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Page 1 of \* 396

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

File No. \* SR 2022 - \* 801

Amendment No. (req. for Amendments \*)

Filing by National Securities Clearing Corporation

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
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Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	Rule <input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6)		
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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 \*).

Establish the Securities Financing Transaction Clearing Service and Make Other Changes

**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 \* [Redacted] Last Name \* [Redacted]

Title \* [Redacted]

E-mail \* RuleFilingAdmin@dtcc.com

Telephone \* [Redacted] Fax [Redacted]

**Signature**

Pursuant to the requirements of the Securities Exchange of 1934, National Securities Clearing Corporation has duty caused this filing to be signed on its behalf by the undersigned thereunto duty authorized.

Date 03/28/22

(Title \*)

By [Redacted]

[Redacted]

(Name \*)

NOTE: Clicking the signature block at right will initiate digitally signing the form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Date: 2022.03.28  
12:36:19 -04'00'

Required fields are shown with yellow backgrounds and astericks.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

**Form 19b-4 Information \***

Add Remove View

AN Narrative - NSCC SFT - 2022-032

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advanced Notice by Clearing Agencies \***

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AN Exh 1A - NSCC SFT - 2022-0324

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2- Notices, Written Comments, Transcripts, Other Communications**

Add Remove View

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit Sent As Paper Document

**Exhibit 3 - Form, Report, or Questionnaire**

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AN Exhibit 3a NSCC-2021-803 083020  
AN Exhibit 3b NSCC-2021-803 022820

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit Sent As Paper Document

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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AN Exh 5 - NSCC SFT - 2022-0324 Fi

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

## **1. Text of Advance Notice**

(a) This advance notice of National Securities Clearing Corporation (“NSCC”) is attached hereto as Exhibit 5 and consists of proposed modifications to the NSCC Rules & Procedures (“Rules”)<sup>1</sup> that would (i) establish new membership categories and requirements for sponsoring members and sponsored members whereby existing Members would be permitted to sponsor certain institutional firms into membership, (ii) establish a new membership category and requirements for agent clearing members whereby existing Members would be permitted to submit, on behalf of their customers, transactions to NSCC for novation, (iii) establish the securities financing transaction clearing service (“Securities Financing Transaction Clearing Service” or “SFT Clearing Service”) to make central clearing available at NSCC for equity securities financing transactions, which are, broadly speaking, transactions where the parties exchange equity securities against cash and simultaneously agree to exchange the same securities and cash, plus or minus a rate payment, on a future date (collectively, “Securities Financing Transactions” or “SFTs”), and (iv) make other amendments and clarifications to the Rules, as described in greater detail below.

(b) Not applicable.

(c) Not applicable.

## **2. Procedures of the Self-Regulatory Organization**

The filing of this advance notice with the Securities and Exchange Commission (the “Commission”) was approved by the Risk Committee and the Businesses, Technology and Operations Committee of NSCC’s Board of Directors on October 16, 2018 and December 18, 2018, respectively. On December 14, 2021 and February 22, 2022, both Committees approved amendments to the advance notice.

## **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 Advance Notice Received from Members, Participants, or Others**

NSCC reviewed the proposal with various Members and market participants (e.g., agent lenders, brokers, matching service providers, and books and records service providers) in order to benefit from their expertise and industry knowledge. Written comments relating to this

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<sup>1</sup> Capitalized terms not defined herein are defined in the Rules, [available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf).

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(b) Not applicable.

(c) Not applicable.

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Not applicable.

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

Not applicable.

## **5. Self-Regulatory Organization’s Statement on Comments on the Advance Notice Received from Members, Participants, or Others**

NSCC reviewed the proposal with various Members and market participants (e.g., agent lenders, brokers, matching service providers, and books and records service providers) in order to benefit from their expertise and industry knowledge. Written comments relating to this proposal have not been received from Members or any other person. If any written comments

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<sup>1</sup> Capitalized terms not defined herein are defined in the Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf).

are received, they will be publicly filed as an Exhibit 2 to this filing, as required by Form 19b-4 and the General Instructions thereto.

Persons submitting comments are cautioned that, according to Section IV (Solicitation of Comments) of the Exhibit 1A in the General Instructions to Form 19b-4, the Commission does not edit personal identifying information from comment submissions. Commenters should submit only information that they wish to make available publicly, including their name, email address, and any other identifying information.

All prospective commenters should follow the Commission's instructions on how to submit comments, available at <https://www.sec.gov/regulatory-actions/how-to-submit-comments>. General questions regarding the rule filing process or logistical questions regarding this filing should be directed to the Main Office of the Commission's Division of Trading and Markets at [tradingandmarkets@sec.gov](mailto:tradingandmarkets@sec.gov) or 202-551-5777.

NSCC reserves the right not to respond to any comments received.

**6. Extension of Time Period for Commission Action**

Not applicable.

**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 Exchange Act**

Not applicable.

**10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing, and Settlement Supervision Act of 2010**

*Nature of the Proposed Change*

The purpose of this proposed rule change is to (i) establish new membership categories and requirements for sponsoring members and sponsored members whereby existing Members would be permitted to sponsor certain institutional firms into membership, (ii) establish a new

membership category and requirements for agent clearing members whereby existing Members would be permitted to submit, on behalf of their customers, transactions to NSCC for novation, (iii) establish the SFT Clearing Service to make central clearing available at NSCC for SFTs, and (iv) make other amendments and clarifications to the Rules, as described in greater detail below.

**(i) Background**

NSCC is proposing to introduce central clearing for SFTs, which are, broadly speaking, securities lending transactions where parties exchange equity securities against cash and simultaneously agree to exchange the same securities and cash, plus or minus a rate payment, on a future date. In particular, the proposed SFT Clearing Service would expand central clearing at NSCC to include SFTs with a one Business Day term (i.e., overnight SFTs) in eligible equity securities that are entered into by Members, institutional firms that are sponsored into NSCC by a Sponsoring Member (as defined below and in the proposed rule change), or Agent Clearing Members (as defined below and in the proposed rule change) on behalf of Customers (as defined below and in the proposed rule change), as applicable.

SFTs involve the owner of securities (typically a registered investment company, pension plan, sovereign wealth fund or other institutional firm) transferring those securities temporarily to a borrower (typically a hedge fund). SFTs are often facilitated and intermediated by broker-dealers and agent lenders (i.e., custodial banks or other institutions that lend out securities as agent on behalf of institutional firms). In return for the lent securities, the borrower transfers collateral, and a net rate payment is typically transferred to either the lender or the borrower that reflects the liquidity of the lent securities, as well as interest on any cash collateral.<sup>2</sup> NSCC understands that SFTs provide liquidity to markets and facilitates the ability of market participants to make delivery on short-sales, and thereby avoid failures to deliver, “naked” shorts, and similar situations. On a typical Business Day, The Depository Trust Company (“DTC”), an NSCC affiliate, processes deliver orders related to securities lending transactions on securities having a value of approximately \$150 billion.

*Capital Efficiency Opportunities*

The Basel III<sup>3</sup> capital and leverage requirements, as implemented by the U.S. banking regulators, constrain the ability of agent lenders and brokers to intermediate and facilitate SFTs.<sup>4</sup>

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<sup>2</sup> This rate payment is typically calculated in a manner similar to interest on the principal balance of a loan and accrues on a daily basis. As a result, the rate payment is typically calculated as the product of a specified balance (typically the amount of cash collateral unless the collateral consists of securities) and a specified rate (reflecting both the liquidity of the securities and the ability of the lender to re-use the cash collateral), divided by 360 or a similar day count fraction.

<sup>3</sup> Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007 – 2009.

<sup>4</sup> See, e.g., 12 C.F.R. Part 3 (Office of the Comptroller of the Currency – Capital Adequacy Standards); 12 C.F.R. Part 217 (Federal Reserve – Capital Adequacy of Bank Holding

NSCC believes central clearing of SFTs would be able to address these constraints, which may otherwise impair market participants' ability to engage in SFTs.

For example, NSCC believes it is uniquely positioned to create balance sheet netting opportunities for market participants (i.e., the ability to offset cash payables and receivables versus NSCC) by becoming the legal counterparty to both pre-novation counterparties to an SFT through novation. Specifically, market participants that borrow securities through NSCC and then onward lend those securities, or other securities, to another NSCC Member through the proposed SFT Clearing Service may have the ability to net down the cash collateral return obligations and entitlements related to such SFTs. By contrast, for bilateral SFTs, market participants may be required to record those payables and receivables on their balance sheets on a gross (rather than netted) basis. A netted balance sheet can create significant capital benefits for market participants because it can reduce the amount of regulatory capital they must hold against SFTs under the U.S. "supplementary leverage ratio" and other capital requirements that favor a netted balance sheet.<sup>5</sup>

In addition, under Basel III, bank holding companies that have broker-dealer subsidiary borrowers are required to reserve capital against their exposures to institutional firm lenders of securities in relation to the cash collateral posted by such borrowers. Those capital requirements can vary depending on the credit profile of the institutional firm lender, and generally are well in excess of those applied to exposures to qualifying central counterparties, such as NSCC.<sup>6</sup> The counterparty risk weight of a qualifying central counterparty, like NSCC, is 2%,<sup>7</sup> which may result in considerable capital savings to these bank holding companies, to the extent they participate in central clearing.

Moreover, agent lending banks and bank holding company parents of broker-dealer borrowers that participate in central clearing could receive beneficial treatment under the single counterparty credit limits, which exempt exposures to qualifying central counterparties.<sup>8</sup>

In light of the potential for central clearing to alleviate the aforementioned capital constraints otherwise applicable to bilateral SFTs, NSCC believes that central clearing of SFTs may increase the capacity of market participants to engage in SFTs.<sup>9</sup>

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Companies, Savings and Loan Holding Companies, and State Member Banks); 12 C.F.R. Part 252, Subpart Q (Single Counterparty Credit Limits); 12 C.F.R. Part 324 (Federal Deposit Insurance Corporation – Capital Adequacy of FDIC-Supervised Institutions).

<sup>5</sup> See 12 C.F.R. § 217.10(c)(4)(ii)(E)-(F).

<sup>6</sup> See 12 C.F.R. §§ 217.32 and 217.37 generally.

<sup>7</sup> See 12 C.F.R. § 217.35(c)(3).

<sup>8</sup> See 12 C.F.R. § 252.77(a)(3).

<sup>9</sup> Members should discuss this matter with their accounting and regulatory capital experts.

*Fire Sale Risk Mitigation*

In addition to creating capital efficiency opportunities for market participants, NSCC believes that broadening the scope of central clearing at NSCC to SFTs would also reduce the potential for market disruption from fire sales.

In the case of securities lending transactions, the primary risk of fire sales<sup>10</sup> relates to the reinvestment of cash collateral by institutional firms that are the lenders in securities lending transactions. Those institutional firms will typically reinvest the cash collateral they receive from the borrower into other securities. If the borrower of the securities thereafter defaults, the institutional firm lenders generally need to quickly liquidate the securities representing the reinvestment in order to raise cash to purchase the originally lent security. A substantial number of disconnected and competing liquidations by multiple lenders can create fire sale conditions for the securities being liquidated, which can harm not only the institutional firm lenders by potentially lowering the amount of cash they can raise in the sale of such securities, but also create market losses for all holders of such securities.<sup>11</sup>

Moreover, if an institutional firm lender should default and fail to return the cash collateral back to its borrowers, the borrowers would typically be looking to liquidate the borrowed securities in order to make themselves whole for the cash collateral they delivered to the institutional firm lender. Competing and disconnected sales of such securities could similarly create fire sale conditions and not only harm the borrowers to the extent the value of the securities decline, but also create market losses for all holders of the borrowed securities.

NSCC believes that broadening the scope of central clearing at NSCC to SFTs would reduce the potential for market disruption from fire sales for a number of reasons. First, in the event of a default, NSCC would conduct a centralized, orderly liquidation of the defaulter's SFT Positions (as defined below and in the proposed rule change). Such an organized liquidation should result in substantially less price depreciation and market disruption than multiple independent non-defaulting parties racing against one another to liquidate the positions. Second, NSCC would only need to liquidate the defaulter's net positions. By contrast, in the context of a default by a broker-dealer intermediary that runs a matched book in the bilateral securities market, both the ultimate lender and the ultimate borrower need to liquidate the defaulter's gross positions. Limiting the positions that need to be liquidated to the defaulter's net positions should

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<sup>10</sup> Fire sale risk is the risk of rapid sales of assets in large amounts that temporarily depress market prices of such assets and create financial instability.

<sup>11</sup> See Financial Stability Board, *Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*, at 5 (August 29, 2013) available at [https://www.fsb.org/wp-content/uploads/r\\_130829b.pdf?page\\_moved=1](https://www.fsb.org/wp-content/uploads/r_130829b.pdf?page_moved=1). See also United States Securities and Exchange Commission: *Securities Lending and Short Sale Roundtable Transcript* (September 29, 2009), Former Chairman Schapiro's Remarks, at 2-3, available at <https://www.sec.gov/news/openmeetings/2009/roundtable-transcript-092909.pdf>.



reduce the volume of required sales activity, which in turn should limit the price and market impact of the close-out of the defaulter's positions. Lastly, NSCC would use its risk management resources to provide confidence to market participants that they will receive back their cash or securities, as applicable, which should limit the propensity for market participants to seek to unwind their transactions in a stressed market scenario.

#### *Liquidity Drain Risk Mitigation*

Liquidity risk may also arise if, in the context of a stressed market scenario, borrowers or lenders concerned about their counterparties' creditworthiness seek to unwind their securities lending transactions and obtain the return of their cash collateral or securities. This occurred to a certain extent in 2008, when borrowers began demanding to return borrowed securities in exchange for the cash collateral the borrowers had posted to institutional firm lenders.<sup>12</sup> These "runs" may require institutional firm lenders to quickly sell off securities that are the subject of their cash reinvestments to raise cash to return to the borrowers, thereby also creating potential fire sale conditions with respect to the reinvestment securities, as described above. Similarly, borrowers may need to purchase or re-borrow securities in stressed market conditions, leading to potentially significant losses.

NSCC believes that having SFTs be centrally cleared by NSCC would lower the risk of a liquidity drain in a stress scenario. Specifically, NSCC believes that having it clear SFT activity would provide confidence to borrowers and lenders that they will receive back their cash or securities and thereby lessen parties' inclination to rush to unwind their transactions in a stressed market scenario.

#### *Addition of New Membership Categories for Institutional Firm SFT Activity*

When evaluating the opportunity to expand its cleared offerings to SFTs, NSCC engaged in extensive discussions with numerous market participants, including agent lenders, brokers, institutional firms, and critical third parties, such as matching service providers and books and records service providers. NSCC also organized several industry working groups to discuss the possibility of clearing SFTs. Each constituency has a unique perspective on the proposed SFT Clearing Service. By capturing their differing viewpoints in the design, NSCC has sought to ensure that the proposed SFT Clearing Service would reflect their needs and facilitate industry adoption of the proposed SFT Clearing Service.

