

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-96345; File Nos. SR-DTC-2022-006; SR-FICC-2022-004; SR-NSCC-2022-006)

November 17, 2022

Self-Regulatory Organizations; The Depository Trust Company; Fixed Income Clearing Corporation; National Securities Corporation; Order Granting Proposed Rule Changes to Amend the Stress Testing Framework and Liquidity Risk Management Framework

On May 26, 2022, The Depository Trust Company (“DTC”), Fixed Income Clearing Corporation (“FICC”), and National Securities Clearing Corporation (“NSCC”) (each a “Clearing Agency,” and collectively, the “Clearing Agencies”), filed with the Securities and Exchange Commission (“Commission”) proposed rule changes SR-DTC-2022-006, SR-FICC-2022-004, and SR-NSCC-2022-006 (the “Proposed Rule Changes”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup> to amend the Stress Testing Framework and Liquidity Risk Management Framework adopted by the Clearing Agencies, as well as to update the FICC Mortgage-Backed Securities Division (“MBSD”) Rules.

The Proposed Rule Changes were published for comment in the Federal Register on June 15, 2022.<sup>3</sup> On July 14, 2022, the Commission published notices designating a longer period of time for Commission action and a longer period for public comment on

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 95080 (June 9, 2022), 87 FR 36191 (June 15, 2022) (File No. SR-DTC-2022-006) (“DTC Notice”); Securities Exchange Act Release No. 95079 (June 9, 2022), 87 FR 36182 (June 15, 2022) (File No. SR-FICC-2022-004) (“FICC Notice”); Securities Exchange Act Release No. 95078 (June 10, 2022), 87 FR 36158 (June 15, 2022) (File No. SR-NSCC-2022-006) (“NSCC Notice”).

the Proposed Rule Changes.<sup>4</sup> On September 9, 2022, the Commission issued orders instituting proceedings on the Proposed Rule Changes.<sup>5</sup> The Commission has received comments on the changes proposed therein.<sup>6</sup> This order approves the Proposed Rule Changes.

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<sup>4</sup> Securities Exchange Act Release No. 95282 (July 14, 2022), 87 FR 43354 (July 20, 2022) (SR-DTC-006); Securities Exchange Act Release No. 95283 (July 14, 2022), 87 FR 43364 (July 20, 2022) (SR-FICC-2022-004); Securities Exchange Act Release No. (July 14, 2022), 87 FR 43354 (July 20, 2022) (SR-NSCC-2022-006).

<sup>5</sup> Securities Exchange Act Release No. 95729 (Sept. 9, 2022), 87 FR 56733 (Sept. 15, 2022) (SR-DTC-2022-006); Securities Exchange Act Release No. 95724 (Sept. 9, 2022), 87 FR 56732 (Sept. 15, 2022) (SR-FICC-2022-004); Securities Exchange Act Release No. 95725 (Sept. 9, 2022), 87 FR 56735 (Sept. 15, 2022) (SR-NSCC-2022-006).

<sup>6</sup> Specifically, the Commission received comments only on the DTC Notice, and the comment is available at <https://www.sec.gov/comments/sr-dtc-2022-006/srdtc2022006.htm>. The commenter raised a concern regarding the confidentiality of the proposed rule. *Id.* DTC asserted that the exhibits to the filing, including the proposed rule, were entitled to confidential treatment because, if released, they could cause harm to the Clearing Agencies and their participants. Under Section 23(a)(3) of the Exchange Act, the Commission is not required to make public statements filed with the Commission in connection with a proposed rule change of a self-regulatory organization if the Commission could withhold the statements from the public in accordance with the Freedom of Information Act (“FOIA”), 5 U.S.C. 552. 15 U.S.C. 78w(a)(3). The Commission has reviewed the documents for which DTC requests confidential treatment and concludes that they could be withheld from the public under the FOIA. FOIA Exemption 4 protects confidential commercial or financial information. 5 U.S.C. 552(b)(4). Under Exemption 4, information is confidential if it “is both customarily and actually treated as private by its owner and provided to government under an assurance of privacy.” Food Marketing Institute v. Argus Leader Media, 139 S. Ct. 2356, 2366 (2019). The Commission understands that DTC has not disclosed the confidential exhibits to the public, and believes that the information is the type that would not customarily be disclosed to the public. In addition, by requesting confidential treatment, DTC had an assurance of privacy because the Commission generally protects information that can be withheld under Exemption 4. Thus, the Commission has determined to accord confidential treatment to the confidential exhibits.

