) the proposed changes are purely a tax on small firms and NSCC is intent on creating artificial barriers to entry through unjustified capital requirements and (iv) the current policies, procedures and standards are more than adequate to guard against risk at the small firm-level.

First, the proposed changes would not solely burden the least active and


5 The letter sent by the Member also contained comments relating to another proposal that are not addressed herein.
lowest risk firms. Members that maintain a minimum Required Fund Deposit of less than $250,000 do include smaller firms and firms that conduct infrequent activity, but they also consist of newer firms that are ramping up activity and firms that are winding down, regardless of size. Second, the backtesting results indicate that the Members that maintain a minimum Required Fund Deposit of less than $250,000 contributed to 30% of the total backtesting deficiencies which indicate a risk that Required Fund Deposit will be insufficient to manage risk in the event of such Members default. Third, the proposed increase to the Required Fund Deposit is not purely a tax on small firms and not intended as an artificial barrier to entry. While the proposed changes would be an added expense on certain smaller firms that currently have a Required Fund Deposit of less than $250,000, it would apply to all firms, regardless of size, that maintain a minimum Required Fund Deposit. In addition, as indicated above, although the proposed changes may be more of a burden on those Members that have lower operating margins, lower cash reserves or higher costs of capital compared to other Members, NSCC believes that the increase in Required Fund Deposit is necessary and appropriate as it would apply in direct relation to the specific risks presented by Members that currently maintain a Required Fund Deposit of less than $250,000. For that reason, the proposed changes are not an artificial barrier to entry but a necessary and appropriate change to address specific risk. Finally, as indicated by the backtesting results, NSCC believes that the current minimum Required Fund Deposit does indicate risk with respect to those Members that maintain a minimum Required Fund Deposit of less than $250,000 and the increase in the minimum Required Fund Deposit would reduce that risk. NSCC believes that increasing the minimum Required Fund Deposit to $250,000 would provide an appropriate balance
of improving Member backtesting results and NSCC’s Clearing Fund coverage which will reduce risk for all Members, while minimizing the impact to Members by not raising the minimum Required Fund Deposit to a higher amount.

Finally, the Member stated that while it objected to raising the minimum Required Fund Deposit to $250,000, it would not object to an increase to $100,000. NSCC observed that the increased improvement of the Clearing Fund coverage by 0.13% overall, and the elimination of 12 additional backtesting deficiencies during the Impact Study Period (as defined below) provided by a minimum $250,000 Required Fund Deposit as compared to a minimum $100,000 Required Clearing Fund Deposit validates raising the minimum to $250,000. While an increase to a minimum Required Fund Deposit to $100,000 would also represent an improvement of the Clearing Fund coverage, the number of deficiencies mitigated or reduced would be fewer. If the minimum Required Fund Deposit were raised to $250,000, NSCC observed a 28% increase in the number of eliminated or reduced deficiencies during the Impact Study Period. As a result, NSCC believes that $250,000 is the appropriate minimum Required Fund Deposit amount that will minimize the financial impact to its Members while maximizing risk management of activity that is guaranteed at the point of validation or comparison by NSCC.

NSCC will notify the Commission of any additional written comments received by NSCC.

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

Description of Proposed Changes
NSCC is proposing to increase the minimum Required Fund Deposit, as described in greater detail below.

**The Minimum Required Fund Deposit**

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.⁶ 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 liquidation of the Member’s portfolio in the event NSCC ceases to act for that Member (hereinafter referred to as a “default”).⁷ The aggregate of all Members’ Required Fund Deposits, together with certain other deposits required under the Rules, constitutes the Clearing Fund of NSCC, which it would access, among other instances, 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

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⁶ See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules (“Procedure XV”), 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).

⁷ 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.
faced by NSCC, as identified within Procedure XV.\(^8\) Currently, each Member is required to maintain a minimum Required Fund Deposit amount of $10,000.\(^9\) If a Member’s Required Fund Deposit, as calculated by Procedure XV, is less than $10,000 on a given day, NSCC requires a deposit to bring the Member’s Required Fund Deposit up to $10,000. The first 40% of a Member’s Required Fund Deposit, but no less than the minimum Required Fund Deposit amount of $10,000, is required to be in cash.\(^10\)

NSCC regularly assesses the market, liquidity and other risks that its margining methodologies are designed to mitigate to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market. In connection with such regular reviews, NSCC has determined that there are circumstances where the current minimum Required Fund Deposit amount is insufficient to manage NSCC’s risk in the event of an abrupt or sudden increase in a Member’s activity.

NSCC employs daily backtesting to determine the adequacy of each Member’s

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\(^8\) Procedure XV, supra note 4.

