

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-93070; File No. SR-NSCC-2021-011)

September 20, 2021

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Partial Amendment No. 1 to Remove ID Net Transactions from the Required Fund Deposit Calculations and Make Other Changes to the Rules

I. Introduction

On July 27, 2021, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² proposed rule change SR-NSCC-2021-011. On August 6, 2021, NSCC filed Amendment No.1 to the proposed rule change, to make clarifications and corrections to the proposed rule change.³ The proposed rule change was published for public comment in the Federal Register on August 11, 2021,⁴ and the Commission has received comments on the changes proposed therein.⁵ For the reasons discussed below, the Commission is approving the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Partial Amendment No. 1 made clarification corrections to the description of the proposed rule change, namely the insertion of a legend noting the changes to the Rules have been approved but not yet implemented.

⁴ Securities Exchange Act Release No. 92566 (August 5, 2021), 86 Fed. Reg. 44100 (August 11, 2021) (“Notice”).

⁵ See Letter from NSCC, dated August 6, 2021, to Vanessa Countryman, Secretary, Commission, available at <https://www.sec.gov/comments/sr-nsc-2021-011/srnscc2021011-9122299-247146.pdf> (providing notice of Amendment No.

II. Description of the Proposed Rule Change

NSCC is proposing to revise the margin methodology set forth in its Rules & Procedures (“Rules”)⁶ to remove institutional delivery (“ID”) transactions that are processed through the ID Net Service from the calculation of its members’ required margin. The ID Net Service is a joint service of NSCC and Depository Trust Company (“DTC”) that allows subscribers to the service, which are generally executing brokers, to net, on the one side, affirmed eligible ID transactions that are processed through ITP Matching (US) LLC (“ITP”) and then held at DTC with, on the other side, broker-dealer transactions have been processed through NSCC’s continuous net settlement (“CNS”) system.⁷ The ID Net Service was designed to provide Members with the operational benefit of efficiency by allowing them to net their affirmed ID transactions with their CNS transactions.⁸ Although ID transactions processed through the ID Net Service (“ID Net Transactions”) are netted with transactions that have been processed through NSCC’s

1). Two other comments letters were received that do not raise issues related to this proposed rule change.

⁶ Capitalized terms not defined herein are defined in the Rules, available at http://dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf.

⁷ DTC is a clearing agency and affiliate of NSCC that serves as a central securities depository providing settlement services for NSCC. ITP is a DTC affiliate that offers buy-side, sell-side and custodian firms an end-to-end straight-through-processing solution for trading activity, which is then settled at DTC.

⁸ See Securities Exchange Act Release No. 57573 (March 27, 2008), 73 Fed. Reg. 18019, 18019 (April 2, 2008).

CNS system, these transactions are not subject to NSCC's trade guarantee, meaning in the event of a default, ID Net Transactions will not be completed by NSCC.⁹

NSCC is also proposing to amend the Rules to provide greater transparency regarding the status of the ID Net Service as a non-guaranteed service and how ID Net Transactions are handled following a member default. Finally, NSCC is proposing to make other changes to the Rules to implement these proposed changes.

A. Required Fund Deposit and Risk Management of ID Net Transactions

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.¹⁰ The Required Fund Deposit serves as each Member's margin. The objective of a Member's margin 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").¹¹ The aggregate of all Members' Required Fund Deposits constitutes the Clearing Fund of NSCC. NSCC

⁹ See Procedure XVI (ID Net Service), supra note 6. As explained in the Notice, transactions processed through the ID Net Service have never been subject to NSCC's trade guarantee. See Notice, 86 Fed. Reg. at 44101.

¹⁰ See generally Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters). NSCC states that its 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). See Notice, 86 Fed. Reg. at 44102.

¹¹ 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), supra note 6.

would access its Clearing Fund should a defaulting Member's own margin be insufficient to satisfy losses to NSCC caused by the liquidation of that Member's portfolio.¹²

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, and are described in Procedure XV of the Rules. Because ID Net Transactions are netted with CNS transactions, these transactions are currently included in the netted positions that are used to calculate certain components of Members' Required Fund Deposits. These components include (i) the volatility component, (ii) the mark-to-market component, which includes both (a) a Regular Mark-to-Market charge and (b) an ID Net Mark-to-Market charge, (iii) the Margin Requirement Differential component, and (iv) a margin liquidity adjustment charge ("MLA charge"). Each component is calculated by a different methodology as identified by NSCC in the Rules.¹³

B. Proposed Enhancement to NSCC's Margining Methodology

NSCC proposes to revise its margining methodology to remove ID Net Transactions from the calculation of Members' Required Fund Deposits. As noted above, NSCC does not guarantee the completion of these ID Net Transactions, and, in the event of a Member default, these transactions are excluded from NSCC's operations to be settled away from NSCC.¹⁴

¹² See Rule 4, section 4, supra note 6. See also Notice, 86 Fed. Reg. at 44101.