## **I. DESCRIPTION OF THE PROPOSED RULE CHANGES**

### **A. Background and Overview of the Changes**

The Clearing Agencies adopted the Clearing Agency Stress Testing Framework (Market Risk) (“ST Framework”) to set forth the manner in which they identify, measure, monitor, and manage their credit exposures to participants and those arising from their respective payment, clearing, and settlement processes by, for example, maintaining sufficient prefunded financial resources to cover its credit exposures to each participant fully with a high degree of confidence and testing the sufficiency of those prefunded financial resources through stress testing.<sup>7</sup> The ST Framework describes the stress testing activities of each of the Clearing Agencies. The Clearing Agencies adopted the Clearing Agency Liquidity Risk Management Framework (“LRM Framework,” and, together with the ST Framework, the “Frameworks”) to set forth the manner in which they measure, monitor and manage the liquidity risks that arise in or are borne by each of the Clearing Agencies by, for example, (1) maintaining sufficient liquid resources to effect same-day settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for each Clearing Agency in extreme but plausible market conditions, and (2) determining the amount and regularly testing the sufficiency of qualifying liquid

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<sup>7</sup> Securities Exchange Act Release No. 82368 (Dec. 19, 2017), 82 FR 61082 (Dec. 26, 2017) (SR-DTC-2017-005; SR-FICC-2017-009; SR-NSCC-2017-006) (“Initial ST Framework Order”).

resources by conducting stress testing of those resources.<sup>8</sup> The LRM Framework describes the liquidity risk management activities of each of the Clearing Agencies.

First, the proposed rule change would amend both the ST Framework and the LRM Framework to move descriptions of the Clearing Agencies' liquidity stress testing activities,<sup>9</sup> from the LRM Framework to the ST Framework. In connection with this proposed change, the Clearing Agencies are also proposing to recategorize the liquidity stress scenarios by removing the Level 1, Level 2 and Level 3 labels and instead categorizing all stress scenarios as either regulatory or informational.

Second, the proposed changes would amend the ST Framework to (1) enhance stress testing for GSD to obtain certain data utilized in stress testing from external vendors and implement a back-up stress testing calculation that would be utilized in the event such data is not supplied by its vendors, and amend the ST Framework to reflect these practices for both GSD and MBSD; (2) reflect that a stress testing team is primarily responsible for the actions described in the ST Framework, and (3) make other revisions to update and clarify the statements in the ST Framework, as further described below.

Third, the proposed changes would amend the LRM Framework to update and clarify the statements in the LRM Framework, as further described below.

Finally, the proposed changes would amend the MBSD Rules to remove duplicative disclosures regarding the stress testing program, as further described below.

B. Changes to Move Activities Related to Stress Testing Qualifying Liquid Resources from the LRM Framework to the ST Framework

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<sup>8</sup> Securities Exchange Act Release Nos. 82377 (December 21, 2017), 82 FR 61617 (December 28, 2017) (File Nos. SR-DTC-2017-004; SR-FICC-2017-008; SR-NSCC-2017-005) (“Initial LRM Framework Order”).

<sup>9</sup> 17 CFR 240.17Ad-22(e)(7)(vi).

The proposed changes would amend both the ST Framework and the LRM Framework to move descriptions of the Clearing Agencies' liquidity stress testing activities from the LRM Framework to the ST Framework. These activities are primarily performed by the Stress Testing Team within the Group Chief Risk Office ("GCRO") of the Depository Trust and Clearing Corporation, which includes members of the Market Risk Management and the Liquidity Risk Management groups within the GCRO.<sup>10</sup> The Clearing Agencies state that the Stress Testing Team, which was previously responsible for stress testing the Clearing Agencies' prefunded financial resources, as part of the market risk management function, took over stress testing of the Clearing Agencies' liquidity resources related to liquidity risk management in order to centralize stress testing activities and related responsibilities under one team.<sup>11</sup>

The Clearing Agencies propose several amendments to both the ST Framework and the LRM Framework to incorporate these changes. First, Section 1 (Executive Summary) and Section 4 (Liquidity Risk Management Regulatory Requirements) of the LRM Framework would be amended to make clear that compliance with the requirements of Rule 17Ad-22(e)(7)(vi) are not addressed in that document, and are addressed in the ST Framework. Section 2 (Glossary of Key Terms) of the LRM

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<sup>10</sup> DTCC is the parent company of the Clearing Agencies. DTCC operates on a shared services model with respect to the Clearing Agencies and its other subsidiaries. Most corporate functions are established and managed on an enterprise-wide basis pursuant to intercompany agreements under which it is generally DTCC that provides a relevant service to its subsidiaries, including the Clearing Agencies.