\(^9\) Section 1 of Rule 4, supra note 4.

\(^10\) Section II.(A) of Procedure XV, supra note 4.
Required Fund Deposit.\textsuperscript{11} NSCC compares the Required Fund Deposit\textsuperscript{12} for each Member with the simulated liquidation gains/losses using the actual positions in the Member’s portfolio, and the actual historical security returns. A backtesting deficiency occurs when NSCC determines that a Member’s Required Fund Deposit would not have been adequate to address the projected liquidation losses estimated from a Member’s settlement activity based on the backtesting results. NSCC investigates the cause(s) of any backtesting deficiencies. As a part of this investigation, NSCC pays particular attention to Members with backtesting deficiencies that bring the results for that Member below the 99\% confidence target (i.e., greater than two backtesting deficiency days in a rolling twelve-month period) to determine if there is an identifiable cause of repeat backtesting deficiencies.\textsuperscript{13} NSCC also evaluates whether multiple Members may


\textsuperscript{12} Members may be required to post additional collateral to the Clearing Fund in addition to their Required Fund Deposit amount. See e.g., Rule 15 (Assurance of Financial Responsibility and Operational Capability), supra note 4 (providing that adequate assurances of financial responsibility of a participant may be required, such as increased Clearing Fund deposits). For backtesting comparisons, NSCC uses the Required Fund Deposit amount, without regard to the actual, total collateral posted by the Member to the Clearing Fund.

\textsuperscript{13} The 99\% confidence target is consistent with Rule 17Ad-22(e)(6)(iii) which requires NSCC to calculate margin to cover its “potential future exposure” which is defined in Rule 17Ad-22(a)(13) to mean the “maximum exposure estimated to occur at a future point in time with an established single-tailed confidence level of at least 99 percent with respect to the estimated distribution of future exposure.” 17 CFR 240.17Ad-22(a)(13), (e)(6)(iii).
experience backtesting deficiencies for the same underlying reason. Backtesting deficiencies highlight exposure that could subject NSCC to potential losses under normal market conditions in the event that a Member defaults.

While multiple factors may contribute to a Member’s backtesting deficiency, NSCC has observed that some Members with position increases after the calculation of their Required Fund Deposit may incur backtesting deficiencies due to the additional exposure that is not mitigated until the collection of the Required Fund Deposit occurs intraday, or on the next business day. In addition, NSCC has determined that based on a review of backtesting deficiencies during the period from September 2017 to January 2018 (“Impact Study Period”), approximately 30% of backtesting deficiencies occurred with Members that maintained a Required Fund Deposit of less than $250,000. Approximately 90% of the deficiencies of those Members whose maintained a Required Fund Deposit of less than $250,000 would have been mitigated during that period if the Required Fund Deposit were $250,000 or higher.

Typical examples where Members may be maintaining a minimum Required Fund Deposit amount of $10,000 include (1) when a new Member has activated its clearing accounts at NSCC but is growing its business; (2) when a Member generally has limited or infrequent transaction activity; and (3) when a Member is winding down its business and is in the process of retiring its NSCC membership. In each of these circumstances, an abrupt increase in clearing activity following a period of low or no clearing activity could cause NSCC to be under-marginated with respect to the Member and may result in backtesting deficiencies. Therefore, NSCC is proposing to increase the minimum Required Fund Deposit amount of $10,000 to address the risk that NSCC
becomes under-margined in circumstances when a Member is subject to the current minimum Required Fund Deposit amount.

In determining the appropriate minimum Required Fund Deposit amount, NSCC reviewed varying minimum Required Fund Deposit amounts to determine the anticipated effects of increasing the minimum Required Fund Deposits on Clearing Fund coverage and on backtesting results. NSCC also conducted a review of minimum deposit requirements of registered clearing agencies and foreign central counterparty clearing houses (“CCPs”) to compare NSCC’s minimum Required Fund Deposit with the deposits required by registered clearing agencies and foreign CCPs. As discussed below, based on the results of the reviews and the comparison of other registered clearing agencies and foreign CCPs, NSCC believes that a proposed minimum Required Fund Deposit amount of $250,000 would provide an appropriate balance of improving Member backtesting results and NSCC’s Clearing Fund coverage, while minimizing the impact to Members.