There was a considerable amount of discussion between NSCC and market participants regarding the appropriate model(s) through which institutional firms should access central clearing. Some market participants expressed interest in allowing Members to sponsor institutional firms into NSCC membership in a manner similar to that provided for under the sponsoring member/sponsored member program at the Government Securities Division ("GSD") of Fixed Income Clearing Corporation ("FICC"), an NSCC affiliate ("FICC's Sponsoring

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<sup>12</sup> See, e.g., *id.*

Member/Sponsored Member Program”).<sup>13</sup> Under FICC’s Sponsoring Member/Sponsored Member Program, sponsoring members may submit to FICC transactions entered into on a principal-to-principal basis between the sponsoring member and the sponsored member.<sup>14</sup> On the other hand, certain other market participants, including in particular certain agent lending banks, requested that the central clearing service accommodate agent-style trading (i.e., where the agent lender enters into the transaction on behalf of the institutional firm, rather than as principal counterparty). As NSCC understands it, agent-style trading is the way such agent lenders are typically approved to transact in securities lending transactions on behalf of their institutional firm clients today.<sup>15</sup>

NSCC considered all of this input, as well as the recent experiences of FICC in expanding the suite of both transactions and participants eligible for FICC’s Sponsoring Member/Sponsored Member Program,<sup>16</sup> and ultimately decided to incorporate both the sponsoring/sponsored membership type (to facilitate principal style trading for institutional firms and their sponsoring members) as well as the Agent Clearing Member membership type (to facilitate agent-style trading by agent lenders on behalf of institutional firm clients) into the proposed SFT Clearing Service.<sup>17</sup> NSCC expects these proposed new membership types would

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<sup>13</sup> See Rule 3A (Sponsoring Members and Sponsored Members) of the FICC GSD Rulebook (“GSD Rules”), [available at](http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf) [http://dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_gov\\_rules.pdf](http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf).

<sup>14</sup> FICC’s Sponsoring Member/Sponsored Member Program also allows sponsoring members to submit to FICC transactions entered into between a sponsored member and a third-party netting member. However, based on feedback from market participants, NSCC has decided to address this type of trading via the proposed agent clearing model for SFT.

<sup>15</sup> In addition, certain other agent lenders who are not themselves banks or broker-dealers (and so are not eligible to become Members of NSCC) preferred a model where the institutional firm client becomes the direct member of NSCC with no obligations running between the agent lender and the clearing agency.

<sup>16</sup> See Securities Exchange Act Release Nos. 80563 (May 1, 2017), 82 FR 21284 (May 5, 2017) (SR-FICC-2017-003) (Expand the types of entities that are eligible to participate in FICC as Sponsored Members), 85470 (March 29, 2019), 84 FR 13328 (April 4, 2019) (SR-FICC-2018-013) (Expand Sponsoring Member Eligibility in the GSD Rulebook), and 88262 (February 21, 2020), 85 FR 11401 (February 27, 2020) (SR-FICC-2019-007) (Close-Out and Funds-Only Settlement Processes Associated with the Sponsoring Member/Sponsored Member Service).

<sup>17</sup> NSCC decided at this time not to incorporate a direct model for institutional firm clearing into the proposed SFT Clearing Service because in its experience with a similar model in FICC (the CCIT Service), the requirements that a clearing agency, such as NSCC, would be required to apply to an institutional firm that participated as a direct member (e.g., Clearing Fund and loss allocation) would, as a general matter, not likely be compatible with the regulatory requirements and investment guidelines applicable to many of the

help expand access to central clearing for institutional firms and facilitate industry adoption of the proposed SFT Clearing Service.

The proposed SFT Clearing Service would also allow for the submission of broker-to-broker activity as well as client-to-client activity (credit intermediated by Sponsoring Members and/or Agent Clearing Members) into the NSCC system.

## **(ii) Key Parameters of the Proposed SFT Clearing Service**

### *Overnight SFTs*

NSCC is proposing central clearing for SFTs with a one Business Day term (i.e., overnight SFTs) in eligible equity securities that are entered into by Members, institutional firms that are sponsored into NSCC by Sponsoring Members, or Agent Clearing Members on behalf of customers. NSCC has determined that overnight term SFTs with a daily pair off option are more appropriate for the proposed SFT Clearing Service than open transactions with mark-to-market collections. This is because, as NSCC understands it, open transactions are not eligible for balance sheet netting given they do not have a scheduled off-leg/settlement date. As described above, the proposed SFT Clearing Service is designed to offer both balance sheet netting and capital efficiency opportunities to market participants. NSCC therefore finds it appropriate to make overnight term SFTs with a scheduled date for Final Settlement (as defined below and in the proposed rule change) of the next Business Day, rather than open transactions, eligible for central clearing through the proposed SFT Clearing Service.

For example, assume that a Transferor (as defined below and in the proposed rule change) and Transferee (as defined below and in the proposed rule change) enter into an SFT pursuant to which: (i) in the Initial Settlement (as defined below and in the proposed rule change) on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. In the Final Settlement on Tuesday, the Transferee will return 100 shares of security X to the Transferor for \$100 per share. The Rate Payment (as defined below and in the proposed rule change) would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process.

### *SFT Counterparties*

The proposed SFT Clearing Service would only be available for SFTs entered into between (i) a Member and another Member, (ii) a Sponsoring Member and its Sponsored Member (as defined below and in the proposed rule change), and (iii) an Agent Clearing Member acting on behalf of a Customer and either (x) a Member or (y) the same or another Agent Clearing Member acting on behalf of a Customer. As used in the Rules, "Member" includes full-

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regulated institutional firms that NSCC anticipates would be interested in participating in the proposed SFT Clearing Service.

service NSCC clearing members, but not Sponsored Members.<sup>18</sup> In addition, as proposed, the only SFTs entered into by Sponsored Members that would be eligible for novation to NSCC would be SFTs between the Sponsored Member and its Sponsoring Member.<sup>19</sup>

#### *Approved SFT Submitters*

Consistent with the manner in which NSCC accepts cash market transactions, SFTs would be required to be submitted to NSCC on a locked-in/matched basis by an Approved SFT Submitter (as defined below and in the proposed rule change) in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Approved SFT Submitters would be selected by the SFT Members (as defined below and in the proposed rule change), subject to NSCC's approval. An Approved SFT Submitter could either be a Member or a third-party vendor. SFTs submitted to NSCC by an Approved SFT Submitter would be valid and binding obligations of each SFT Member designated by the Approved SFT Submitter as a party thereto.

#### *Eligible Equity Securities and Per Share Price Minimum*

NSCC will maintain eligibility criteria for the securities that may underlie an SFT that NSCC will accept for novation. Consistent with NSCC's general approach to eligibility for securities, the eligibility criteria would not be a rule, but a separate document maintained by NSCC and available to Members. It is currently contemplated that eligible securities for SFTs in the proposed SFT Clearing Service will be limited to CNS-eligible securities.

In light of the fact that central clearing of SFTs would be a new service for NSCC, and market participants would be able to elect which of their eligible SFTs to novate to NSCC (i.e., central clearing of SFTs would not be mandatory for Members), NSCC is not able to anticipate at this time the size and composition of the SFT portfolios that would be novated to NSCC. Due to this lack of history, NSCC would, as an initial matter, provide proposed SFT Clearing Service for only those SFTs where the underlying securities are CNS-eligible equity securities that have a per share price of \$5 or more. NSCC selected \$5 as the per share price minimum for underlying equity securities that could be the subject of a novated SFT because \$5 is a common share price minimum adopted in brokerage margin eligibility schedules.

This proposed share price limitation would be implemented systemically by NSCC as one of the eligibility criteria for determining whether an equity security is eligible to be the subject of a novated SFT (rather than as a rule), and such per share price limitation could be modified by

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<sup>18</sup> As defined in Rule 1 (Definitions and Descriptions), the term "Member" means any Person specified in Section 2.(i) of Rule 2 who has qualified pursuant to the provisions of Rule 2A. As such, the term "Member" does not include a Sponsored Member. Supra note 1.

<sup>19</sup> See Section 5 of proposed Rule 56, which provides that a Sponsoring Member shall be permitted to submit to NSCC SFTs between itself and its Sponsored Members.

NSCC<sup>20</sup> at a later date after NSCC gains more experience with the nature of the SFT portfolios submitted for clearing. In addition, if the share price of underlying securities of an SFT that has already been novated to NSCC falls below \$5, such SFT would continue to be novated to NSCC, but the Required SFT Deposit (as defined below and in the proposed rule change) for the affected Members would include an amount equal to 100% of the market value of such underlying securities until such time as the per share price of the underlying securities equals or exceeds \$5.

### *Cash Collateral*

Consistent with the cash market transactions NSCC clears today where cash is used to satisfy Members' purchase obligations in eligible securities, cash would likewise be the only eligible form of collateral for novated SFTs under the proposed SFT Clearing Service.<sup>21</sup> More specifically, NSCC would limit the SFTs that it is willing to novate to SFTs that have SFT Cash (as defined below and in the proposed rule change) equal to or greater than 100% market value of the lent securities, and would not novate any obligations to return collateral consisting of securities.<sup>22</sup>

NSCC would novate the Final Settlement obligations of an SFT as of the time the Initial Settlement of such SFT is completed, unless the SFT is a Bilaterally Initiated SFT (as defined below and in the proposed rule change) or a Sponsored Member Transaction (as defined below and in the proposed rule change), in which case novation of the Final Settlement obligations would occur upon NSCC reporting to the Approved SFT Submitter that the SFT has been validated and novated to NSCC.

As described above, each SFT would be collateralized by cash equal to no less than 100% of the market value of the lent securities. In addition, in order to address regulatory and investment guideline requirements applicable to certain institutional firms,<sup>23</sup> a Member would be permitted (but not required) to transfer an additional cash haircut above 100% (e.g., 102%) to such institutional firms, i.e., Independent Amount SFT Cash (as defined below and in the proposed rule change), as part of the Initial Settlement of the SFT. The Sponsoring Member or

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<sup>20</sup> The per share price limitation could be modified by NSCC without any regulatory filings; however, any change in the per share price limitation would be announced by NSCC via an Important Notice posted to its website.

<sup>21</sup> This is referred to as "SFT Cash" in the proposed rule text.

<sup>22</sup> See Section 5(a) of proposed Rule 56 and the definition of "Securities Financing Transaction".

<sup>23</sup> As an example, a registered investment company that lends securities through an agent may be required under Section 17(f) of the Investment Company Act of 1940 and Rule 17f-2 thereunder to collect cash collateral equal to no less than 102% of the market value of the lent securities. See, e.g., The Adams Express Company, SEC No-Action Letter (Oct. 8, 1984). Other institutional firms may be subject to similar requirements under their established investment guidelines or applicable rules, regulations or guidance.

Agent Clearing Member, as applicable, that receives the Independent Amount SFT Cash in the Initial Settlement would also receive a commensurate Clearing Fund call, i.e., an Independent Amount SFT Cash Deposit Requirement (as defined below and in the proposed rule change), from NSCC to reflect the value received by such Member above the market price of the equity security lent. NSCC's novation of Final Settlement obligations related to Independent Amount SFT Cash would be tied to the time the Sponsoring Member or Agent Clearing Member, as applicable, satisfies the related Independent Amount SFT Cash Deposit Requirement in cash.

#### *RVP/DVP Settlement at DTC*

The Final Settlement obligations of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle receive-versus-payment/delivery-versus-payment ("RVP/DVP") at DTC.<sup>24</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. DTC would accept delivery instructions for an SFT from NSCC, as agent for DTC participants that are SFT Members.<sup>25</sup>

Pre-novation counterparties to an SFT that is due to settle may elect to pair off (i.e., offset) the Final Settlement obligations of such SFT against the Initial Settlement obligations of a new SFT between the same parties on the same securities. NSCC believes that such offsets would minimize the operational burden of settling overnight obligations. NSCC would calculate and process the difference in cash collateral between the paired off SFTs, i.e., Price Differential (as defined below and in the proposed rule change). Price Differential would also be processed in accordance with DTC rules and procedures, including provisions relating to risk controls. DTC would accept Price Differential payment orders for an SFT from NSCC, as agent for DTC participants that are SFT Members.

Settlement of the Rate Payment obligations and payment obligations arising from certain mandatory corporate actions and cash dividends would be processed as part of NSCC's end-of-day final money settlement process.

As an example of an SFT with a full pair off (i.e., offset), assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final

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<sup>24</sup> As described below, the Final Settlement and other obligations of each Sponsored Member Transaction would, at the direction of NSCC, settle on the books and records of the relevant Sponsoring Member.

<sup>25</sup> On March 28, 2022, DTC submitted a proposed rule change to provide DTC participants that are also NSCC Members with settlement services in connection with NSCC's proposed SFT Clearing Service. See SR-DTC-2022-002, which was filed with the Commission but has not yet been published in the Federal Register. A copy of this proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to pair off the parties' Final Settlement obligations on the Settling SFT (as defined below and in the proposed rule change) with a Linked SFT (as defined below and in the proposed rule change) pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 100 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 100 shares of security X to the Transferor against \$99 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in connection with the pair off. In addition, the Rate Payment for the Settling SFT would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process. In the Final Settlement on Wednesday, the Transferee will return 100 shares of security X to the Transferor for \$99 per share. The Rate Payment for the Linked SFT would be passed by NSCC as between the Transferor and Transferee on Wednesday as part of NSCC's end-of-day final money settlement process.

As an example of an SFT with a partial pair off (i.e., offset), assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to partially pair off the parties' Final Settlement obligations on the Settling SFT with a Linked SFT pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 25 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 25 shares of security X to the Transferor against \$99 per share. In the Final Settlement on Tuesday for the remaining Settling SFT, the Transferee will return 75 shares of security X to the Transferor for \$100 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in relation to the shares subject to pair off (i.e., 25 shares of security X). In addition, the Rate Payment for the Settling SFT (i.e., 100 shares of security X) would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process. In the Final Settlement on Wednesday for the Linked SFT, the Transferee will return 25 shares of security X to the Transferor for \$99 per share. The Rate Payment on the Linked SFT (i.e., 25 shares of security X) would be passed by NSCC as between the Transferor and Transferee on Wednesday as part of NSCC's end-of-day final money settlement process.