<sup>11</sup> DTC Notice, supra note 3, 87 FR at 36193; FICC Notice, supra note 3, 87 FR at 36184; NSCC Notice, supra note 3, 87 FR at 36159.

Framework would also be amended to include definitions of “Clearing Agency Stress Testing Framework” and the “Stress Testing Team,” and to remove the definition of the Enterprise Stress Testing Council, which is an internal forum that addresses stress testing matters. Finally, Section 6 (Liquidity Risk Management) of the LRM Framework would be amended to describe at a high-level the activities related to stress testing of the Clearing Agencies’ qualifying liquid resources and to state that these activities are described in greater detail in the ST Framework.

The proposed change would also require revisions throughout the ST Framework to include descriptions of liquidity stress testing activities that support the Clearing Agencies’ compliance with the requirements of Rule 17Ad-22(e)(7)(vi) within the existing sections of the ST Framework. These proposed changes would include revisions to Section 1 (Executive Summary) of the ST Framework to clarify that stress testing related to liquidity risk management is described in this document, and revisions to Section 2 (Glossary of Key Terms) to include definitions related to these activities. These definitions would include the Liquidity Risk Management group within GCRO and a Clearing Agency Liquidity Risk Management Framework. Section 4 of the ST Framework would be renamed “Stress Testing Requirements” and would be amended to make clearer which requirements in Rules 17Ad-22(e)(4) and (7) are addressed in the ST Framework, and to identify the documents where the requirements not addressed in the ST Framework are addressed.

The proposed changes to the ST Framework would create a new Section 6, which would be named “Qualifying Liquid Resources – Liquidity Risk Management,” to describe at a high-level how each of the Clearing Agencies determine the amount and

regularly test the sufficiency of their respective qualifying liquid resources. This new section would include language that is substantially identical to language that would be removed from Section 6 (Liquidity Risk Management) of the LRM Framework.

The new Section 7 (Stress Testing Methodologies) (previously numbered Section 6) of the ST Framework would be updated to include descriptions of the methodologies used in liquidity stress testing. Such methodologies would not change substantively, and the language used in the revisions to this section would be substantively identical to language that would be removed from Section 6 (Liquidity Risk Management) of the LRM Framework.

Finally, the new Section 8 of the ST Framework (previously numbered Section 7), which would be renamed “Stress Testing Governance and Escalation Procedures,” would be amended to include matters related to liquidity stress testing. More specifically, the new Section 8.1 would address governance and oversight of stress testing, which is set forth in a number of internal documents, and overseen by a stress testing committee, the Management Risk Committee and the Risk Committee of the Board of Directors of the Clearing Agencies. The new Section 8.2 would describe the daily monitoring for threshold breaches and liquidity shortfalls, and the escalations and actions that would follow those breaches. More specifically, the Clearing Agencies monitor for breaches of a “Cover One Ratio,” which is defined as the ratio of a family of affiliated Members’ deficiency over the total value of the applicable Clearing Agencies’ Clearing Fund or Participants Fund, excluding the sum value of the applicable family’s required deposit to the Clearing Fund or Participants Fund, as applicable. With respect to liquidity stress

testing, the Clearing Agencies monitor daily for liquidity shortfalls, which trigger a series of escalations and remediation actions, which would be identified in this new Section 8.2.

The new Section 8.3 would address comprehensive analyses of stress scenarios, which occur on at least a monthly basis. These analyses include (1) daily stress testing results, model parameters, model assumptions, and model performance, and (2) each stress scenario set for its comprehensiveness and relevance, including any changes or updates to such scenarios for the period. The new Section 8.4 would address the escalations and reporting of the monthly analyses of stress scenarios. Finally, the new Section 8.5 would address the regular escalation of the results of stress testing, including any concerns related to those results.