NSCC conducted a review of backtesting deficiencies during the Impact Study Period to determine the anticipated backtesting coverage using $250,000 as the minimum Required Fund Deposit amount and amounts lower and higher than $250,000. The results of the reviews indicated that using $250,000 as its minimum Required Fund Deposit amount would improve NSCC’s rolling twelve-month Clearing Fund coverage and reduce the number of Members with backtesting coverage below 99%.14 The

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14 Backtesting percentages indicate the risk that a minimum Required Fund Deposit will be sufficient to manage risk in the event of a Member’s default. A backtesting coverage that is below the 99% confidence target for a Member means that the Member has more than two backtesting deficiency days in a rolling twelve-month period. As indicated above, consistent with Rule 17Ad-22(e)(6)(iii), NSCC pays particular attention to Members with backtesting deficiencies that bring the results for that Member below the 99% confidence
reviews indicated that the proposed changes would reduce backtesting deficiencies for Members who maintain a minimum Required Fund Deposit of less than $250,000 by approximately 90%. The review of backtesting deficiencies during the Impact Study Period also indicated that raising the minimum Required Fund Deposit to $250,000 would decrease backtesting deficiencies to a greater extent than raising it to a lower amount such as $100,000 and would increase the Clearing Fund coverage to a greater extent15.

NSCC’s review of the requirements of other clearing agencies and foreign CCPs indicated that NSCC’s minimum Required Fund Deposit requirement of $10,000 was significantly lower than minimum deposits or equivalent required by such other entities.16 While the minimum required fund deposits of such other entities is not dispositive as to the risk borne by NSCC or the proper fund deposit amounts to offset such risk, it is indicative of the amounts that users of other similarly situated entities can expect to pay

target to determine if there is an identifiable cause of repeat backtesting deficiencies. See supra note 13.

15 Over the Impact Study Period, if the minimum Required Fund Deposit had been set to $250,000 compared to $100,000, there would have been 12 more backtesting deficiencies eliminated; overall increasing the 12-month backtesting coverage percentage by 0.13%.

as a minimum required fund deposit to use the services of the clearing agencies and foreign CCPs and the impact to such users. The comparison shows that entities using other clearing agencies and foreign CCPs pay significantly more in minimum fund deposits to use similar services than the minimum Required Fund Deposit amount at NSCC.

Based on the backtesting results discussed above and the impact to Members of raising the minimum Required Fund Deposit amount to $250,000, NSCC believes that raising it to $250,000 is the appropriate minimum Required Fund Deposit amount that will minimize the financial impact to its Members while maximizing risk management of activity that is guaranteed at the point of validation or comparison by NSCC.

As is currently provided for in the Rules, NSCC is proposing to continue to require that Members deposit an amount equal to the minimum Required Fund Deposit in cash.17 NSCC permits Members to satisfy their Required Fund Deposit obligations through a combination of cash and open account indebtedness secured by Eligible Clearing Fund Securities.18 Cash deposits are fungible. NSCC would be therefore be further strengthening its liquidity resources by requiring each Member to deposit a baseline of $250,000 in cash to the Clearing Fund.

**Proposed Rule Changes**

In order to implement the proposed increase in the minimum Required Fund Deposit amount to $250,000, Section 1 of Rule 4 would be revised to state that the minimum Required Fund Deposit for each Member shall be $250,000. In addition,

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17  Section II.(A) of Procedure XV, supra note 4.
18  Rule 4, Section 1, supra note 4.
Section II.(A) of Procedure XV would be revised to replace the minimum contribution amount from $10,000 to $250,000. Section II.(A) of Procedure XV currently provides that no less than $10,000, the minimum Required Fund Deposit, of a Member’s Required Fund Deposit must be in cash. To reflect the increase in the minimum Required Fund Deposit, NSCC would also increase the minimum cash requirement to $250,000 to match the proposed increased minimum Required Fund Deposit amount.

Expected Effect on and Management of Risk

NSCC believes that the proposed changes to increase the minimum Required Fund Deposit amount would enable NSCC to better limit its risk exposures to Members that would otherwise maintain a Required Fund Deposit of less than $250,000. By increasing the minimum Required Fund Deposit to $250,000, the proposed change addresses exposure that could subject NSCC to potential losses in the event that a Member defaults. Specifically, the proposed rule change seeks to remedy potential situations that are described above where NSCC could be under-margined, such as when a Member has an abrupt increase in clearing activity following a period of low or no clearing activity, by increasing the minimum margin requirements. Therefore, by enabling NSCC to collect margin that more accurately reflects the risk characteristics of its Members, the proposal would enhance NSCC’s risk management capabilities.

By providing NSCC with a more effective limit on its exposures, as described above, the proposed change would also mitigate risk for Members because lowering the risk profile for NSCC would in turn lower the risk exposure that Members may have with

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19 Section II.(A) of Procedure XV, supra note 4.
respects to NSCC in its role as a central counterparty. Further, the proposal is designed to meet NSCC’s risk management goals and its regulatory obligations, as described below.