#### *Buy-In, Recall and Accelerated Settlement*

It is occasionally the case in the securities lending market that a borrower is solvent and able to satisfy its general obligations as they become due but unable to deliver the lent securities to the lender within the timeline requested by the lender. The contractual remedy that has developed in the bilateral securities lending market for these situations is a "buy-in." Under this remedy, the lender may purchase securities equivalent to the borrowed securities in the market

and charge the borrower for the cost of this purchase. This serves to benefit the lender because it allows the lender to recover the securities within its required timeline, and it benefits the borrower by avoiding a situation in which the borrower's failure to perform under a single transaction results in an event of default and close-out of all of its securities lending transactions (and potentially other positions through a cross-default). Similarly, in the bilateral space, securities borrowers may have the need to accelerate settlement of securities lending transactions if they lose a "permitted purpose" for such loans under Regulation T. The proposed SFT Clearing Service would seek to retain the buy-in and acceleration mechanisms, as they ensure the smooth functioning of securities markets without causing unnecessary and disorderly defaults or regulatory violations.<sup>26</sup>

Consistent with their rights under industry-standard documentation for bilateral SFTs, as proposed, Transferors would have the right to submit a Recall Notice (as defined below and in the proposed rule change) to NSCC in respect of a novated SFT for which Final Settlement obligations have not yet been satisfied. If the Transferee does not return the lent securities by the Recall Date (as defined below and in the proposed rule change) specified in such notice, and the Transferor would be eligible to Buy-In (as defined below and in the proposed rule change), in accordance with such timeframes and deadlines as established by NSCC for such purpose, such securities.

For example, assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to pair off (i.e., offset) the parties' Final Settlement obligations on the Settling SFT with a Linked SFT pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 100 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 100 shares of security X to the Transferor against \$99 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in connection with the pair off. In addition, the Rate Payment for the Settling SFT would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process.

Later in the day on Tuesday, the Transferor determines it now needs 100 shares of security X back in its inventory, and so the Approved SFT Submitter submits a Recall Notice to NSCC, prior to the deadline established by NSCC, on behalf of the Transferor for 100 shares of

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<sup>26</sup> NSCC does not believe retaining the buy-in and acceleration mechanisms would undermine novation because NSCC would remain the obligor and obligee in respect of the Final Settlement, Rate Payment, and Distribution Payment (as defined below and in the proposed rule change) entitlements and obligations. These mechanisms simply affect the timing and manner in which those obligations are discharged.



security X with a Recall Date of Thursday. At the end of day on Tuesday, the share price of security X is \$98 per share. Upon receipt of the Recall Notice, the SFT would be treated as a Non-Returned SFT (as defined below and in the proposed rule change) by NSCC pursuant to Section 9(e) of proposed Rule 56 (Securities Financing Transaction Clearing Service). Accordingly, pursuant to Section 9(a) of proposed Rule 56, the Final Settlement Date (as defined below and in the proposed rule change) of the SFT would be rescheduled to Thursday, and NSCC would, on Wednesday collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee on the Non-Returned SFT. The Rate Payment for the Non-Returned SFT would also be passed by NSCC as between the Transferor and Transferee on Wednesday as part of NSCC's end-of-day final money settlement process.

Assume further that the Transferee does not transfer the 100 shares of security X on Wednesday and that the end of day price of security X on Wednesday is \$97 per share. On Thursday, NSCC would again collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee on the Non-Returned SFT. The Rate Payment for the Non-Returned SFT would also be passed by NSCC as between the Transferor and Transferee on Thursday as part of NSCC's end-of-day final money settlement process. In addition, since the Recall Notice specified Thursday as the Recall Date, the Transferor would be entitled to purchase (or deem itself to have purchased) 100 shares of security X in accordance with the provisions of Section 9(b) of proposed Rule 56. Assuming that the Transferor paid a price of \$95 per share for security X and submitted a written notice to NSCC of its Buy-In Costs (as defined below and in the proposed rule change) on Thursday, the Transferor would owe NSCC a Buy-In Amount (as defined below and in the proposed rule change) of \$2 per share (\$100 per share of SFT Cash received by the Transferor at the Initial Settlement of the SFT, less the \$95 per share Buy-In Costs of the Transferor, minus \$3 per share Price Differential paid by the Transferor to NSCC), and such Buy-In Amount would be debited by NSCC from the Transferor and credited to the Transferee as part of NSCC's end-of-day final money settlement process on Friday.

Similarly, consistent with their rights under industry-standard documentation for bilateral SFTs, Transferees would have the right to accelerate the scheduled Final Settlement of a novated SFT through notice from the Approved SFT Submitter to NSCC of such accelerated settlement.

For example, assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to net the parties' Final Settlement obligations on the Settling SFT with a Linked SFT pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 100 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 100 shares of security X to the Transferor against \$99 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in connection with the pair off. Later in the day on Tuesday, the Transferee loses permitted purpose under Regulation T for the borrowing of 100

shares of security X. Therefore, pursuant to Section 11 of proposed Rule 56 (Securities Financing Transaction Clearing Service), the Approved SFT Submitter submits a notice to NSCC on behalf of the Transferee to accelerate the Final Settlement of the Linked SFT to Tuesday. The Transferee then on Tuesday returns 100 shares of security X to NSCC for \$99 per share, and NSCC returns 100 shares of security X to the Transferor for \$99 per share. The Rate Payment would be passed by NSCC for the Settling SFT as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process.

### *Risk Management of SFT Positions*

Under the proposal, NSCC is requiring a deposit to the Clearing Fund<sup>27</sup> for SFT Positions, i.e., Required SFT Deposit. From a market risk standpoint, SFT activity would, except as otherwise noted below, be risk managed by NSCC in a manner consistent with Members' CNS positions but would be margined independently of the Member's other positions,<sup>28</sup> and a Required SFT Deposit would be collected by NSCC for all SFT activity of an SFT Member, subject to a \$250,000 minimum deposit.<sup>29</sup> Specifically, NSCC is proposing to calculate an SFT Member's Required SFT Deposit by applying the sections of Procedure XV (Clearing Fund Formula and Other Matters) specified in Section 12 of proposed Rule 56 (i.e., Sections I.(A)(1)(a), (b), (c), (e), (f), (g) of Procedure XV as well as the additional Clearing Fund formula in Section I.(B)(5) (Intraday Mark-to-Market Charge) of Procedure XV as such sections apply to CNS Transactions, and the additional Clearing Fund formula in Sections I.(B)(1) (Additional Deposits for Members on the Watch List); (2) (Excess Capital Premium), (3) (Backtesting Charge), (4) (Bank Holiday Charge); Minimum Clearing Fund and Additional Deposit Requirements in Sections II.(A)1(a) – (b), II.(B), II.(C), and II.(D); as well as Section III (Collateral Value of Eligible Clearing Fund Securities) of Procedure XV, as such sections apply to Members). Furthermore, NSCC would require an additional Required SFT Deposit for Non-Returned SFTs that is intended to mirror the premium charged for CNS Fails Positions. NSCC would also apply the Independent Amount SFT Cash Deposit Requirement for SFTs that have Incremental Additional Independent Amount SFT Cash.

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<sup>27</sup> As currently defined in Rule 1 (Definitions and Descriptions), the term "Clearing Fund" means the fund created pursuant to Rule 4. Supra note 1.

<sup>28</sup> NSCC is not proposing at this time to portfolio margin a Member's SFT Positions with any CNS positions of the Member, except with respect to the MLA charge. NSCC may reconsider this position after it obtains a reasonable amount of experience observing the nature and volume of SFT activity submitted by Members to NSCC for novation through the proposed SFT Clearing Service.

<sup>29</sup> This \$250,000 minimum deposit is a requirement that is separate from a Member's minimum (non-SFT) Clearing Fund deposit requirement, although it is designed to be consistent with such requirement.

For the purpose of applying Section I.(A)(1)(a)(i) of Procedure XV (Value-at-Risk (VaR) charge), unlike the current calculation of the volatility of a Member's Net Unsettled Positions<sup>30</sup> in CNS Transactions, NSCC is proposing that the volatility of an SFT Member's SFT Positions shall be the sum of (a) the highest resultant value between Section I.(A)(1)(a)(i)I. (Core Parametric Estimation) and Section I.(A)(1)(a)(i)III. (Margin Floor) and (b) the resultant value of Section I.(A)(1)(a)(i)II. (Gap Risk Measure). This proposed change is designed to capture idiosyncratic risk associated with an SFT Member's portfolio by enabling NSCC to apply the Gap Risk Measure more frequently.

NSCC is also proposing that, for the purpose of applying Section I.(A)(1)(g) of Procedure XV (Margin Liquidity Adjustment (MLA) charge), SFT Positions shall be aggregated with Net Unsettled Positions in the same asset group or subgroup; provided, however, in the event such aggregation results in a reduction of the aggregate positions in the relevant asset group or subgroup, NSCC shall apply the greater of (a) the sum of MLA charges separately calculated for SFT Positions and Net Unsettled Positions in the asset group or subgroup and (b) the MLA charge calculated from aggregating the SFT Positions and the Net Unsettled Positions in the asset group or subgroup. This proposed change is designed to enable NSCC to better risk manage the SFT activity by assessing the MLA charge in a circumstance where the combined SFT Positions and Net Unsettled Positions in total trigger the applicable MLA charge thresholds, whereas, if calculated separately, the MLA charge would not be triggered.

In addition, NSCC is proposing that each SFT Member, other than an SFT Member that is a Sponsored Member, so long as such Member is an SFT Member, would provide Supplemental Liquidity Deposits to the Clearing Fund, as may be required pursuant to Rule 4A (Supplemental Liquidity Deposits).

Consistent with the manner in which clearing fund requirements are satisfied by members of FICC for their cleared securities financing transactions, NSCC would require that (i) a minimum of 40% of an SFT Member's Required SFT Deposit consist of a combination of cash and Eligible Clearing Fund Treasury Securities and (ii) the lesser of \$5,000,000 or 10% of an SFT Member's Required SFT Deposit (but not less than \$250,000) consist of cash.<sup>31, 32</sup> NSCC

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<sup>30</sup> "Net Unsettled Positions" means a Member's net of unsettled Regular Way, When-Issued and When-Distributed positions in CNS Securities that have not yet passed Settlement Date and net positions in CNS Securities that did not settle on Settlement Date. See Rule 1, supra note 1.

<sup>31</sup> This \$250,000 minimum cash deposit requirement is designed to be consistent with the minimum amount of cash that must be used to satisfy a Member's (non-SFT) Clearing Fund deposit requirement. NSCC believes a \$250,000 minimum cash deposit would serve to strengthen NSCC's liquidity resources. Cash may also be easier to access upon a Member's default, further reducing the risk of losses and using non-defaulting Member's securities or funds, or NSCC funds.

<sup>32</sup> These requirements are designed to be consistent with FICC GSD's clearing fund requirements of its members given that NSCC anticipates that there would be considerable overlap between the membership of FICC GSD that participate in FICC for

would also have the discretion to require an SFT Member to post its Required SFT Deposit in proportion of cash higher than would otherwise be required as described above. NSCC's determination to impose any such requirement would be made in view of market conditions and other financial and operational capabilities of the relevant SFT Member. For example, as proposed in Section 12 of Rule 56, if NSCC had specific concerns about a particular SFT Member's financial or operational capabilities, but NSCC had not yet come to the determination that ceasing to act for the SFT Member would be appropriate (but could potentially become appropriate within the near term), NSCC may request that a greater portion of the SFT Member's Required SFT Deposit to the Clearing Fund be in the form of cash in order to simplify any potential close-out liquidation required in the event of that SFT Member's default. Separately, pursuant to Section II.(A)1(a) of Procedure XV, if an SFT Member's deposit of Eligible Clearing Fund Agency Securities or Eligible Clearing Fund Mortgage-Backed Securities is in excess of 25% of the SFT Member's Required Fund Deposit, NSCC would subject the deposit to an additional haircut.

The Sponsoring Member Required Fund Deposits (as defined below and in the proposed rule change) and Agent Clearing Member Required Fund Deposits (as defined below and in the proposed rule change) would each be calculated on a gross basis, and no offsets for netting of positions as between different Sponsored Members or different Customers,<sup>33</sup> as applicable, would be permitted. This is to ensure that NSCC's volatility-based Clearing Fund deposit requirements represent the sum of each individual institutional firm's activity.

As proposed and as described above, the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>34</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from

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purposes of clearing their securities financing transaction activity (including in particular sponsored repo activity) and the Members that would elect to participate in the proposed SFT Clearing Service. Specifically, FICC GSD Rule 4, Section 3 requires (i) a minimum of 40 percent of a member's required fund deposit to be in the form of cash and/or eligible clearing fund treasury securities and (ii) the lesser of \$5,000,000 or 10 percent of the required fund deposit, with a minimum of \$100,000, be made and maintained in cash. See Rule 4 (Clearing Fund and Loss Allocation) of the FICC GSD Rulebook, supra note 13.

<sup>33</sup> See Section 7(c) of proposed Rule 2C and Section 6(c) of proposed 2D.

<sup>34</sup> Supra note 24.

and to the SFT Accounts (as defined below and in the proposed rule change) of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member (as defined below and in the proposed rule change), on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>35</sup> By continuing to process these Price Differential payments until Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact is generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT Deposit and any Supplemental Liquidity Deposits ("SLD") that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>36,37</sup> In addition, NSCC would anticipate being in regular

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<sup>35</sup> See proposed Rule 56, Section 14(b)(ix).

<sup>36</sup> See Securities Exchange Act Release Nos. 82377 (December 21, 2017), 82 FR 61617 (December 28, 2017) (File No. SR-NSCC-2017-005); 90649 (December 11, 2020), 85 FR 81961 (December 17, 2020) (File No. SR-NSCC-2020-021). This framework sets forth the manner in which NSCC measures, monitors and manages the liquidity risks that arise in or are borne by it, and the qualifying liquidity resources that NSCC maintains in order to cover those risks. Such resources include, for example, cash deposits to the Clearing Fund and SLD that may be collected, when applicable.

<sup>37</sup> For example, assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. Assume further that at midnight on Monday, NSCC ceases to act for the Transferor.

communication with the non-defaulting SFT Members as to the timing of the satisfaction of any Final Settlement obligations related to a defaulting SFT Member.

### **(iii) Sponsoring Members and Sponsored Members**

NSCC is proposing a sponsored membership program to allow Members to play the role of pre-novation counterparty and credit intermediary for their institutional firm clients in clearing.

NSCC has modeled a number of the aspects of the proposed sponsored member program, including the eligibility criteria and many of the risk management requirements, on FICC's Sponsoring Member/Sponsored Member Program. FICC's Sponsoring Member/Sponsored Member Program allows an FICC Netting Member to sponsor an entity that satisfies certain requirements and submit to FICC for novation certain securities transactions between the Netting Member and the sponsored entity. These securities transactions generally include the off-leg of repurchase transactions on U.S. government or agency securities or straight purchase and sales of such securities. Such transactions present similar risk management, legal, accounting, and operation considerations to SFTs, as both involve an obligation of a sponsored member and a

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On Tuesday, NSCC executes a sale of 100 shares of security X for \$99 per share. In accordance with the normal settlement cycle for purchases and sales of equity securities, this sale will settle on Thursday.