Each of these subsections would address stress testing related to market risk, using language that is currently in the ST Framework, and would include language to address liquidity stress testing that would be substantially similar to the language removed from the LRM Framework. Revisions to the language removed from the LRM Framework would be primarily drafting revisions, as the Clearing Agencies are not proposing changes to how they conduct liquidity stress testing.<sup>12</sup>

In connection with the changes described above, the proposed amendments would also reflect the recategorization of liquidity stress scenarios. Previously, liquidity stress scenarios were categorized as Level 1, 2 and 3 scenarios. Level 1 scenarios described qualifying liquid resources under normal market conditions and were considered “baseline” scenarios. Level 2 scenarios assumed a wide range of foreseeable stress

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<sup>12</sup> DTC Notice, supra note 3, 87 FR at 36192, 36193; FICC Notice, supra note 3, 87 FR at 36185; NSCC Notice, supra note 3, 87 FR at 36160.

scenarios that included, but were not limited to, the default of the family of affiliated Members that would generate the largest aggregate payment obligation for each Clearing Agency in extreme but plausible market conditions. These scenarios were designed to identify the qualifying liquid resources each Clearing Agency should maintain to meet compliance with Rule 17Ad-22(e)(7)(i). Finally, the Level 3 scenarios were divided into either (1) regulatory scenarios, which were designed to meet the requirements of Rule 17Ad-22(e)(7)(vi)(A), and (2) informational scenarios, which were designed to be performed for informational and monitoring purposes using stress scenarios that exceed the requirements of Rule 17Ad-22(e)(7)(vi)(A).<sup>13</sup>

The Clearing Agencies state that, while they continue to maintain a wide range of stress scenarios that are designed to comply with the requirements of Rules 17Ad-22(e)(7), in order to simplify the descriptions of its liquidity stress scenarios and align them with the categorization of market risk stress scenarios, the Clearing Agencies have re-categorized the liquidity stress scenarios and eliminated the Level 1, Level 2 and Level 3 categories. Instead, all stress scenarios would be described in Section 6 of the ST Framework as being either (1) regulatory stress scenarios, which are designed to comply with the requirements of Rules 17Ad-22(e)(4)(i) and (vi)(A), and Rules 17Ad-22(e)(7)(i) and (vi)(A); or (2) informational stress scenarios, which may utilize parameters and assumptions that exceed the requirements of Rules 17Ad-22(e)(4)(vi)(A) and (7)(vi)(A) and are utilized for informational, analytical and/or monitoring purposes only. The Clearing Agencies state that this proposed change is a change only to the categorization of these stress scenarios and is not a change to how the Clearing Agencies conduct

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<sup>13</sup> Initial LRM Framework Order, supra note 7, 82 FR at 61619.

liquidity stress testing or otherwise meet the requirements of Rule 17Ad-22(e)(7)(vi)(A).<sup>14</sup> Those revisions regarding the categorization of the liquidity stress scenarios would be reflected in Section 7 of the ST Framework.

C. Proposed Amendments to the ST Framework

The proposed changes would amend the ST Framework to (1) incorporate the use of certain data utilized in stress testing from external vendors and implement a back-up stress testing calculation that would be utilized in the event such data is not supplied by its vendors, similar to the process currently used at MBSD, which is currently the case; (2) reflect that a stress testing team is primarily responsible for the actions described in the ST Framework, and (3) make other revisions to update and clarify the statements in the ST Framework, as further described below.

1. Enhance GSD Stress Testing to Use Vendor-Sourced Data

First, the proposed changes would amend GSD stress testing to utilize vendor-supplied historical risk factor time series data (“Historical Data”) and vendor-supplied security-level risk sensitivity data (“Security-Level Data”) in the stress testing program. This proposed enhancement would be similar to the approach utilized in MBSD stress testing.<sup>15</sup>

The vendor-sourced Historical Data would include data regarding (1) interest rate, (2) implied inflation rate, (3) agency spread, (4) mortgage option adjusted spread, (5) interest rate volatility, and (6) mortgage basis. The vendor-sourced Security-Level

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<sup>14</sup> DTC Notice, supra note 3, 87 FR at 36194; FICC Notice, supra note 3, 87 FR at 36184; NSCC Notice, supra note 3, 87 FR at 36160.

<sup>15</sup> See Securities Exchange Act Release No. 88382 (March 13, 2020), 85 FR 15830 (March 19, 2020) (SR-FICC-2020-801).

Data would include data regarding (1) sensitivity to interest rates, (2) implied inflation rate, (3) agency spread, (4) convexity, (5) sensitivity to mortgage option adjusted spread, (6) sensitivity to interest rate volatility, and (7) sensitivity to mortgage basis. FICC currently utilizes the Historical Data and Security-Level Data in GSD's value-at-risk ("VaR") model, which calculates the VaR Charge component of GSD's Clearing Fund (referred to in the GSD Rulebook as Required Fund Deposit).<sup>16</sup> FICC now proposes to use at GSD the data set currently used in MBSD's stress testing program.