**Consistency with the Clearing Supervision Act**

Although Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)

20 does not specify a standard of review for an advance notice, its stated purpose is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities. 21

NSCC believes that the proposal is consistent with the Clearing Supervision Act, specifically with the risk management objectives and principles of Section 805(b), and with certain of the risk management standards adopted by the Commission pursuant to Section 805(a)(2), for the reasons described below. 22

(i) **Consistency with Section 805(b) of the Clearing Supervision Act**

For the reasons described below, NSCC believes that the proposed changes in this advance notice are consistent with the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision.

As discussed above, NSCC is proposing to increase the minimum Required Fund Deposit to be paid by Members and to require that such minimum Required Fund Deposit


22 12 U.S.C. 5464(a)(2) and (b).
be paid in cash. Required Fund Deposits are 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. NSCC believes the proposed changes are consistent with promoting robust risk management because they are designed to enable NSCC to better limit its exposure to Members in the event of a Member default. Specifically, as a review of backtesting deficiencies during the Impact Study Period has indicated, raising the minimum Required Fund Deposit to $250,000 would decrease the number of backtesting deficiencies and ensure that NSCC maintains the coverage of credit exposures for more Members at a confidence level of at least 99%.

Furthermore, NSCC believes that the changes proposed in this advance notice are consistent with promoting safety and soundness, which, in turn, is consistent with reducing systemic risks and supporting the stability of the broader financial system, consistent with Section 805(b) of the Clearing Supervision Act.23 The proposed changes are designed to better limit NSCC’s exposures to Members in the event of Member default. As discussed above, the proposed changes would allow NSCC to limit its exposure to Members that would otherwise have a Required Fund Deposit of less than $250,000. The proposed increase in the minimum Required Fund Deposit would allow NSCC to collect margin at levels that reflect the risk presented by Members and would help NSCC limit its exposures to Members that have an abrupt or sudden increase in clearing activity following a period of low or no clearing activity. In addition, by continuing to require that Members pay an amount equal to the minimum Required Fund Deposit amount in cash, NSCC would be making available additional collateral that is

easier for NSCC to access upon a Member’s default, further limiting the credit exposure to its Members.

By better limiting NSCC’s exposures to Members in the event of a Member default, the proposed changes are consistent with promoting safety and soundness, which, in turn, is consistent with reducing systemic risks and supporting the stability of the broader financial system.

(ii) Consistency with Section 805(a)(2) of the Clearing Supervision Act

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like NSCC, and financial institutions engaged in designated activities for which the Commission is the supervisory agency or the appropriate financial regulator.\(^{24}\) The Commission has accordingly adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (“Covered Clearing Agency Standards”).\(^{25}\)

The Covered Clearing Agency Standards require registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.\(^{26}\) NSCC believes that the proposed changes are consistent with Rule 17Ad-22(e)(4)(i) and (e)(6)(iii), each promulgated under the

\(^{24}\) 12 U.S.C. 5464(a)(2).

\(^{25}\) 17 CFR 240.17Ad-22(e).

\(^{26}\) Id.
Rule 17Ad-22(e)(4)(i) under the Act requires 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 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. More specifically, as a review of backtesting deficiencies during the Impact Study Period has indicated, raising the minimum Required Fund Deposit amount to $250,000 would decrease the number of backtesting deficiencies and help ensure that NSCC maintains the coverage of credit exposures for more Members at a confidence level of at least 99%. In addition, by requiring that Members pay an amount equal to the minimum Required Fund Deposit amount in cash, NSCC would be making available collateral that is easier to access when Members default further reducing the risk of losses, which would require using non-defaulting Members’ securities or funds, or NSCC funds. Therefore, NSCC believes that the proposed changes would enhance NSCC’s ability to effectively identify, measure, monitor and manage its credit exposures and would enhance its ability to

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

Rule 17Ad-22(e)(6)(iii) under the Act requires 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, calculates margin sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default.30 NSCC employs daily backtesting to determine the adequacy of each Member’s Required Fund Deposit paying particular attention to Members that have backtesting deficiencies below the 99% confidence target. Such backtesting deficiencies highlight exposure that could subject NSCC to potential losses if a Member defaults. As discussed above, NSCC has determined that approximately 30% of all backtesting deficiencies occur for those Members that maintain a Required Fund Deposit of less than $250,000 and that approximately 90% of the deficiencies of those Members would have been mitigated during the Impact Study Period if the Required Fund Deposit were $250,000 or higher. By raising the minimum Required Fund Deposit amount to $250,000, NSCC believes it can decrease the backtesting deficiencies by Members, and thus decrease exposure to such Members in the event of a default. NSCC believes that the increase in margin for those Members that currently maintain a Required Fund Deposit of less than $250,000 would improve the probabilities that the margin