Pursuant to Section 14(b)(viii) of proposed Rule 56 (Securities Financing Transaction Clearing Service), NSCC would likewise settle the Final Settlement obligations of the defaulting Transferor's SFT with the non-defaulting Transferee on Thursday.

Assume further that the end-of-day price of security X on Tuesday is \$99 per share. On Wednesday, NSCC would pay \$1 per share in Price Differential to the non-defaulting Transferee pursuant to Section 14(b)(ix) of proposed Rule 56. Assume further that the end-of-day price of security X on Wednesday is \$98 per share.

On Thursday, NSCC would pay an additional \$1 per share in Price Differential to the non-defaulting Transferee pursuant to Section 14(b)(ix) of proposed Rule 56. The Transferee would then return 100 shares of security X to NSCC and receive \$98 per share (i.e., the current market price for security X) from NSCC. As such, the non-defaulting Transferee would be made whole by NSCC for the \$100 per share it transferred in the Initial Settlement of the Defaulted-Related SFT (as defined below and in the proposed rule change) since NSCC would have transferred to it \$98 per share in Final Settlement plus an additional \$2 per share in Price Differential.

NSCC would incur a net loss of \$1 per share in this example since it would have sold security X for \$99 per share and paid the non-defaulting Transferee a total of \$100 per share (i.e., \$98 per share in Final Settlement proceeds plus \$2 per share in Price Differential). NSCC would be entitled to deduct this amount from the defaulted Transferor's Clearing Fund deposits (including its SFT Deposit).

sponsoring member to exchange cash against securities. Since 2005, FICC has worked with its members to improve its Sponsoring Member/Sponsored Member Program to address these considerations. Based on feedback from Members and its own internal assessments, NSCC believes that leveraging the provisions of FICC's Sponsoring Member/Sponsored Member program and the learning over the past decade and a half would allow NSCC to provide a sponsored member program that has a solid risk management, accounting, legal and operational foundation.

### *Sponsoring Members*

Under the proposal, all Members would be eligible to apply to become Sponsoring Members in NSCC, subject to credit criteria that are designed to be substantially similar to those applicable to category 2 sponsoring members in FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) "Sponsoring Members and Sponsored Members."<sup>38</sup> A Member whose application to become a Sponsoring Member has been approved by the Board of Directors or NSCC, as applicable, pursuant to proposed Rule 2C ("Sponsoring

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<sup>38</sup> If a Member is a Registered Broker-Dealer, then such Member would only be eligible to apply to become a Sponsoring Member if it satisfies the credit criteria in proposed Rule 2C (Sponsoring Members and Sponsored Members) (i.e., if it has (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million). Such credit criteria are comparable to the credit criteria applicable to category 2 sponsoring members that are registered broker-dealers in FICC's Sponsoring Member/Sponsored Member Program. A Sponsoring Member applicant would be viewed and surveilled as the credit counterparty to NSCC in respect to its Sponsored Member Sub-Account(s) (as defined below and in the proposed rule change) in light of its responsibility to NSCC as the processing agent and unconditional guarantor of its Sponsored Members' performance to NSCC.

In addition, NSCC may require that a Person be a Member for a time period deemed necessary by NSCC before that Person may be considered to become a Sponsoring Member. This requirement may be imposed by NSCC on a new Member that has yet to demonstrate a track record of financial responsibility and operational capability.

Furthermore, as proposed, the application of a Member to be a Sponsoring Member at NSCC that is an Agent Clearing Member or an existing FICC sponsoring member would not be required to be approved by the NSCC Board of Directors. NSCC believes this approach to Board of Director's approval for Sponsoring Members is appropriate in light of the fact that the critical components of the FICC sponsoring member application as well as the NSCC Sponsoring Member and Agent Clearing Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar. Nonetheless, NSCC would apply the same rigorous counterparty credit review process to any Member applying to be a Sponsoring Member at NSCC, whether or not the Member is an existing FICC sponsoring member.

Member”) would be permitted to sponsor their institutional firm clients into membership as Sponsored Members. Such Sponsoring Members would then be able to facilitate their institutional firm clients’ cleared activity via two back-to-back principal SFTs, i.e., client-to-Sponsoring Member and Sponsoring Member-to-broker (or to another institutional firm client that the Sponsoring Member has sponsored into membership), and each of such transactions would be eligible for novation to NSCC.

Consistent with the requirements applicable to sponsoring members in FICC’s Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) “Sponsoring Members and Sponsored Members,” a Sponsoring Member would be responsible for (i) submitting data on its Sponsored Members’ SFTs to NSCC or appointing a third-party Approved SFT Submitter to do so, (ii) posting to NSCC all of the Clearing Fund associated with the SFT activity of its Sponsored Members, which would be calculated on a gross basis (i.e., SFT activity would not be netted across Sponsored Members for Clearing Fund purposes), (iii) providing an unconditional guaranty to NSCC for its Sponsored Members’ Final Settlement and other obligations to NSCC, and (iv) covering any default loss allocable to its Sponsored Members (in addition to its own default loss allocation as a Member).

Specifically, as proposed, a Sponsoring Member would be permitted to submit to NSCC for novation Sponsored Member Transactions, subject to an activity limit designed to be substantially similar to that applicable to category 2 sponsoring members in FICC’s Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) “Sponsoring Members and Sponsored Members.” Under the proposal, if the sum of the Volatility Charges (as defined below and in the proposed rule change) applicable to a Sponsoring Member’s Sponsored Member Sub-Accounts (as defined below and in the proposed rule change) and its other accounts at NSCC exceeds its Net Member Capital (as defined below and in the proposed rule change), the Sponsoring Member would not be permitted to submit activity into its Sponsored Member Sub-Accounts, unless otherwise determined by NSCC in order to promote orderly settlement. As defined in Section 5 of proposed Rule 2C, Sponsored Member Transactions are SFTs between a Sponsoring Member and its Sponsored Members.

The Sponsoring Member would establish one or more accounts at NSCC for its Sponsored Members’ positions arising from such Sponsored Member Transactions, i.e., Sponsored Member Sub-Accounts, which would be separate from the Sponsoring Member’s proprietary accounts. For operational and administrative purposes, NSCC would interact solely with the Sponsoring Member as agent of its Sponsored Members.

Sponsoring Members would be responsible for providing NSCC with a Sponsoring Member Guaranty (as defined below and in the proposed rule change) whereby the Sponsoring Member guarantees to NSCC the payment and performance by its Sponsored Members of their obligations under the Sponsored Member Transactions submitted by the Sponsoring Member for novation. Although Sponsored Members are principally liable to NSCC for their own settlement obligations under such transactions in accordance with the Rules, the Sponsoring Member Guaranty requires the Sponsoring Member to satisfy those settlement obligations on behalf of a Sponsored Member if the Sponsored Member defaults and fails perform its settlement obligations.



In addition, a Sponsoring Member would be responsible for posting to NSCC all of the Clearing Fund associated with the Sponsored Member Transactions (which would not be netted across Sponsored Members for Clearing Fund purposes) and covering any default loss allocable to its Sponsored Members, as well as its own default loss allocation as a Member.<sup>39</sup>

As proposed, consistent with FICC’s Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) “Sponsoring Members and Sponsored Members,” NSCC would also provide a mechanism by which a Sponsoring Member may cause the termination and liquidation of a Sponsored Member’s positions arising from Sponsored Member Transactions between the Sponsoring Member and such Sponsored Member that have been novated to NSCC.<sup>40</sup>

### *Sponsored Members*

Consistent with the requirements applicable to sponsored members in FICC’s Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) “Sponsoring Members and Sponsored Members,” any Person that has been approved by NSCC to be sponsored into membership by a Sponsoring Member pursuant to proposed Rule 2C (“Sponsored Member”) would be required to be either a “qualified institutional buyer” as defined by Rule 144A<sup>41</sup> under the Securities Act of 1933, as amended (“Securities Act”),<sup>42</sup> or a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act, satisfies the financial requirements necessary to be a “qualified institutional buyer” as specified in that paragraph.

#### **(iv) Agent Clearing Members and Customers**

NSCC is proposing an agent clearing membership designed to allow Members to play the role of agent and credit intermediary for their institutional firm clients in clearing. This

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<sup>39</sup> The following example illustrates how loss allocation would occur with respect to Sponsoring Members and Sponsored Members: Assume NSCC incurs a \$100 million aggregate loss from a Defaulting Member Event. In addition, assume that the Corporate Contribution amount that NSCC would first apply to any loss from a Defaulting Member Event is \$25 million. This means NSCC would allocate the remaining \$75 million losses (i.e., \$100 million minus \$25 million) to Members pursuant to Section 4 of Rule 4 (Clearing Fund), including Sponsored Member Sub-Accounts as if each were a Member. If the allocated losses to a Sponsoring Member’s Sponsored Member Sub-Accounts is \$1 million and the allocated losses to its Sponsoring Member in its capacity as a Member is \$2 million, the Sponsoring Member would be responsible for a total of \$3 million loss allocation (\$1 million for its Sponsored Member Sub-Account loss allocation amount and \$2 million for its own default loss allocation as a Member).

<sup>40</sup> See Section 14 of proposed Rule 2C (Sponsoring Members and Sponsored Members).

<sup>41</sup> 17 CFR 230.144A.

<sup>42</sup> 15 U.S.C. 77a et seq.

membership type is being proposed in response to the request of certain market participants, including in particular certain agent lending banks, that the proposed SFT Clearing Service accommodate agent-style trading (i.e., where the agent lender enters into the transactions on behalf of its institutional firm clients with a third-party market participant, rather than acting as its institutional firm clients' principal prenovation counterparty). Agent-style trading is the manner in which such agent lenders are typically approved to transact in securities lending transactions on behalf of their institutional firm clients. Under the proposal, a Member that enters into transactions on behalf of its institutional firm clients in accordance with the provisions of proposed Rule 2D ("Agent Clearing Member") would be permitted to submit SFTs executed by it (as agent on behalf of its institutional firm clients, with each such client referred to as a "Customer") with a Member participating in the proposed SFT Clearing Service (which could include a Member acting in a proprietary capacity within the proposed SFT Clearing Service as well as an Agent Clearing Member).

All Members would be eligible to apply to become Agent Clearing Members in NSCC, subject to credit criteria that are substantially similar to those applicable to Sponsoring Members as well as category 2 sponsoring members in FICC's Sponsoring Member/Sponsored Member Program.<sup>43</sup>

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<sup>43</sup> If a Member is a Registered Broker-Dealer, then such Member would only be eligible to apply to become an Agent Clearing Member if it satisfies the credit criteria in proposed Rule 2D (i.e., if it has (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million). Such credit criteria are comparable to the credit criteria applicable to sponsoring members that are registered broker-dealers in FICC's Sponsoring Member/Sponsored Member Program. Similar to the review of a Sponsoring Member applicant, an Agent Clearing Member applicant would also be viewed and surveilled as the credit counterparty to NSCC in light of its role as the Member with respect to its Agent Clearing Member Customer Omnibus Account(s).

In addition, NSCC may require a Person be a Member for a time period deemed necessary by NSCC before that Person may be considered to become an Agent Clearing Member. This requirement may be imposed by NSCC on a new Member that has yet to demonstrate a track record of financial responsibility and operational capability.

Furthermore, as proposed, the application of a Member to be an Agent Clearing Member at NSCC that is a Sponsoring Member or an existing FICC sponsoring member would not be required to be approved by the NSCC Board of Directors. NSCC believes this approach to the Board of Director's approval for Agent Clearing Members is appropriate in light of the fact that the critical components of the FICC sponsoring member application as well as the NSCC Sponsoring Member and Agent Clearing Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar. Nonetheless, NSCC would apply the same rigorous counterparty credit review process to any Member

Under the proposal, the requirements to be imposed on Agent Clearing Members would largely mirror those imposed on Sponsoring Members. However, NSCC is not proposing to impose the same types of requirements on an Agent Clearing Member's Customers as it does on Sponsored Members because a Customer would not be a direct member of NSCC.

Specifically, as proposed, an Agent Clearing Member would be permitted to submit to NSCC for novation Agent Clearing Member Transactions (as defined below and in the proposed rule change), on behalf of one or more of its Customers, subject to an activity limit. Specifically, under the proposal, if the sum of the Volatility Charges applicable to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account(s) (as defined below and in the proposed rule change) and its other accounts at NSCC exceeds its Net Member Capital, the Agent Clearing Member would not be permitted to submit activity into its Agent Clearing Member Customer Omnibus Account(s), unless otherwise determined by NSCC in order to promote orderly settlement. As defined in Section 4 of proposed Rule 2D, Agent Clearing Member Transactions are SFTs that an Agent Clearing Member submits to NSCC on behalf of one or more Customers.

The Agent Clearing Member would establish one or more accounts at NSCC for its Customers' positions, i.e., an Agent Clearing Member Customer Omnibus Account, that would be in the name of the Agent Clearing Member for the benefit of its Customers; however, each Agent Clearing Member Customer Omnibus Account may only contain activity where the Agent Clearing Member is acting as Transferor on behalf of its Customers, or as Transferee on behalf of its Customers, but not both (i.e., activity would not be netted across Customers for Clearing Fund purposes). Under the proposal, the Agent Clearing Member would act solely as agent of its Customers in connection with the clearing of Agent Clearing Member Transactions; however, the Agent Clearing Member would remain fully liable for the performance of all obligations to NSCC arising in connection with Agent Clearing Member Transactions.

In addition, as proposed under the sponsoring/sponsored membership model, the Agent Clearing Member would be responsible for posting to NSCC all of the Clearing Fund and any applicable SLD associated with the activity of its Customers and covering any default loss allocable to its Customers, as well as its own default loss allocation as a Member;<sup>44</sup> however,

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applying to be an Agent Clearing Member at NSCC, whether or not the Member is an existing FICC sponsoring member.

<sup>44</sup> The following example illustrates how loss allocation would occur with respect to Agent Clearing Members: Assume NSCC incurs a \$100 million aggregate loss from a Defaulting Member Event. In addition, assume that the Corporate Contribution amount that NSCC would first apply to any loss from a Defaulting Member Event is \$25 million. This means NSCC would allocate the remaining \$75 million losses (i.e., \$100 million minus \$25 million) to Members pursuant to Section 4 of Rule 4 (Clearing Fund), including Agent Clearing Member Customer Omnibus Accounts as if each were a Member. If the allocated losses to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account is \$1 million and the allocated losses to the Agent Clearing Member in its capacity as a Member is \$2 million, the Agent Clearing Member would be responsible for a total of \$3 million loss allocation (\$1 million for its Agent Clearing

unlike a Sponsoring Member, an Agent Clearing Member would not be required to provide an unconditional guaranty to NSCC for its Customer's obligations. This is because, as described above, the Agent Clearing Member would be fully liable for all obligations of its Customers under the Agent Clearing Member Transactions that it submitted to NSCC as the Member.