As described in greater detail in the ST Framework,<sup>17</sup> stress testing involves three key components: (1) risk identification, (2) scenario development, which involves the construction of comprehensive and relevant sets of extreme but plausible historical and hypothetical stress scenarios; and (3) risk measurement and aggregation, in which risk metrics are calculated to estimate the profits and losses in connection with the hypothetical close out of a participant's portfolio in certain stress scenarios.

FICC would utilize the vendor-sourced data in the development of historical stress scenarios and in the risk measurement and aggregation process of the GSD stress testing program. More specifically, the Historical Data would be used to identify the largest historical changes of risk factors that influence the pricing of product cleared by GSD, in connection with the development of stress scenarios. The vendor-sourced Historical Data would identify stress risk exposures under broader and more varied market conditions than the data currently available to FICC.

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<sup>16</sup> GSD Rulebook, [available at https://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_gov\\_rules.pdf](https://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf).

<sup>17</sup> These key components of stress testing are also described in the Initial ST Framework Filing. [See supra](#) note 6.

FICC would utilize both the Historical Data and the Security-Level Data in the risk measurement and aggregation process of stress testing. FICC believes that the vendor-sourced Security-Level Data is more stable and robust than the data currently utilized by FICC for GSD stress testing.<sup>18</sup> Because the stress profits and losses calculation that occur in connection with the risk measurement and aggregation process in stress testing would include Security-Level Data, FICC believes that the calculated results would be improved and would reflect results that are closer to actual price changes for government securities during larger market moves which are typical of stress testing scenarios.<sup>19</sup>

Finally, the proposed changes to enhance GSD stress testing would also implement a back-up calculation that GSD would utilize in the event that the vendor fails to provide such data to GSD. Specifically, if the vendor fails to provide any data or a significant portion of data in accordance with the timeframes agreed to by FICC and the vendor, FICC would use the most recently available data on the first day that such disruption occurs in its stress testing calculations. Subject to discussions with the vendor, if FICC determines that the vendor would resume providing data within five (5) Business Days, FICC would determine whether the daily stress testing calculation should continue to be calculated by using the most recently available data or whether the back-up calculation (as described below) should be invoked. Subject to discussions with the vendor, if FICC determines that the data disruption would extend beyond five (5)

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<sup>18</sup> FICC Notice, supra note 3, 87 FR at 36185.

<sup>19</sup> Id.

Business Days, the back-up calculation would be employed for daily stress testing, subject to appropriate internal governance.

The proposed back-up calculation would include the following calculations: (1) calculate each Netting Member's portfolio net exposures, (2) calculate the historical stress return, and (3) calculate each Netting Member's stress profits and losses. FICC would use publicly available indices as the data source for the stress return calculations. This calculation would be referred to as the Back-up Stress Testing Calculation in the ST Framework.

The Clearing Agencies would describe the use of vendor-sourced data in stress testing for GSD and MBSD and the Back-up Stress Testing Calculation, as described above, in a new Section 7.1 of the ST Framework.

## 2. Identify the Stress Testing Team as Responsible for Stress Testing

As described above, stress testing for the Clearing Agencies is primarily performed by the Stress Testing Team, which includes members of both Market Risk Management and Liquidity Risk Management of DTCC within GCRO. The Stress Testing Team took over stress testing responsibilities related to liquidity risk management in late 2019 to centralize stress testing and related responsibilities under one team.

Therefore, the Clearing Agencies are proposing to include a general statement in Section 1 (Executive Summary) of the ST Framework that, unless otherwise specified, actions in the ST Framework related to stress testing are performed by the Stress Testing Team. The proposed changes would also amend Section 3 (Framework Ownership and Change Management) of the ST Framework to make it clear that the Stress Testing Team

owns and manages the ST Framework and is responsible for reviewing the ST Framework no less frequently than annually.

In connection with this proposed change, the ST Framework would also be updated to describe actions related to stress testing without specifically identifying the group responsible for those actions. These proposed changes would simplify the descriptions in the ST Framework, while clarifying the team responsible for conducting these actions in a general statement in the ST Framework.