29 Id.
30 17 CFR 240.17Ad-22(e)(6)(iii).
maintained by such Members is sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(iii) under the Act.31

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

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

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

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

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

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the Advance Notice is consistent with the Clearing Supervision 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-2020-803 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-2020-803. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the Advance Notice that are filed with the Commission, and all written communications relating to the Advance Notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC.
20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC’s website (http://dtcc.com/legal/sec-rule-filings.aspx). All comments received will be posted without change. 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-2020-803 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary
Re: NSCC Clearing Fund - Minimum Deposit Requirement Increase Proposal

This firm has been a responsible member of DTC-NSCC for more than thirty years. Please take this comment as our strong objection to the recent NSCC proposal to increase minimum deposit requirements by a factor of 25 times from $10,000 to $250,000. NSCC already has a clear and deliberate process to set deposit requirements for member firms based on activity level. Under the circumstances, we see no justification for any increase in minimum deposit requirements, which solely burden the least active and lowest risk firms.

Viewed more broadly, DTC/NSCC recent proposed changes to membership capital requirements are deeply troubling. The subject proposal complements another which seeks to vastly increase required excess net capital on small and mid-sized firms while having no effect on industry leaders. Please see our comment letter (attached) delineating the disproportionate impact. That proposal is disturbing because it appears to be risk based – matching capital to VAR – but is obviously not because the maximum VAR levels entailed don’t begin to match those of the industry’s largest participants. In contrast, the current proposal regarding deposit levels doesn’t even purport to have correlation with risk or any appropriate cost allocation at NSCC. It is purely a tax on small firms. The overall impression of the two proposals combined is that DTCC/NSCC is an entity of, by and for the large firms—and intent on creating artificial barriers to entry through unjustified capital requirements.

We believe that the current policies, procedures and standards are more than adequate to guard against risk at the small firm level. Although there must have been some small firm problems over the years, we cannot remember the last time a small firm liquidated to a deficit and caused any loss to NSCC or DTC. Even in the highly unlikely event that several small firms ‘fell’ in a catastrophic situation, DTC would hardly be impacted, if at all. ... And DTC would probably be struggling with some very real unforeseen risks affecting one or more big firms.

We reiterate our strong objection to increasing the minimum Deposit Requirement. Nonetheless, we would not object to a less egregious increase to $100,000.

Finally, we respectfully request a more transparent and organized program for submitting comments to DTCC/NSCC – one with clear deadlines and publication so that participants can read and respond to any comments received.

Respectfully Submitted, Bonnie K Wachtel, CEO Wendie L Wachtel, COO
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TEXT OF PROPOSED RULE CHANGE

Bold and underlined text indicates proposed added language.

Bold and strikethrough text indicates proposed deleted language.
RULE 4. CLEARING FUND

SEC. 1. Required Fund Deposits. Each Member shall make and maintain on an ongoing basis a deposit to the Clearing Fund. The amount of each Member’s required deposit shall be determined by the Corporation in accordance with Procedure XV and other applicable Rules and Procedures (the “Required Fund Deposit”). The minimum Required Fund Deposit for each Member shall be $125,000. The Corporation may require any such Member to deposit additional amounts to the Clearing Fund pursuant to Rule 15. A Member may in its discretion maintain additional deposits at the Corporation, subject to any Procedures or other requirements the Corporation may establish for such excess amounts. For purposes of these Rules and Procedures, such additional deposits shall be deemed to be part of the Clearing Fund and the Member’s Actual Deposit but shall not be deemed to be part of the Member’s Required Fund Deposit.

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1 Clearing Fund deposits for Sponsored Accounts (as defined in Procedure IX.B.) relative to such Sponsored Accounts’ DTC activity will be calculated and held by DTC in accordance with their procedures, and shall not be included in determining the Required Fund Deposit or the minimum cash requirement.
PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS

II. Minimum Clearing Fund and Additional Deposit Requirements

(A) Each Member of the Corporation shall be required to contribute a minimum of $125,000 (the “minimum contribution”). The first 40% (but no less than $4250,000) of a Member’s Required Fund Deposit must be in cash and the remaining amount, may be evidenced by open account indebtedness secured by the pledge of Eligible Clearing Fund Securities, which shall be valued, for collateral purposes, as set forth in subsection III below. A Mutual Fund/Insurance Services Member’s entire deposit is required to be in cash.

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