As proposed, NSCC would also provide a mechanism by which an Agent Clearing Member may, upon a default of a Customer and consent of NSCC, transfer Agent Clearing Member Transactions of the Customer established in one or more of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts from such Agent Clearing Member Customer Omnibus Accounts to the Agent Clearing Member's proprietary account at NSCC as a Member.<sup>45</sup>

**(v) Sponsoring Member/Sponsored Member vs. Agent Clearing Member/Customers**

The direct costs of central clearing (i.e., Clearing Fund, loss allocation, fees and performance on behalf of an institutional firm clients) would be largely equivalent as between what NSCC proposes to apply to a Sponsoring Member and what NSCC proposes to apply to an Agent Clearing Member. Likewise, the capital costs to Sponsoring Members and Agent Clearing Members of intermediating institutional firm activity as between the two buy-side clearing models would be largely equivalent. That being said, because Sponsoring Members would be required to ensure that (i) each of their clients separately onboards with NSCC as a Sponsored Member (which NSCC understands is generally required from an accounting perspective in order for the Sponsoring Member to net on its balance sheet its SFTs with Sponsored Members against the Sponsoring Member's other NSCC-cleared SFTs),<sup>46</sup> (ii) each of their client's SFTs is individually submitted to NSCC for clearing, and (iii) each Sponsored Member continues to remain in compliance with the financial standards applicable to Sponsored Members throughout the course of its membership, Sponsoring Members may incur more legal, onboarding, operational and ongoing administrative costs than Agent Clearing Members with respect to their institutional firm clearing activity.

However, the sponsoring/sponsored membership model allows for principal-style trading between a Sponsoring Member and its Sponsored Member where the Sponsoring Member and Sponsored Member are pre-novation counterparties, which would generally create the opportunity for a Sponsoring Member to make an economic spread between its trade with its Sponsored Member and its offsetting trades with other NSCC Members or Sponsored Members. The opportunity for such economic spread and the ability of a Sponsoring Member to achieve balance sheet netting and capital efficiency on such trading activity through the novation of SFTs

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Member Customer Omnibus Account loss allocation amount and \$2 million for its own default loss allocation as a Member).

<sup>45</sup> See Section 11 of proposed Rule 2D (Agent Clearing Members).

<sup>46</sup> Supra note 9.

to NSCC could, for some market participants, offset the indirect additional costs associated with acting as a Sponsoring Member, rather than acting as an Agent Clearing Member.

On the other hand, as NSCC understands it, for some market participants, particularly agent lenders, their business models are not typically predicated on principal-style trading. Rather, these agency businesses typically charge fees for their services (rather than taking economic spreads) and their business models and their agreed upon investment guidelines with their institutional firm customers may only permit agented (rather than principal-style) trading for securities lending transactions. So, for such market participants, participating in clearing at NSCC as an Agent Clearing Member may be a better fit for their overall business model.

From the perspective of an institutional firm client, the costs of clearing that may be passed through to it by its intermediary (depending on their commercial arrangements) would be largely equivalent. That said, some institutional firms that engage in securities lending may be prohibited from acting as Sponsored Members and engaging in principal-style trading with their intermediary in clearing for regulatory and/or investment guideline reasons. For those institutional firms, being able to transact SFTs as a Customer within an Agent Clearing Member Customer Omnibus Account would offer them a means to access central clearing that would otherwise not be available to them if the sponsoring/sponsored membership model were the only model available for buy-side clearing.

**(vi) Proposed Rule Changes**

**(A) Proposed Rule 2C – Sponsoring Members and Sponsored Members**

NSCC is proposing to add Rule 2C, entitled “Sponsoring Members and Sponsored Members.” This new rule would govern the proposed sponsored membership and would be comprised of 14 sections, each of which is described below.

*Proposed Rule 2C, Section 1 (General)*

Section 1 of proposed Rule 2C would be a general provision regarding the Rules applicable to Sponsoring Members and Sponsored Members.

Section 1 of proposed Rule 2C would provide that NSCC will permit the establishment of a sponsored membership relationship between a Member that is approved as a Sponsoring Member and one or more Persons that are accepted by NSCC as Sponsored Members of that particular Sponsoring Member. Section 1 of proposed Rule 2C would further provide that the rights, liabilities and obligations of Sponsoring Members and Sponsored Members shall be governed by proposed Rule 2C, and that references to the term “Member” in other Rules would not apply to Sponsoring Members and to Sponsored Members, in their respective capacities as such, unless specifically noted as such in proposed Rule 2C or in such other Rules.

Section 1 of proposed Rule 2C would also provide that a Sponsoring Member shall continue to have all of the rights, liabilities and obligations as set forth in the Rules and in any agreement between it and NSCC pertaining to its status as a Member, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as a Sponsoring

Member except as contemplated under Sections 7, 8 and 9 of proposed Rule 2C and under the Sponsoring Member Guaranty.

*Proposed Rule 2C, Section 2 (Qualifications of Sponsoring Members, the Application Process and Continuance Standards)*

Section 2 of proposed Rule 2C would establish the eligibility requirements for Members that wish to become Sponsoring Members, the membership application process that would be required of each Member to become a Sponsoring Member, the on-going membership requirements that would apply to Sponsoring Members, as well as the requirements regarding a Sponsoring Member's election to voluntarily terminate its membership.

Under Section 2(a) of proposed Rule 2C, any Member would be eligible to apply to become a Sponsoring Member; however, if a Member is a Registered Broker-Dealer, such Member would only be permitted to apply to become a Sponsoring Member if it has (1) Net Worth (as defined below and in the proposed rule change) of at least \$25 million and (2) excess net capital over the minimum net capital requirement imposed by the Commission (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million.<sup>47</sup> In connection therewith, NSCC is proposing "Net Worth" to mean, as of a particular date, the amount equal to the excess of the assets of a Person over the liabilities of such Person, computed in accordance with generally accepted accounting principles, and for Registered Broker-Dealers, Net Worth shall include liabilities that are subordinated to the claims of creditors pursuant to a satisfactory subordination agreement, as defined in Appendix D to Rule 15c3-1 of the Securities Exchange Act of 1934, as amended (the "Act").<sup>48</sup> As proposed, NSCC may require that a Person be a Member for a certain time period before that Person may be considered to become a Sponsoring Member.

Section 2(b) of proposed Rule 2C would provide that each Member applicant to become a Sponsoring Member would be required to provide an application and other information requested

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<sup>47</sup> NSCC is proposing these financial minimums for Registered Broker-Dealer Sponsoring Member applicants to reflect the additional responsibility that the applicant would undertake as a Sponsoring Member. These financial minimums are determined based on NSCC's assessment of the minimum capital that would be necessary for a broker-dealer to conduct meaningful level of NSCC-cleared activity while serving as a credit counterparty in respect of others' trades. In its assessment, NSCC considered various factors, such as the amount of a Registered Broker-Dealer Member's capital and its impact on such Member's financial responsibility and operational capability, comparability with the financial requirements of other clearing agencies, and the desire to strike a balance between credit risk mitigation and member accessibility. For the reasons described above in Item 10(iii) "Sponsoring Members and Sponsored Members," these financial minimums are also designed to be consistent with the requirements applicable to registered broker/dealers that are sponsoring members in FICC's Sponsoring Member/Sponsored Member Program.

<sup>48</sup> 17 CFR 240.15c3-1d.

by NSCC. Sponsoring Member applications shall first be reviewed by NSCC and would require the Board of Directors' approval, unless the Member applicant is already an Agent Clearing Member under proposed Rule 2D or a sponsoring member of FICC.<sup>49</sup> NSCC believes this approach to the Board of Director's approval for Sponsoring Members is appropriate in light of the fact that the critical components of the FICC sponsoring member application as well as the NSCC Sponsoring Member and Agent Clearing Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar.

Under Section 2(c) of proposed Rule 2C, if the Sponsoring Member application is denied, such denial would be handled in accordance with Section 1 of Rule 2A (Initial Membership Requirements).

As proposed in Section 2(d) of proposed Rule 2C, NSCC may impose additional financial requirements on a Sponsoring Member applicant based upon the level of the anticipated positions and obligations of such applicant, the anticipated risk associated with the volume and types of transaction such applicant proposes to process through NSCC as a Sponsoring Member and the overall financial condition of such applicant. Under the proposal, with respect to an application of a Member to become a Sponsoring Member that requires the Board of Directors' approval, the Board of Directors shall also approve any increased financial requirements imposed by NSCC in connection with the approval of the application, and NSCC would thereafter regularly review such Sponsoring Member regarding its compliance with the increased financial requirements.<sup>50</sup>

In addition, under Section 2(e) of proposed Rule 2C, NSCC may require each Sponsoring Member or any Sponsoring Member applicant to furnish adequate assurances of such Sponsoring Member or Sponsoring Member applicant's financial responsibility and operational capability within the meaning of Rule 15 (Assurances of Financial Responsibility and Operational Capability), as NSCC may at any time or from time to time deem necessary or advisable in order to protect NSCC, its participants, creditors or investors, to safeguard securities and funds in the

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<sup>49</sup> It is NSCC's understanding that FICC is evaluating a change to the GSD Rules to provide that the application of an FICC sponsoring member applicant that is already an NSCC Sponsoring Member or Agent Clearing Member would not require approval of FICC's board of directors.

<sup>50</sup> If the increased financial requirements are imposed in connection with a Sponsoring Member application that does not require the Board of Directors' approval, the increased financial requirements would not be subject to the Board of Directors' approval. Nonetheless, once a Sponsoring Member application is approved with increased financial requirements, NSCC would thereafter regularly review such Sponsoring Member regarding its continued adherence to such increased financial requirements as well as determine whether such increased financial requirements are still appropriate. If the Sponsoring Member is unable to adhere to the increased financial requirements, the Board of Directors may, pursuant to Section 10 of proposed Rule 2C, suspend, prohibit or limit the Sponsoring Member's access to NSCC's services.

custody or control of NSCC and for which NSCC is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions.<sup>51</sup>

Section 2(f) of proposed Rule 2C would provide that each Member whose Sponsoring Member application is approved would sign and deliver to NSCC (i) an agreement between NSCC and the Member and specifies the terms and conditions deemed by NSCC to be necessary in order to protect itself and its participants (“Sponsoring Member Agreement”), (ii) a guaranty, in the form and substance acceptable to NSCC, whereby the Member, in its capacity as a Sponsoring Member, guarantees to NSCC the payment and performance by its Sponsored Members of their obligations under the Rules in respect of the Sponsoring Member’s Sponsored Member Sub-Accounts, including, without limitation all of the settlement obligations of its Sponsored Members in respect of such Sponsored Member Sub-Accounts (“Sponsoring Member Guaranty”), and a related legal opinion in a form satisfactory to NSCC. In addition, Section 2(f) of proposed Rule 2C would provide that nothing in the Rules shall prohibit a Sponsoring Member from seeking reimbursement from a Sponsored Member for payments made by the Sponsoring Member (whether pursuant to the Sponsoring Member Guaranty, out of Clearing Fund deposits or otherwise) with respect to obligations as to which the Sponsored Member is a principal obligor under the Rules, or as otherwise may be agreed by the Sponsored Member and Sponsoring Member.

Section 2(g) of proposed Rule 2C would provide that each Sponsoring Member shall submit to NSCC, within the timeframes and in the formats required by NSCC, the reports and information that all Members are required to submit regardless of type of Member and the reports and information required to be submitted for its respective type of Member, all pursuant to Section 2 of Rule 2B (Ongoing Membership Requirements and Monitoring) and, if applicable, Addendum O (Admission of Non-US Entities as Direct NSCC Members).

Section 2(h) of proposed Rule 2C would provide that a Sponsoring Member’s books and records, insofar as they relate to the Sponsored Member Transactions submitted to NSCC, shall be open to the inspection of the duly authorized representatives of NSCC to the same extent provided in Rule 2A (Initial Membership Requirements) for other Members.

Section 2(i) of proposed Rule 2C would provide that a Sponsoring Member shall promptly inform NSCC, both orally and in writing, if it is no longer in compliance with the relevant standards and qualifications for applying to become a Sponsoring Member set forth in the proposed Rule 2C. Notification must take place immediately and in no event later than 2 Business Days from the date on which the Sponsoring Member first learns of its non-compliance. As proposed, NSCC would assess a fine in accordance with the Fine Schedule in

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<sup>51</sup> As an example, NSCC may require a Sponsoring Member or a Sponsoring Member applicant to furnish adequate assurances of such Sponsoring Member or Sponsoring Member applicant’s financial responsibility and operational capability if NSCC has concerns about such Sponsoring Member or Sponsoring Member applicant’s overall financial health or credit rating.



Addendum P against any Sponsoring Member that fails to so notify NSCC.<sup>52</sup> If the Sponsoring Member fails to remain in compliance with the relevant standards and qualifications, NSCC would, if necessary, undertake appropriate action to determine the status of the Sponsoring Member and its continued eligibility as such. In addition, NSCC may review the financial responsibility and operational capability of the Sponsoring Member, and otherwise require from the Sponsoring Member additional reports of its financial or operational condition at such intervals and in such detail as NSCC shall determine. In addition, if NSCC has reason to believe that a Sponsoring Member may fail to comply with any of the Rules applicable to Sponsoring Members, it may require the Sponsoring Member to provide it, within such timeframe, and in such detail, and pursuant to such manner as NSCC shall determine, with assurances in writing of a credible nature that the Sponsoring Member shall not, in fact, violate any of the Rules.

Section 2(j) of proposed Rule 2C would provide that in the event that a Sponsoring Member fails to remain in compliance with the relevant requirements of the Rules, the Sponsoring Member Agreement or the Sponsoring Member Guaranty, NSCC shall have the right to cease to act for the Sponsoring Member in its capacity as a Sponsoring Member pursuant to Section 10 of proposed Rule 2C, unless the Sponsoring Member requests that such action not be taken and NSCC determines that, depending upon the specific circumstances and the record of the Sponsoring Member, it is appropriate instead to establish for such Sponsoring Member a time period, which shall be determined by NSCC and which shall be no longer than 30 calendar days unless otherwise determined by NSCC, during which the Sponsoring Member must resume compliance with such requirements. As proposed, in the event that the Sponsoring Member is unable to satisfy such requirements within the time period specified by NSCC, NSCC shall, pursuant to the Rules, cease to act for the Sponsoring Member in its capacity as a Sponsoring Member pursuant to Section 10 of the proposed Rule 2C.

Section 2(k) of proposed Rule 2C would provide that if the sum of the Volatility Charges applicable to a Sponsoring Member's Sponsored Member Sub-Accounts and its other accounts at NSCC exceeds its Net Member Capital (as defined below and in the proposed rule change), the Sponsoring Member shall not be permitted to submit activity into its Sponsored Member Sub-Accounts, unless otherwise determined by NSCC in order to promote orderly settlement.<sup>53</sup> As proposed, "Volatility Charge" would mean, in respect to a Member, the amount of its Required Fund Deposit calculated by NSCC by applying Sections I.(A)(1)(a)(i)-(iii) of Procedure XV (Clearing Fund Formula and Other Matters); "Net Member Capital" would mean Net Capital (as defined below and in the proposed rule change), net assets or equity capital, as applicable to a Member, based on the type of regulation, and in particular the capital requirements, to which the Member is subject; and "Net Capital" would mean, as of a particular date, the amount equal to

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<sup>52</sup> See Addendum P (Fine Schedule), *supra* note 1.