### 3. Update and Clarify the ST Framework

Finally, the proposed changes would also make immaterial revisions to update and clarify the ST Framework. For example, the proposed changes would update the names of certain documents that support the ST Framework to refer to the Clearing Agencies, rather than DTCC, in the document titles. These documents were renamed to conform to internal document naming conventions. The proposed changes would also amend Section 2 (Glossary of Key Terms) of the ST Framework to clarify and simplify the use of certain key terms. For example, the proposed changes would move the definitions of “Members” and “Participants” from a footnote in Section 4 to Section 2, and would update the definition of “BRC,” which refers to the Risk Committee of the Boards of Directors of the Clearing Agency, to be more descriptive.

The proposed amendments would update Section 4 (Stress Testing Requirements) of the ST Framework to (1) more clearly state which requirements under Rules 17Ad-22(e)(4) and (7) are addressed in the ST Framework, (2) identify the separate documents that describe the requirements that are not addressed in the ST Framework, and

(3) identify the requirements that are not applicable to the Clearing Agencies and, therefore, not described in any document.

In addition, the proposed change would also revise the description of reverse stress testing to more clearly describe the goal and purpose of this testing.<sup>20</sup> Specifically, reverse stress testing is used to identify tail risks by using extreme stress scenarios. In this way, reverse stress testing, which is conducted semi-annually, can be used to inform regular stress testing activities. The proposed changes would provide more transparency into the purpose of reverse stress testing conducted by the Clearing Agencies.

None of these proposed changes would make substantive revisions to the ST Framework or reflect material changes to how the Clearing Agencies conduct the activities described in the ST Framework but would update and clarify those descriptions.<sup>21</sup>

D. Proposed Amendments to Update and Clarify the LRM Framework

In addition to removing descriptions of stress testing activities from the LRM Framework, as described in section I.A above, the proposed changes would also make immaterial revisions to update and clarify the LRM Framework. For example, the proposed changes would update the name of the team within the GCRO that is responsible for liquidity risk management from the Liquidity Product Risk Unit, or

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<sup>20</sup> Tail risk generally refers to risks of outcomes that are caused by extreme or rare events.

<sup>21</sup> DTC Notice, supra note 3, 87 FR at 36195; FICC Notice, supra note 3, 87 FR at 36186; NSCC Notice, supra note 3, 87 FR at 36161.

LPRU, to Liquidity Risk Management. This proposed change would reflect a recent organizational change to the name of this group.<sup>22</sup>

Additionally, the proposed changes would update Section 10 (Liquidity Risk Tolerances) of the LRM Framework to state that an officer in Liquidity Risk Management is responsible for reviewing the Liquidity Risk Tolerance Statement.<sup>23</sup> The LRM Framework currently identifies the specific title of the individual who is responsible for reviewing the Liquidity Risk Tolerance Statement on at least an annual basis. The proposed change would provide the Clearing Agencies with flexibility to change the title of the person responsible for this review.<sup>24</sup>

E. Proposed Amendments to MBSD Rules to Remove Stress Testing Descriptions

Finally, the proposed rule change would remove descriptions of stress testing from the MBSD Rules, which would be duplicative of statements added to the ST Framework, described above. The Clearing Agencies do not believe that it is necessary to describe its stress testing program in multiple places in its rules, and that duplicative disclosures create a risk of inconsistencies. The ST Framework was designed to, among other things, describe the manner in which the Clearing Agencies test the sufficiency of

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<sup>22</sup> DTC Notice, supra note 3, 87 FR at 36195; FICC Notice, supra note 3, 87 FR at 36186; NSCC Notice, supra note 3, 87 FR at 36161.

<sup>23</sup> The Liquidity Risk Tolerance Statement is liquidity risk management control that, among other things, (1) defines liquidity risk and describes how liquidity risk would materialize for each Clearing Agency specifically, (2) sets forth how liquidity risk is monitored by the Clearing Agencies, and (3) describes the various risk tolerance levels and thresholds for each Clearing Agency.

<sup>24</sup> DTC Notice, supra note 3, 87 FR at 36195; FICC Notice, supra note 3, 87 FR at 36186; NSCC Notice, supra note 3, 87 FR at 36161-62.

their respective prefunded financial resources through stress testing and, therefore, the Clearing Agencies believe this is the appropriate rule for these disclosures.<sup>25</sup>

As such, the proposed change would remove the duplicative descriptions of the MBSD stress testing program from the MBSD Rules by deleting the definition of “Back-up Stress Testing Calculation” from MBSD Rule 1 and Section 13 of MBSD Rule 4. As described in section II.C.1 above, the matters being removed from the MBSD Rules in this proposal would be addressed in the ST Framework.