¹³ See generally Procedure XV, supra note 6.

¹⁴ See note 9 supra and accompanying text.

Including ID Net Transactions in the margin calculations presents the risk that NSCC is either under-margining or over-margining the positions of Members that use the ID Net Service.¹⁵ NSCC states that it could more accurately measure the risks it faces following a Member default by removing these non-guaranteed positions from its margining methodology.¹⁶

To implement this proposed rule change, NSCC proposes to remove ID Net Transactions from Members' Net Unsettled Positions for purposes of calculating the volatility charge and the MLA charge. NSCC also proposes to (1) eliminate the ID Net Mark-to-Market charge from the Required Fund Deposit, and (2) amend the Rules to make clear that ID Net Transactions are not included in the calculation of the Regular Mark-to-Market charge. NSCC does not propose any other changes to the calculation of margin charges and is not proposing any changes to the operation of the ID Net Service.

C. Proposed Changes to Clarify the Non-Guaranteed Status of ID Net Service

NSCC also proposes to amend the Rules to provide greater transparency and clarity into how ID Net Transactions are processed in the event of a Member default. Currently, the Rules describe the circumstances in which NSCC may remove a Member's status as an ID Net Subscriber, which include the circumstances that provide NSCC with

¹⁵ See Notice, 86 Fed. Reg. at 44102. For example, if the inclusion of ID Net Transactions in a Member's Net Unsettled Positions results in a lower margin charge (as compared to the margin charge that would have been calculated for that Member if those ID Net Transactions were excluded from its Net Unsettled Positions), NSCC could be under-margining on that Net Unsettled Position.

¹⁶ See Notice, 86 Fed. Reg. at 44102. NSCC states it does not expect the proposed change to have a material impact on the size of its Clearing Fund. See id.

the right to suspend, prohibit or limit a Member's access to NSCC's services.¹⁷ Additionally, the Rules describe NSCC's ability to exit ID Net Transactions from its operations.¹⁸ NSCC has stated that because the ID Net Service is not a guaranteed service, NSCC would rely on these Rules to exit ID Net Transactions from its operations in the event of a Member default.¹⁹ Specifically, if NSCC ceased to act for a Member that is an ID Net Subscriber, that firm would no longer be eligible to use the service, NSCC would exit its ID Net Transactions from its operations, and those transactions would be settled on a trade-for-trade basis outside the ID Net Service.²⁰

NSCC proposes to amend the Rules to expressly identify ID Net as a non-guaranteed service and to provide further clarity on how ID Net Transactions will be processed in the event of a Member default.

D. Other Proposed Changes to the NSCC Rules to Implement the Proposed Rule Change

NSCC proposes additional changes to the Rules in order to implement the proposed changes described above. These changes generally are minor modifications relating to relevant definitions and renumbering margin components.

III. Discussion and Commission Findings

¹⁷ See Rule 65, Section 5, supra note 6.

¹⁸ See Procedure XVI (ID Net Service), supra note 6.

¹⁹ See id.

²⁰ See id.

Section 19(b)(2)(C) of the Act²¹ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considered the proposed rule change, the Commission finds that the proposed changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to NSCC. In particular, the Commission finds the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,²² and Rules 17Ad-22(e)(4)(i) and (e)(6)(i), each promulgated under the Act,²³ for the reasons described below.

A. Consistency with Section 17A(b)(3)(F)

Section 17A(b)(3)(F) of the Act²⁴ requires that the rules of NSCC be designed to, among other things, to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.

As described in Section II.B above, the proposed rule change would revise NSCC's margining methodology to remove ID Net Transactions from the calculation of Members' Required Fund Deposits. The Commission believes that this increased change in the determination of Members' Required Fund Deposits should allow both NSCC and Members to more effectively manage and understand the risks related to ID Net

²¹ See id. at 44103.

²² 15 U.S.C. 78q-1(b)(3)(F).

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

²⁴ 15 U.S.C. 78q-1(b)(3)(F).

Transactions. Therefore, the Commission believes that the proposed rule change is designed to promote the prompt and accurate clearance and settlement of ID Net Transactions and assure the safeguarding of securities and funds which are in the custody or control of NSCC, consistent with Section 17A(b)(3)(F) of the Act.²⁵

In addition, as described in Sections II.C and D above, the proposed rule change would amend the Rules to improve the transparency in describing ID Net Transactions as non-guaranteed and to provide clarity on how these transactions will be processed in the event of a Member default. The proposed rule would also make technical changes to implement the proposed changes described above. The Commission believes that by clearly stating the nature of ID Net Transactions, further clarifying the default procedure involving ID Net Transactions, and making technical changes to implement the changes, the proposed rule change should help ensure that the Rules are accurate and clear to Members, thus promoting prompt and accurate clearance and settlement.