<sup>53</sup> NSCC selected the Volatility Charges and Net Member Capital as the criteria for purposes of establishing the activity limit for Sponsoring Members. This is because a Sponsoring Member's total Volatility Charges being in excess of its Net Member Capital is an important indicator that the Sponsoring Member's financial resources, as measured by its Net Capital, net assets or equity capital, may be insufficient to meet the largest component of its Required Fund Deposit (i.e., Volatility Charges).

the net capital of a Registered Broker-Dealer as defined in Rule 15c3-1(c)(2) of the Act,<sup>54</sup> or any successor rule or regulation thereto.

Section 2(l) of proposed Rule 2C would provide that a Sponsoring Member may voluntarily elect to terminate its status as a Sponsoring Member, with respect to all Sponsored Members or with respect to one or more Sponsored Members from time to time, by providing NSCC with a written notice from a Sponsoring Member to NSCC that the Sponsoring Member is voluntarily electing to terminate its status as a Sponsoring Member with respect to all of its Sponsored Members or with respect to one or more of its Sponsored Members (“Sponsoring Member Voluntary Termination Notice”). The Sponsoring Member shall specify in the Sponsoring Member Voluntary Termination Notice the Sponsored Member(s) in respect of which the Sponsoring Member is terminating its status (the “Former Sponsored Members”) and a desired date for such termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Sponsoring Member to NSCC with respect to the Former Sponsored Members as of the time such Sponsoring Member Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC.

Section 2(l) of proposed Rule 2C would also provide that such termination would not be effective until accepted by NSCC, which shall be no later than 10 Business Days after the receipt of the Sponsoring Member Voluntary Termination Notice from such Sponsoring Member. NSCC’s acceptance shall be evidenced by a notice to NSCC’s participants announcing the termination of the Sponsoring Member’s status as such with respect to the Former Sponsored Members and the date on which the termination of the Sponsoring Member’s status as a Sponsoring Member becomes effective (“Sponsoring Member Termination Date”). As proposed, after the close of business on the Sponsoring Member Termination Date, the Sponsoring Member shall no longer be eligible to submit Sponsored Member Transactions on behalf of the Former Sponsored Members, and each Former Sponsored Member shall cease to be a Sponsored Member unless it is the Sponsored Member of another Sponsoring Member. If any Sponsored Member Transactions is submitted to NSCC by the Sponsoring Member on behalf of a Former Sponsored Member that is scheduled to settle after the Sponsoring Member Termination Date, such Sponsoring Member’s Sponsoring Member Voluntary Termination Notice would be deemed void, and the Sponsoring Member would remain subject to the proposed Rule 2C as if it had not given such Sponsoring Member Voluntary Termination Notice.

Section 2(m) of proposed Rule 2C would provide that a Sponsoring Member’s voluntary termination of its status as such, in whole or in part, shall not affect its obligations to NSCC, or the rights of NSCC, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Transactions submitted to NSCC before the applicable Sponsoring Member Termination Date. Any such Sponsored Member Transactions that have been novated to NSCC shall continue to be processed by NSCC. The return of the Sponsoring Member’s Clearing Fund deposit shall be governed by Section 7 of Rule 4 (Clearing Fund). If an Event Period were to occur after a Sponsoring Member has submitted the Sponsoring Member Voluntary Termination Notice but on or prior to the Sponsoring Member Termination Date, in order for the Sponsoring Member to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the Sponsoring

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<sup>54</sup> 17 CFR 240.15c3-1(c)(2).

Member would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Sponsoring Member Voluntary Termination Notice previously submitted by the Sponsoring Member.

Section 2(n) of proposed Rule 2C would provide that any non-public information furnished to NSCC pursuant to proposed Rule 2C shall be held in confidence as may be required under the laws, rules and regulations applicable to NSCC that relate to the confidentiality of records. Section 2(n) would also provide that each Sponsoring Member shall maintain DTCC Confidential Information in confidence to the same extent and using the same means it uses to protect its own confidential information, but no less than a reasonable standard of care, and shall not use DTCC Confidential Information or disclose DTCC Confidential Information to any third party except as necessary to perform such Sponsoring Member's obligations under the Rules or as otherwise required by applicable law. Section 2(n) would further provide that each Sponsoring Member acknowledges that a breach of its confidentiality obligations under the Rules may result in serious and irreparable harm to NSCC and/or DTCC for which there is no adequate remedy at law. In addition, Section 2(n) would provide that in the event of such a breach by the Sponsoring Member, NSCC and/or DTCC shall be entitled to seek any temporary or permanent injunctive or other equitable relief in addition to any monetary damages thereunder.<sup>55</sup>

*Proposed Rule 2C, Section 3 (Qualifications of Sponsored Members, Approval Process and Continuance Standards)*

Section 3 of proposed Rule 2C would establish the eligibility requirements for Sponsored Members, the membership application process that would be required of each Sponsored Member, the on-going membership requirements that would apply to Sponsored Members, as well as the requirements regarding a Sponsored Member's election to voluntarily terminate its membership.

Section 3(a) of proposed Rule 2C would provide that a Person shall be eligible to apply to become a Sponsored Member if: (x) it is sponsored into membership by a Sponsoring Member, and (y) it (1) is a "qualified institutional buyer" as defined by Rule 144A<sup>56</sup> under the Securities Act,<sup>57</sup> or (2) is a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act, satisfies the financial requirements necessary to be a "qualified institutional buyer" as specified in that paragraph. NSCC would have the right to rely on the representation provided by the Sponsoring Member regarding satisfaction of (y).

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<sup>55</sup> Section 2(n) of proposed Rule 2C is designed to be consistent with provisions in the Rules relating to the confidentiality of information furnished by participants. See Rule 2A (Initial Membership Requirements), supra note 1.

<sup>56</sup> 17 CFR 230.144A.

<sup>57</sup> 15 U.S.C. 77a et seq.

Section 3(b) of proposed Rule 2C would provide that each time that a Sponsoring Member wishes to sponsor a Person into membership, it shall provide NSCC with the representation referred to in Section 3(a) of proposed Rule 2C, as well as any additional information in such form as may be prescribed by NSCC. NSCC shall approve or disapprove Persons as Sponsored Members. If NSCC denies the request of a Sponsoring Member to add a Person as a Sponsored Member, such denial shall be handled in the same manner as set forth in Section 1 of Rule 2A (Initial Membership Requirements) with respect to membership applications except that the written statement referred to therein shall be provided to both the Sponsoring Member and the Person seeking to become a Sponsored Member.

Section 3(c) of proposed Rule 2C would provide that each Person to become a Sponsored Member shall sign and deliver to NSCC an agreement whereby the Person shall agree to any terms and conditions deemed by NSCC to be necessary in order to protect itself and its participants (the “Sponsored Member Agreement”). Each Person to become a Sponsored Member that shall be an FFI Member must be FATCA Compliant.

Section 3(d) of proposed Rule 2C would provide that a Sponsored Member shall immediately inform its Sponsoring Member, both orally and in writing, if the Sponsored Member is no longer in compliance with the requirements of Section 3(a) of proposed Rule 2C. A Sponsoring Member shall promptly inform NSCC, both orally and in writing, if a Sponsored Member is no longer in compliance with the requirements of Section 3(a) of proposed Rule 2C. Notification to NSCC by the Sponsoring Member must take place within one (1) Business Day from the date on which the Sponsoring Member first learns of the Sponsored Member’s non-compliance. NSCC would assess a fine in accordance with the Fine Schedule in Addendum P against any Sponsoring Member that fails to so notify NSCC.<sup>58</sup>

Section 3(e) of proposed Rule 2C would provide that a Sponsored Member may voluntarily elect to terminate its membership by providing NSCC with a written notice from the Sponsored Member to NSCC that the Sponsored Member is voluntarily electing to terminate its membership (“Sponsored Member Voluntary Termination Notice”). The Sponsored Member shall specify in the Sponsored Member Voluntary Termination Notice a desired date for the termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Sponsored Member to NSCC as of the time such Sponsored Member Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC.

In addition, Section 3(e) of proposed Rule 2C would provide that such termination would not be effective until accepted by NSCC, which shall be no later than 10 Business Days after the receipt of the Sponsored Member Voluntary Termination Notice from such Sponsored Member. NSCC’s acceptance shall be evidenced by a notice to NSCC’s participants announcing the termination of the Sponsored Member and the date on which the termination of the Sponsored Member becomes effective (“Sponsored Member Termination Date”). After the close of business on the Sponsored Member Termination Date, the relevant Sponsoring Member shall no longer be eligible to submit Sponsored Member Transactions on behalf of the Sponsored

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<sup>58</sup> See Addendum P (Fine Schedule), supra note 1.

Member. If any Sponsored Member Transaction is submitted to NSCC by the relevant Sponsoring Member on behalf of the Sponsored Member that is scheduled to settle after the Sponsored Member Termination Date, such Sponsored Member's Sponsored Member Voluntary Termination Notice would be deemed void, and the Sponsored Member would remain subject to the proposed Rule 2C as if it had not given such Sponsored Member Voluntary Termination Notice.

Section 3(f) of proposed Rule 2C would provide that a Sponsored Member's voluntary termination shall not affect its obligations to NSCC, or the rights of NSCC, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Transactions submitted to NSCC before the Sponsored Member Termination Date, and the Sponsoring Member Guaranty shall remain in effect to cover all outstanding obligations of the Sponsored Member to NSCC that are within the scope of such Sponsoring Member Guaranty.

*Proposed Rule 2C, Section 4 (Compliance with Laws)*

Section 4 of proposed Rule 2C would provide that each Sponsoring Member and Sponsored Member shall comply in all material respects with all applicable laws, including applicable laws relating to securities, taxation and money laundering, as well as global sanctions laws, in connection with the use of NSCC's services.

*Proposed Rule 2C, Section 5 (Sponsored Member Transactions)*

Section 5 of proposed Rule 2C would provide that a Sponsoring Member shall be permitted to submit to NSCC SFTs between itself and its Sponsored Members ("Sponsored Member Transactions") in accordance with proposed Rule 56, as described below. Section 5 of proposed Rule 2C would further provide that NSCC directs each Sponsored Member and Sponsoring Member to settle all Final Settlement, Rate Payment, Price Differential, and other securities delivery and payment obligations arising under a Sponsored Member Transaction that has been novated to NSCC by causing the relevant cash and securities to be transferred to the Transferor or Transferee, as applicable, on the books and records of the Sponsoring Member, and each Sponsored Member and Sponsoring Member agrees that any such transfer shall satisfy NSCC's corresponding obligation with respect to such Sponsored Member Transaction.

*Proposed Rule 2C, Section 6 (Sponsoring Member Agent Obligations)*

Section 6 of proposed Rule 2C would provide that a Sponsored Member shall appoint its Sponsoring Member to act as agent with respect to the Sponsored Member's satisfaction of its settlement obligations arising under Sponsored Member Transactions between the Sponsored Member and the Sponsoring Member and for performing all functions and receiving reports and information set forth in the Rules. NSCC's provision of such reports and information to the Sponsoring Member shall constitute satisfaction of any obligation of NSCC to provide such reports and information to the affected Sponsored Members. As proposed, notwithstanding the foregoing and any other activities the Sponsoring Member may perform in its capacity as agent for Sponsored Members, each Sponsored Member shall be obligated as principal to NSCC with respect to all settlement obligations under the Rules, and the Sponsoring Member shall not be a principal under the Rules with respect to settlement obligations of its Sponsored Members.

Proposed Rule 2C, Section 7 (Clearing Fund Obligations)

Section 7 of proposed Rule 2C would set forth the Clearing Fund obligations.

Section 7(a) of proposed Rule 2C would provide that NSCC shall maintain a ledger maintained on the books and records of NSCC for a Sponsoring Member that reflects the outstanding SFTs that a Sponsoring Member enters into in respect of a Sponsored Member and that have been novated to NSCC, the SFT Positions or SFT Cash associated with those transactions and any debits or credits of cash associated with such transactions effected pursuant to Rule 12 (Settlement) (each a “Sponsored Member Sub-Account”). Each Sponsoring Member shall make and maintain so long as such Member is a Sponsoring Member a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in its Sponsored Member Sub-Accounts (the “Sponsoring Member Required Fund Deposit”).

Under Section 7(a), each Sponsoring Member, so long as such Member is a Sponsoring Member, shall also provide SLD to the Clearing Fund, as may be required pursuant to Rule 4A (Supplemental Liquidity Deposits); however, the Supplemental Liquidity Deposits shall be calculated without regard to Sponsored Member Transactions. This is because Sponsored Member Transactions do not independently create liquidity risk for NSCC as NSCC would not be required to complete settlement of any Sponsored Member Transactions in the event that either the Sponsoring Member or Sponsored Member defaults. In the event that the Sponsoring Member defaults, Section 12(b) of proposed Rule 2C (as described below) would permit NSCC to closeout (rather than settle) the Sponsored Member Transactions of the defaulter’s Sponsored Members. Likewise, if the Sponsored Member defaults, NSCC would also not be required to complete settlement. Rather, under Section 8 of proposed Rule 2C (as described below), NSCC may offset its settlement obligations to the Sponsoring Member against the Sponsoring Member’s obligations under the Sponsoring Member Guaranty to perform on behalf of its defaulted Sponsored Member.

Section 7(a) would also propose that deposits to the Clearing Fund would be held by NSCC or its designated agents, to be applied as provided in the Rules.

Section 7(b) of proposed Rule 2C would provide that, in the ordinary course, for purposes of satisfying the Sponsoring Member’s Clearing Fund requirements under the Rules for its Member activity, its Sponsoring Member activity, and, to the extent applicable, its Agent Clearing Member activity, the Sponsoring Member’s proprietary accounts, its Sponsored Member Sub-Accounts, and its Agent Clearing Member Customer Omnibus Account(s), if any, shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time and without prior notice to the Sponsoring Member (but being obligated to give notice to the Sponsoring Member as soon as possible thereafter) and whether or not the Sponsoring Member or any of its Sponsored Members is in default of its obligations to NSCC, treat the Sponsoring Member’s accounts as a single account for the purpose of applying Clearing Fund deposits; apply Clearing Fund deposits made by the Sponsoring Member with respect to any account as necessary to ensure that the Sponsoring Member meets all of its obligations to NSCC under any other account(s); and otherwise exercise all rights to offset and net against the Clearing Fund deposits

any net obligations among any or all of the accounts, whether or not any other Person is deemed to have any interest in such account.<sup>59</sup>

Section 7(c) of proposed Rule 2C would provide that the Sponsoring Member Required Fund Deposit for each Sponsored Member Sub-Account shall be calculated separately based on the Sponsored Member Transactions in such Sponsored Member Sub-Account, and the Sponsoring Member shall, as principal, be required to satisfy the Sponsoring Member Required Fund Deposit for each of the Sponsoring Member's Sponsored Member Sub-Accounts.