## **II. DISCUSSION AND COMMISSION FINDINGS**

Section 19(b)(2)(C) of the Act<sup>26</sup> 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 considering the Proposed Rule Change, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to FICC. In particular, the Commission finds that the Proposed Rule Change is consistent with Sections 17A(b)(3)(F)<sup>27</sup> of the Act and Rule 17Ad-22(e)(4) thereunder.<sup>28</sup>

### **A. Consistency with Section 17A(b)(3)(F) of the Act**

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<sup>25</sup> FICC Notice, supra note 3, 87 FR at 36186-87.

<sup>26</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>27</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>28</sup> 17 CFR 240.17Ad-22(e)(4).

Section 17A(b)(3)(F) of the Act<sup>29</sup> requires the rules of a clearing agency to, among other things, (i) promote the prompt and accurate clearance and settlement of securities transactions, (ii) assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and (iii) protect investors and the public interest.

As described above in sections I.B, I.C.2, I.C.3, I.D, and I.E, the proposed changes would (1) amend both the ST Framework and the LRM Framework to move the descriptions of liquidity stress testing from the LRM Framework to the ST Framework, as well as to simplify the categorization of the liquidity stress scenarios; (2) amend the ST Framework to reflect that the Stress Testing Team is primarily responsible for stress testing activities; (3) update and clarify descriptions within the ST Framework; (4) update and clarify descriptions within the LRM Framework; and (5) remove certain duplicative sections from the MBSD Rules, as described above. These proposed changes should assist the Clearing Agencies in carrying out their stress testing and liquidity risk management functions and improve the clarity of the Frameworks in describing the Clearing Agencies' processes and responsibilities. With respect to the ST Framework, as described in sections I.B, I.C.2, and I.C.3, these changes should help maintain the Clearing Agencies' ability to determine and evaluate the credit risk presented by Clearing Agencies' members by testing (i) the sufficiency of their credit resources in a variety of extreme but plausible scenarios, and (ii) the potential losses to the Clearing Agencies from a participant default. The continued ability to evaluate credit risk could, in turn,

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<sup>29</sup> 15 U.S.C. 78q-1(b)(3)(F).

enable the Clearing Agencies to deploy their risk-management tools more effectively to manage the credit and market presented by such members. Through such preparation, the Framework could decrease the possibility of a member default. By enabling the Clearing Agencies to use their risk-management tools to monitor its credit and market more effectively, the proposed amendments to the ST Framework are designed to help mitigate the risk that the Clearing Agencies and their non-defaulting members would suffer a loss from a member default.

Similarly, with respect to the LRM Framework, as described in sections I.D, these changes should help continue the Clearing Agencies' ability to carry out its liquidity risk management strategy such that, with respect to FICC and NSCC, they maintain liquid resources sufficient to meet the potential amount of funding required to settle outstanding transactions of a defaulting participant or family of affiliated participants in a timely manner, and with respect to DTC, it maintains sufficient available liquid resources to complete system-wide settlement on each business day, with a high degree of confidence and notwithstanding the failure to settle of the participant or affiliated family of participants with the largest settlement obligation. As such, the Clearing Agencies' liquidity risk management strategies address the Clearing Agencies' maintenance of sufficient liquid resources, which allow them to continue the prompt and accurate clearance and settlement of securities and can continue to assure the safeguarding of securities and funds which are in their custody or control or for which they are responsible notwithstanding the default of a participant or family of affiliated participants.

In addition, moving the description of the Clearing Agencies' liquidity stress testing activities into the ST Framework, the proposed change should create a description of the Clearing Agencies' collective stress testing activities in one place. Moreover, based on its review of the Proposed Rule Changes and its supervisory knowledge, the Commission understands that the Clearing Agencies are not amending their stress testing program in a substantive manner, but instead are reorganizing the stress testing scenarios and Frameworks to avoid duplication and confusion.

Therefore, the Commission finds that the proposed rule changes are designed to help promote prompt and accurate clearance and settlement, and assure the safeguarding of securities and funds which are in the custody or control of the Clearing Agencies or for which they are responsible, consistent with Section 17A(b)(3)(F) of the Act.<sup>30</sup>

Second, as described in Section I.C.1, FICC proposes to use vendor-supplied data in GSD's stress testing program. The Commission believes that vendor-supplied data should allow FICC to identify and analyze risk exposures under a broad and varied range of stressed market conditions, which should, in turn, help FICC identify the amount of financial resources necessary to cover its credit exposure under stress scenarios in extreme but plausible market conditions. The Commission further believes that the use of vendor-supplied data should enable FICC to perform a robust assessment of the stress profits and losses calculation, identify and address potential risks with respect to specific Clearing Members and their affiliates, and in turn, should help FICC ensure that it is collecting adequate prefunded financial resources to cover its potential losses resulting

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<sup>30</sup> 15 U.S.C. 78q-1(b)(3)(F).

from the default of clearing members and their affiliates under extreme but plausible market conditions.