B. Consistency with Rule 17Ad-22(e)(4)(i)

Rule 17Ad-22(e)(4)(i) under the Act²⁶ 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.

²⁵ Id.

²⁶ 17 CFR 240.17Ad-22(e)(4)(i).

As described above, NSCC proposes to remove ID Net Transactions from the calculation of Required Fund Deposits of Members that are ID Net Subscribers because ID Net Transactions are not guaranteed transactions and NSCC would not incur losses from ID Net Transactions. The proposed rule change would enable NSCC to more accurately and effectively measure the risks presented by Members by calculating margin only on the positions that NSCC may be required to complete in the event of a Member default. Therefore, the Commission believes the proposed rule change would enhance NSCC's ability to effectively identify, measure, monitor and, through the collection of Required Fund Deposits, manage its credit exposures to Members by maintaining sufficient financial resources to cover its credit exposure fully with a high degree of confidence. As such, the Commission believes the proposed rule change is consistent with Rule 17Ad-22(e)(4)(i) under the Act.²⁷

C. Consistency With Rule 17Ad-22(e)(6)(i)

Rule 17Ad-22(e)(6)(i) under the Act²⁸ 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.

A Member's margin (in the form of its Required Fund Deposit) is made up of risk-based components that are calculated and assessed daily to limit NSCC's credit exposures to its members. The Commission believes the proposed rule change, which

²⁷ Id.

²⁸ 17 CFR 24017Ad-22(e)(6)(i).

would remove ID Net Transactions from the calculation of Members' margin, should enable NSCC to more effectively measure the risks presented by its Members' guaranteed positions and, therefore, determine a more precise level of margin commensurate with the risks and particular attributes of Members' portfolios. As stated above, Required Fund Deposits are designed to mitigate any potential losses to NSCC associated with liquidating a defaulting Member's portfolio in the event NSCC ceases to act for that Member. ID Net Transactions are not subject to NSCC's trade guarantee. Consequently, in the event of a Member default related to ID Net Transactions, NSCC is not required to complete such transactions, would not have any losses, and would not need to use Required Fund Deposits since there is no losses. As a result, the funds required to cover Members' transactions would not be impacted by the ID Net Service. Accordingly, the Commission believes that by removing non-guaranteed positions from the margin calculation, the proposed rule change would enable NSCC to collect margin more precisely tailored to the nature of the risk presented to NSCC.

As a result, the Commission believes the proposed rule change would enhance NSCC's ability 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. Therefore, the Commission believes the proposed change is consistent with Rule 17Ad-22(e)(6)(i) under the Act.²⁹

IV. Solicitation of Comments

²⁹ Id.

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as modified by Partial Amendment No. 1, is consistent with the Exchange 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-2021-011 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-2021-011. 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 such 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-2021-011 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of the Proposed Rule Change, As Modified by Partial Amendment No. 1

The Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act,³⁰ to approve the proposed rule change prior to the 30th day after the date of publication of Partial Amendment No.1 in the Federal Register. As discussed above, in Partial Amendment No. 1, NSCC updates its proposed rule text to include a legend to indicate a delayed implementation date, specifically that the rule change would be implemented no later than 10 Business Days after Commission approval of the proposed rule change. Partial Amendment No. 1 improves the efficiency of the filing process by obviating the need for NSCC to propose another change to its rules to resolve the omitted legend in the future, while not changing the purpose of or basis for the Proposed Rule Change.

For similar reasons as discussed above, the Commission finds that Partial Amendment No. 1 is consistent with the requirement that NSCC's rules be designed, in

³⁰ 15 U.S.C. 78s(b)(2).

part, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible under Section 17A(b)(3)(F) of the Exchange Act.³¹ Accordingly, the Commission finds good cause for approving the Proposed Rule Change, as modified by Partial Amendment No. 1, on an accelerated basis, pursuant to Section 19(b)(2) of the Exchange Act.³²

VI. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act and the rules and regulations promulgated thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act³³ that the proposed rule change SR-NSCC-2021-011 be, and hereby is, APPROVED.³⁴

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁵

J. Matthew DeLesDernier
Assistant Secretary

³¹ 15 U.S.C. 78q-1(b)(3)(F).

³² 15 U.S.C. 78s(b)(2).

³³ Id.

³⁴ In approving the proposed rule change, the Commission considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³⁵ 17 CFR 200.30-3(a)(12).