Section 7(d) of proposed Rule 2C would provide that Sections 1, 2, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of Rule 4 (Clearing Fund) shall apply to the Sponsoring Member Required Fund Deposit with respect to obligations of a Sponsoring Member under the Rules, including its obligations arising under the Sponsored Member Sub-Accounts, and the obligations of a Sponsoring Member under its Sponsoring Member Guaranty to the same extent as such sections apply to any

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<sup>59</sup> NSCC believes it unlikely that it would exercise this authority, as the Clearing Fund deposits associated with each Sponsored Member Sub-Account, Agent Clearing Member Customer Omnibus Account and proprietary account of a Sponsoring Member are designed to be sufficient to cover the obligations of such account or sub-account. However, if a Sponsoring Member defaults or fails to perform and the Clearing Fund deposits associated with a given account or sub-account of such Sponsoring Member are not sufficient to discharge the Sponsoring Member's obligations in relation to such account or sub-account, NSCC would look to the Clearing Fund deposits related to the Sponsoring Member's other accounts or sub-accounts. For example, if NSCC ceased to act for a Sponsoring Member and the close-out of the SFT Positions established in the Sponsoring Member's Sponsored Member Sub-Accounts resulted in a loss to NSCC in excess of the Clearing Fund previously posted by the Sponsoring Member in relation to such SFT Positions, NSCC may apply to the excess any other Clearing Fund deposits posted by the Sponsoring Member to NSCC, such as Clearing Fund posted in connection with the proprietary positions of the Sponsoring Member. Similarly, if a Sponsoring Member failed to perform under the Sponsoring Member Guaranty outside the context of a cease-to-act situation and the Clearing Fund previously posted by the Sponsoring Member in relation to the SFT Positions established in the Sponsoring Member's Sponsored Member Sub-Accounts was not sufficient to satisfy the obligations under the Sponsoring Member Guaranty, NSCC may apply to the remainder any other Clearing Fund deposits posted by the Sponsoring Member to NSCC.

NSCC believes this is appropriate because the Clearing Fund deposits of a Sponsoring Member are the proprietary assets of the Sponsoring Member, and NSCC generally has the right to apply the Clearing Fund deposits of a Member to any of the Member's obligations to NSCC, regardless of whether those were the obligations that generated the Clearing Fund deposit requirement. NSCC therefore believes that, consistent with the FICC Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) "Sponsoring Members and Sponsored Members," a Sponsoring Member's Clearing Fund deposits should be available to satisfy any of the Sponsoring Member's guaranty or other obligations to NSCC.

Required Fund Deposit and any other obligations of a Member. For purposes of Section 1 of Rule 4, obligations and liabilities of a Member to NSCC that shall be secured shall include, without limitation, a Member's obligations as a Sponsoring Member under the Rules, including, without limitation, any obligation of any such Sponsoring Member to provide the Sponsoring Member Required Fund Deposit, such Sponsoring Member's obligations arising under the Sponsored Member Sub-Accounts of such Sponsoring Member and such Sponsoring Member's obligations under its Sponsoring Member Guaranty.

Section 7(e) of proposed Rule 2C would provide that a Sponsoring Member shall be subject to such fines as may be imposed in accordance with the Rules for any late satisfaction of a Clearing Fund deficiency call.

*Proposed Rule 2C, Section 8 (Right of Offset)*

Section 8 of proposed Rule 2C would provide that in the ordinary course, with respect to satisfaction of any Sponsored Member's obligations under the Rules, the Sponsoring Member's Sponsored Member Sub-Accounts, the Sponsoring Member's proprietary accounts, and the Sponsoring Member's Agent Clearing Member Customer Omnibus Accounts, if any, at NSCC shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time any obligation of the Sponsoring Member arises under the Sponsoring Member Guaranty to pay or perform thereunder with respect to any Sponsored Member, exercise a right of offset and net any such obligation of the Sponsoring Member under its Sponsoring Member Guaranty against any obligations of NSCC to the Sponsoring Member in respect of such Sponsoring Member's proprietary accounts at NSCC.<sup>60</sup> NSCC would generally anticipate exercising this right if, upon a Sponsoring Member default, the Sponsoring Member owed an amount under the Sponsoring Member Guaranty and was owed an amount by NSCC in relation to the Sponsoring Member's proprietary or other obligations.

*Proposed Rule 2C, Section 9 (Loss Allocation Obligations)*

Section 9 of proposed Rule 2C would establish loss allocation obligations under the sponsored membership model.

Section 9(a) of proposed Rule 2C would provide that Sponsored Members shall not be obligated for allocations, pursuant to Rule 4 (Clearing Fund), of loss or liability incurred by NSCC. To the extent that a loss or liability is determined by NSCC to arise in connection with

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<sup>60</sup> NSCC believes the most likely circumstance in which it would exercise this authority would be in the context of a Sponsoring Member default. If, in such circumstance, NSCC realizes a profit in closing out the positions associated with a proprietary account of the Sponsoring Member, but incurs a loss in closing out the positions associated with the Sponsored Member Sub-Accounts of the Sponsoring Member, it would offset its obligation to turn over to the Sponsoring Member the gains in relation to the Sponsoring Member's proprietary account against the obligations of the Sponsoring Member under the Sponsoring Member Guaranty.



Sponsored Member Transactions (i.e., in connection with the insolvency or default of a Sponsoring Member), the Sponsored Members shall not be responsible for or considered in the loss allocation calculation, but rather such loss shall be allocated to other Members in accordance with the principles set forth in Section 4 of Rule 4.

Section 9(b) of proposed Rule 2C would provide that, to the extent NSCC incurs a loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event and a loss allocation obligation arises, that would be the responsibility of a Sponsored Member Sub-Account as if the Sponsored Member Sub-Account were a Member, NSCC shall calculate such loss allocation obligation as if the affected Sponsored Member were subject to such allocations pursuant to Section 4 of Rule 4, but the Sponsoring Member shall be responsible for satisfying such obligations.

Section 9(c) of proposed Rule 2C would provide that the entire amount of the Required Fund Deposit associated with the Sponsoring Member's proprietary accounts at NSCC and the entire amount of the Sponsoring Member Required Fund Deposit may be used to satisfy any amount allocated against a Sponsoring Member, whether in its capacity as a Member, a Sponsoring Member, or otherwise. With respect to an obligation to make payment due to any loss allocation amounts assessed on a Sponsoring Member pursuant to Section 9(b) of proposed Rule 2C, the Sponsoring Member may instead elect to terminate its membership in NSCC pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Sponsoring Member, its Required Fund Deposit shall be the sum of its Required Fund Deposits associated with its proprietary accounts at NSCC (including its proprietary SFT Account pursuant to proposed Rule 56), its Sponsoring Member Required Fund Deposit, and its Agent Clearing Member Required Fund Deposits, if any, for each of its Agent Clearing Member Customer Omnibus Accounts.

*Proposed Rule 2C, Section 10 (Restrictions on Access to Services by a Sponsoring Member)*

Section 10 of proposed Rule 2C would establish the rights of NSCC to restrict a Sponsoring Member's access to NSCC's services.

Section 10(a) of proposed Rule 2C would provide that the Board of Directors may at any time, upon NSCC providing notice to a Sponsoring Member pursuant to Section 5 of Rule 45 (Notices), suspend a Sponsoring Member in its capacity as a Sponsoring Member from any service provided by NSCC either with respect to a particular transaction or transactions or with respect to transactions generally or prohibit or limit such Sponsoring Member's access to services offered by NSCC in the event that one or more of the factors set forth in Section 1 of Rule 46 (Restrictions on Access to Services) is present with respect to the Sponsoring Member.

Section 10(b) of proposed Rule 2C would provide that Rule 46 shall apply with respect to a Sponsoring Member in the same way as it applies to Members, including the Board of Directors' right to summarily suspend the Sponsoring Member and to cease to act for such Sponsoring Member. As under Rule 46, the Board of Directors would need to make the determination of whether to suspend, prohibit or limit a Sponsoring Member's access to services offered by NSCC on the basis of the factors set forth in that rule.

Section 10(c) of proposed Rule 2C would provide that if NSCC ceases to act for a Sponsoring Member in its capacity as a Sponsoring Member, Section 14 of proposed Rule 56 shall apply and NSCC shall decline to accept or process data from the Sponsoring Member on Sponsored Member Transactions and NSCC shall cease to act for all of the Sponsored Members of the affected Sponsoring Member (unless such Sponsored Members are also Sponsored Members of other Sponsoring Members). Section 10(c) would also provide that if NSCC suspends, prohibits or limits a Sponsoring Member in its capacity as a Sponsoring Member with respect to such Sponsoring Member's access to services offered by NSCC, NSCC shall decline to accept or process data from the Sponsoring Member on Sponsored Member Transactions and shall suspend the Sponsored Members of the affected Sponsoring Member (unless they are also Sponsored Members of other Sponsoring Members) for so long as NSCC is suspending, prohibiting or limiting the Sponsoring Member. Any Sponsored Member Transactions which have been novated to NSCC shall continue to be processed by NSCC. In addition, Section 10(c) would provide that NSCC, in its sole discretion, shall determine whether to close-out the affected Sponsored Member Transactions or permit the Sponsored Members to complete their settlement.

This is different from how NSCC would treat Agent Clearing Member Transactions of an Agent Clearing Member under Section 9 of proposed Rule 2D if NSCC ceased to act for the Agent Clearing Member. Specifically, for Agent Clearing Member Transactions, as proposed, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC; however, with respect to Sponsored Member Transactions, consistent with FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) "Sponsoring Members and Sponsored Members," NSCC would have the option to either terminate or settle a Sponsored Member's novated positions after ceasing to act for the Sponsoring Member. NSCC would have the practical and legal capability to make such an election because each Sponsored Member would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customers' novated positions.

*Proposed Rule 2C, Section 11 (Restrictions on Access to Services by a Sponsored Member)*

Section 11 of proposed Rule 2C would establish the rights of NSCC to restrict a Sponsored Member's access to NSCC's services.

Section 11(a) of proposed Rule 2C would provide that the Board of Directors may at any time upon NSCC providing notice to a Sponsored Member and its Sponsoring Member pursuant to Section 5 of Rule 45 (Notices), suspend a Sponsored Member from any service provided by NSCC either with respect to a particular transaction or transactions or with respect to transactions generally, or prohibit or limit such Sponsored Member with respect to access to services offered by NSCC in the event that one or more of the factors set forth in Section 1 of Rule 46 (Restrictions on Access to Services) is present with respect to the Sponsored Member.

Section 11(b) of proposed Rule 2C would provide that Rule 46 shall apply with respect to a Sponsored Member in the same way as it applies to Members, including the Board of Directors' right to summarily suspend a Sponsored Member and to cease to act for such Sponsored Member. As under Rule 46, the Board of Directors would need to make the determination of whether to suspend, prohibit or limit a Sponsored Member's access to services offered by NSCC on the basis of the factors set forth in that rule.

Section 11(c) of proposed Rule 2C would provide that if NSCC ceases to act for a Sponsored Member, Section 14 of proposed Rule 56 shall apply.

Section 11(d) of proposed Rule 2C would provide that NSCC shall cease to act for a Sponsored Member that is no longer in compliance with the requirements of Section 3(a) of proposed Rule 2C.

*Proposed Rule 2C, Section 12 (Insolvency of a Sponsoring Member)*

Section 12(a) of proposed Rule 2C would provide that a Sponsoring Member shall be obligated to immediately notify NSCC that (a) it fails, or is unable, to perform its contracts or obligations or (b) it is insolvent, as required by Section 1 of Rule 20 (Insolvency) for other Members. A Sponsoring Member shall be treated by NSCC in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where NSCC treats a Sponsoring Member as insolvent.

Section 12(b) of proposed Rule 2C would provide that in the event that NSCC determines to treat a Sponsoring Member as insolvent pursuant to Rule 20 (Insolvency), NSCC shall have the right to cease to act for the insolvent Sponsoring Member pursuant to Section 10 of the proposed Rule 2C. If NSCC ceases to act for the insolvent Sponsoring Member, NSCC shall decline to accept or process data from the Sponsoring Member, including Sponsored Member Transactions, and NSCC shall terminate the membership of all of the insolvent Sponsoring Member's Sponsored Members unless they are the Sponsored Members of another Sponsoring Member. Any Sponsored Member Transactions which have been novated to NSCC shall continue to be processed by NSCC. NSCC, in its sole discretion, shall determine whether to close-out the affected Sponsored Member Transactions and/or permit the Sponsored Members to complete their settlement. This is different from how NSCC would treat Agent Clearing Member Transactions. As described above, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC. However, with respect to Sponsored Member Transactions, consistent with FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) "Sponsoring Members and Sponsored Members," NSCC would have the option to either terminate or settle a Sponsored Member's novated positions after ceasing to act for the Sponsoring Member. This is because NSCC would have the practical and legal capability to make such an election because each Sponsored Member would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of

NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customers' novated positions.

*Proposed Rule 2C, Section 13 (Insolvency of a Sponsored Member)*

Section 13 of proposed Rule 2C would establish NSCC's rights in the event of an insolvency of a Sponsored Member.

Section 13(a) of proposed Rule 2C would provide that a Sponsored Member and its Sponsoring Member (to the extent it has knowledge thereof) shall be obligated to immediately notify NSCC that the Sponsored Member is insolvent or that the Sponsored Member would be unable to perform any of its material contracts, obligations or agreements in the same manner as required by Section 1 of Rule 20 (Insolvency) for other Members. For purposes of Section 13 of proposed Rule 2C, a Sponsoring Member shall be deemed to have knowledge that a Sponsored Member is insolvent or would be unable to perform on any of its material contracts, obligations or agreements if one or more duly authorized representatives of the Sponsoring Member, in its capacity as such, has knowledge of such matters. A Sponsored Member shall be treated by NSCC in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where NSCC treats a Sponsored Member as insolvent.

Section 13(b) of proposed Rule 2C would provide that in the event that NSCC determines to treat a Sponsored Member as insolvent pursuant to Rule 20 (Insolvency), NSCC shall have the right to cease to act for the insolvent Sponsored Member pursuant to Section 11 of the proposed Rule 2C. If NSCC ceases to act for the insolvent Sponsored Member, Section 14 of proposed Rule 56 shall apply with respect to the close-out of the insolvent Sponsored Member's Sponsored Member Transactions.