Moreover, as also described in Section I.C.1., FICC proposes to use a back-up calculation for the GSD stress testing program in the event the vendor fails to provide FICC with the vendor-sourced data. The Commission believes that the back-up calculation is designed to provide FICC with a reasonable alternative method for calculating stress profit-and-loss in the event of an interruption in the vendor-sourced data feed. By providing FICC with a reasonable alternative method for conducting stress testing, the Commission believes that the proposed back-up calculation is designed to help FICC avoid gaps in assessing the sufficiency of its prefunded financial resources due to the inability to access the vendor-sourced data.

Taken together, the Commission believes that these aspects of the proposed rule change, as described in section I.C.1, should better enable FICC to evaluate and manage the credit risk presented by its Clearing Members. The Commission believes that the proposed rule change is designed to improve FICC's ability to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient prefunded financial resources that, at a minimum, enable FICC to cover the default of the Clearing Member (including relevant affiliates) that would potentially cause the largest aggregate credit exposure for FICC in extreme but plausible conditions, as required under Rule 17Ad-22(e)(4)(iii).<sup>31</sup> Accordingly, the Commission believes that the proposed rule change should help FICC to continue providing prompt and accurate

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<sup>31</sup> 17 CFR 240.17Ad-22(e)(4).

clearance and settlement of securities transactions even in extreme but plausible historical and hypothetical stress scenarios, consistent with Section 17A(b)(3)(F) of the Act.<sup>32</sup>

**B. Consistency with Rule 17Ad-22(e)(4)(iii) and (vi)**

Rule 17Ad-22(e)(4)(iii) requires, in part, each covered clearing agency to 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, by maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the participant family that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions.<sup>33</sup> Rule 17Ad-22(e)(4)(vi) requires, in part, each covered clearing agency to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, by testing the sufficiency of its total financial resources available by conducting stress testing of its total financial resources once each day using standard predetermined parameters and assumptions.<sup>34</sup>

As described above in Section I.C.1, FICC proposes to change its stress testing methodology to use vendor-supplied data in the GSD stress testing program and to incorporate a back-up calculation that it would utilize in the event of an interruption in the availability of that data. Taken together, these changes should allow FICC to identify

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<sup>32</sup> Id.

<sup>33</sup> 17 CFR 240.17Ad-22(e)(4)(iii).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(4)(vi).

and analyze risk exposures under a broader range of stressed market conditions covering a longer time period, which should, in turn, help FICC identify the amount of financial resources necessary to cover its credit exposure under stress scenarios in extreme but plausible market conditions.

Accordingly, the Commission believes that FICC's proposed amendments to the ST Framework with respect to the GSD stress testing program set forth in section I.C.1 are consistent with Rule 17Ad-22(e)(4)(iii) because it should better enable FICC to assess its ability to maintain sufficient financial resources to cover a wide range of foreseeable stress scenarios that include the default of the member (including relevant affiliates) that would potentially cause FICC's largest aggregate credit exposure in extreme but plausible conditions.<sup>35</sup> Additionally, the Commission believes FICC's proposed amendments to the ST Framework set forth in section I.C.1 are consistent with Rule 17Ad-22(e)(4)(vi) because it should enable FICC to test the sufficiency of its minimum financial resources by conducting stress testing using standard predetermined parameters and assumptions.<sup>36</sup>

## **V. 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<sup>37</sup> and the rules and regulations promulgated thereunder.

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<sup>35</sup> See 17 CFR 240.17Ad-22(e)(4)(iii).

<sup>36</sup> See 17 CFR 240.17Ad-22(e)(4)(vi).

<sup>37</sup> 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>38</sup> that proposed rule changes SR-DTC-2022-006, SR-FICC-2022-004, and SR-NSCC-2022-006, be, and hereby are, APPROVED.<sup>39</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>40</sup>

Sherry R. Haywood,  
Assistant Secretary.

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<sup>38</sup> 15 U.S.C. 78s(b)(2).

<sup>39</sup> In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>40</sup> 17 CFR 200.30-3(a)(12).