*Proposed Rule 2C, Section 14 (Liquidation of Sponsored Member and Related Sponsoring Member Positions)*

Section 14 of proposed Rule 2C would provide a mechanism by which a Sponsoring Member may cause the termination and liquidation of a Sponsored Member's positions arising from Sponsored Member Transactions between the Sponsoring Member and its Sponsored Member that have been novated to NSCC. Specifically, in the event (i) the Sponsoring Member triggers the termination of a Sponsored Member's positions or (ii) NSCC ceases to act for the Sponsored Member and the Sponsoring Member does not continue to perform the obligations of the Sponsored Member, both the Sponsored Member's positions and the Sponsoring Member's corresponding positions arising from the Sponsored Member Transactions between the Sponsoring Member and the Sponsored Member would be terminated. Thereupon, the Sponsoring Member would calculate a net liquidation value of such terminated positions, which liquidation value would be paid either to or by the Sponsored Member by or to the Sponsoring Member. NSCC would not, as a practical matter, be involved in such settlement and would not need to take any market action because the termination of the Sponsored Member's positions and the corresponding Sponsoring Member's positions would leave NSCC flat. Additionally, the

Sponsoring Member would indemnify NSCC for any claim by a Sponsored Member arising out of the Sponsoring Member's calculation of the net liquidation value.

Section 14(a) of proposed Rule 2C would specify the scope of positions to which Section 14 of proposed Rule 2C applies. It would state that Section 14 only applies with respect to the liquidation of positions resulting from Sponsored Member Transactions that have been novated to NSCC.

Section 14(a) of proposed Rule 2C would further state that such section would only apply if (i) a Sponsoring Member is a Defaulting Member and NSCC has not ceased to act for the Sponsoring Member and (ii) a Corporation Default has not occurred. This is because, as described above in Section 12(b) of proposed Rule 2C, NSCC would have discretion in the event it ceases to act for a Sponsoring Member to close-out the positions of Sponsored Members for which the defaulting Sponsoring Member was responsible or to allow them to settle. If NSCC does close-out such positions, it would do so in accordance with Section 14 of proposed Rule 56. If a Corporation Default has occurred with respect to NSCC, each Sponsored Member's positions would be closed out in accordance with Section 17 of proposed Rule 56.

Section 14(b) of proposed Rule 2C would set out the process by which a Sponsoring Member or NSCC may cause the termination of a Sponsored Member's positions. It would provide that on any Business Day, the Sponsoring Member or NSCC may cause such termination by delivering a notice to NSCC or the Sponsoring Member, respectively. NSCC anticipates that each Sponsored Member and Sponsoring Member would agree in the bilateral documentation between them as to what circumstances or events give rise to the ability of the Sponsoring Member to deliver a notice to NSCC terminating the Sponsored Member's positions.<sup>61</sup>

The notice submitted by a Sponsoring Member to NSCC (or vice versa) would cause the termination of all of the SFT Positions of the Sponsored Member established in the Sponsored Member Sub-Account. The notice would also cause the immediate termination of the corresponding SFT Positions of the Sponsoring Member established in the Sponsoring Member's proprietary SFT Account. The effect of such terminations would be to leave NSCC flat.

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<sup>61</sup> It bears noting in this regard that termination of the Sponsored Member's positions would not be the exclusive mechanism by which a Sponsoring Member may limit its credit risk. As described above, under Section 2(m) of proposed Rule 2C, a Sponsoring Member may voluntarily elect to terminate its status as a Sponsoring Member in respect of one or more Sponsored Members. Such a termination would not affect the settlement of the Sponsored Member's existing positions but would restrict the ability of the Sponsored Member to have its future trades accepted for novation by NSCC through such Sponsoring Member. The proposed rule change in Section 14(b) of proposed Rule 2C would not affect the functioning of the proposed rule change in Section 2(m) of proposed Rule 2C or the general ability of a Sponsoring Member and the Sponsored Member to agree on the circumstances of when the Sponsoring Member may terminate its status as Sponsoring Member for the Sponsored Member.

Section 14(b) of proposed Rule 2C would also provide that the termination of the Sponsored Member's positions (and the Sponsoring Member's corresponding positions) would be effected by the Sponsoring Member's establishment of a final net settlement position for each eligible security with a distinct CUSIP number ("Final Net Settlement Position").

Section 14(c) of proposed Rule 2C would specify how the Final Net Settlement Positions established pursuant to Section 14(b) of proposed Rule 2C would be liquidated (*i.e.*, how such positions would be converted into an amount payable). It would also provide how the amount payable arising from the liquidation of the Final Net Settlement Positions would be discharged.

Specifically, Section 14(c) of proposed Rule 2C would first provide that the Sponsoring Member would liquidate the Final Net Settlement Positions established pursuant to Section 14(b) of proposed Rule 2C by establishing (i) a single liquidation amount in respect of the Sponsored Member's Final Net Settlement Positions (a "Sponsored Member Liquidation Amount") and (ii) a single liquidation amount in respect of the Sponsoring Member's Final Net Settlement Positions (a "Sponsoring Member Liquidation Amount"). The Sponsored Member Liquidation Amount would be owed either by NSCC to the Sponsored Member or by the Sponsored Member to NSCC because it would relate to the Sponsored Member's Final Net Settlement Positions with NSCC, while the Sponsoring Member Liquidation Amount would be owed either by NSCC to the Sponsoring Member or by the Sponsoring Member to NSCC because it would relate to the Sponsoring Member's Final Net Settlement Positions with NSCC.

Because the Final Net Settlement Positions of the Sponsoring Member would be identical to, but in the opposite direction of, the Final Net Settlement Positions of the Sponsored Member, the Sponsored Member Liquidation Amount would equal the Sponsoring Member Liquidation Amount. Therefore, if NSCC were to owe the Sponsored Member Liquidation Amount to the Sponsored Member, the Sponsoring Member would owe the Sponsoring Member Liquidation Amount to NSCC. By the same token, if the Sponsored Member were to owe the Sponsored Member Liquidation Amount to NSCC, NSCC would owe the Sponsoring Member the Sponsoring Member Liquidation Amount. In all instances, NSCC would owe and be owed the same amount of money.

Section 14(c) of proposed Rule 2C would also provide how the Sponsoring Member may calculate the Sponsoring Member Liquidation Amount. It would state that the Sponsoring Member may calculate the Sponsoring Member Liquidation Amount based on prevailing market prices of the relevant securities and/or the gains realized and losses incurred by the Sponsoring Member in hedging its risk associated with the liquidation of the Sponsoring Member's Final Net Settlement Positions. Section 14(c) of proposed Rule 2C would further clarify that such Sponsoring Member Liquidation Amount may also take into account any losses and expenses incurred by the Sponsoring Member in connection with the liquidation of the positions.

Section 14(c) of proposed Rule 2C would further provide that, if a Sponsored Member Liquidation Amount is due to NSCC, the Sponsoring Member would be obligated to pay such Sponsored Member Liquidation Amount to NSCC under the Sponsoring Member Guaranty and that this obligation would, automatically and without further action, be set off against the obligation of NSCC to pay the corresponding Sponsoring Member Liquidation Amount to the Sponsoring Member. By virtue of such setoff, the Sponsored Member's obligation to NSCC

would be discharged, as would NSCC's obligation to the Sponsoring Member. The Sponsoring Member would, however, have a reimbursement claim against the Sponsored Member in an amount equal to the Sponsored Member Liquidation Amount. This reimbursement claim would arise as a matter of law by virtue of the Sponsoring Member's performance under Sponsoring Member Guaranty, though Sponsoring Members and Sponsored Members may specify terms related to the reimbursement claim in their bilateral submission. NSCC would have no rights or obligations in respect of any such reimbursement claim.

If a Sponsored Member Liquidation Amount were owed by NSCC to the Sponsored Member, Section 14(c) of proposed Rule 2C would provide for the Sponsoring Member to satisfy that obligation by transferring the Sponsored Member Liquidation Amount to the Sponsoring Member's account at its Settling Bank ("Sponsoring Member Settling Bank Omnibus Account"). Section 14(c) of proposed Rule 2C would state that, to the extent the Sponsoring Member makes such a transfer, it would discharge NSCC's obligation to transfer the Sponsored Member Liquidation Amount to the Sponsored Member and the Sponsoring Member's corresponding obligation to transfer the Sponsoring Member Liquidation Amount to NSCC.

Section 14(d) of proposed Rule 2C would provide for the Sponsoring Member to indemnify NSCC and its employees, officers, directors, shareholders, agents, and Members (collectively, the "Sponsoring/Sponsored Membership Program Indemnified Parties" or "SMP Indemnified Parties") for any and all losses, liability, or expenses arising from any claim by an affected Sponsored Member disputing the Sponsoring Member's calculation of any Sponsored Member Liquidation Amount or Sponsoring Member Liquidation Amount.

Section 14(e) of proposed Rule 2C would provide that NSCC acknowledges that a Sponsoring Member may take a security interest in NSCC's obligations to a Sponsored Member in respect of its transactions that have been novated to NSCC by such Sponsoring Member and established in the Sponsoring Member's Sponsored Member Sub-Account for the Sponsored Member. Such security interest would not impose new obligations on NSCC but could allow the Sponsoring Member to direct NSCC to submit payments due to the Sponsored Member to the Sponsoring Member, so that the Sponsoring Member can apply such amounts to the Sponsored Member's unsatisfied obligations to the Sponsoring Member.

## **(B) Proposed Rule 2D – Agent Clearing Members**

NSCC is proposing to add Rule 2D, entitled "Agent Clearing Members." This new rule would govern the proposed agent clearing membership and would be comprised of 12 sections, each of which is described below.

### *Proposed Rule 2D, Section 1 (General)*

Section 1 of proposed Rule 2D would be a general provision regarding the Rules applicable to Agent Clearing Members.

Section 1 of proposed Rule 2D would provide that NSCC will permit a Member that is approved to be an Agent Clearing Member to submit transactions to NSCC for novation on behalf of one or more of the Agent Clearing Member's Customers. Section 1 of proposed Rule

2D would further provide that the rights, liabilities and obligations of Agent Clearing Members shall be governed by proposed Rule 2D, and that references to the term “Member” in other Rules would not apply to Agent Clearing Members, in their respective capacities as such, unless specifically noted as such in proposed Rule 2D or in such other Rules.

Section 1 of proposed Rule 2D would also provide that an Agent Clearing Member shall continue to have all of the rights, liabilities and obligations as set forth in the Rules and in any agreement between it and NSCC pertaining to its status as a Member, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as an Agent Clearing Member except as contemplated under Sections 6, 7 and 8 of proposed Rule 2D.

*Proposed Rule 2D, Section 2 (Qualifications of Agent Clearing Members, the Application Process and Continuance Standards)*

Section 2 of proposed Rule 2D would establish the eligibility requirements for Members that wish to become Agent Clearing Members, the membership application process that would be required of each Member to become an Agent Clearing Member, the on-going membership requirements that would apply to Agent Clearing Members, as well as the requirements regarding an Agent Clearing Member’s election to voluntarily terminate its membership.

Under Section 2(a) of proposed Rule 2D, any Member would be eligible to apply to become an Agent Clearing Member; however, if a Member is a Registered Broker-Dealer, such Member would only be permitted to apply to become an Agent Clearing Member if it has (1) Net Worth of at least \$25 million and (2) excess net capital over the minimum net capital requirement imposed by the Commission (or such higher minimum capital requirement imposed by the Member’s designated examining authority) of at least \$10 million.<sup>62</sup> As proposed, NSCC may require that a Person be a Member for a certain time period before that Person may be considered to become an Agent Clearing Member.

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<sup>62</sup> NSCC is proposing these financial minimums for Registered Broker-Dealer Agent Clearing Member applicants to reflect the additional responsibility that the applicant would undertake as an Agent Clearing Member. These financial minimums are determined based on NSCC’s assessment of the minimum capital that would be necessary for a broker-dealer to conduct meaningful level of NSCC-cleared activity while serving as a credit counterparty in respect of others’ trades. In addition, NSCC is proposing these financial minimums for Registered Broker-Dealer Agent Clearing Member applicants to be consistent with proposed requirements applicable to Registered Broker-Dealer Sponsoring Member applicants. NSCC believes this approach to financial minimums is appropriate because both Sponsoring Members and Agent Clearing Members would be viewed and surveilled as the credit counterparties to NSCC in respect of the transactions that they submit for clearing in respect of Sponsoring Member Sub-Accounts and Agent Clearing Member Customer Omnibus Accounts, respectively. Although the model of clearing would differ as between Sponsoring Members and Agent Clearing Members, both would be types of Members that would be standing behind the credit of their clients. Accordingly, NSCC believes it is appropriate to use consistent financial minimums.



Section 2(b) of proposed Rule 2D would provide that each Member applicant to become an Agent Clearing Member would be required to provide an application and other information requested by NSCC. Agent Clearing Member applications shall first be reviewed by NSCC and would require the Board of Directors' approval, unless the Member applicant is already a Sponsoring Member under proposed Rule 2C or a sponsoring member of FICC. NSCC believes this approach to the Board of Directors' approval for Agent Clearing Members is appropriate in light of the fact that the critical components of the FICC sponsoring member applications as well as the NSCC Agent Clearing Member and Sponsoring Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar.

Under Section 2(c) of proposed Rule 2D, if the Agent Clearing Member application is denied, such denial would be handled in accordance with Section 1 of Rule 2A (Initial Membership Requirements).

As proposed in Section 2(d) of proposed Rule 2D, NSCC may impose additional financial requirements on an Agent Clearing Member applicant based upon the level of the anticipated positions and obligations of such applicant, the anticipated risk associated with the volume and types of transaction such applicant proposes to process through NSCC as an Agent Clearing Member and the overall financial condition of such applicant. Under the proposal, with respect to an application of a Member to become an Agent Clearing Member that requires the Board of Directors' approval, the Board of Directors shall also approve any increased financial requirements imposed by NSCC in connection with the approval of the application, and NSCC would thereafter regularly review such Agent Clearing Member regarding its compliance with the increased financial requirements.<sup>63</sup>

In addition, under Section 2(e) of proposed Rule 2D, NSCC may require each Agent Clearing Member or any Agent Clearing Member applicant to furnish adequate assurances of such Agent Clearing Member or Agent Clearing Member applicant's financial responsibility and operational capability within the meaning of Rule 15 (Assurances of Financial Responsibility and Operational Capability), as NSCC may at any time or from time to time deem necessary or advisable in order to protect NSCC, its participants, creditors or investors, to safeguard securities

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<sup>63</sup> If the increased financial requirements are imposed in connection with an Agent Clearing Member application that does not require the Board of Directors' approval, the increased financial requirements would not be subject to the Board of Directors' approval. Nonetheless, once an Agent Clearing Member application is approved with increased financial requirements, NSCC would thereafter regularly review such Agent Clearing Member regarding its continued adherence to such increased financial requirements as well as determine whether such increased financial requirements are still appropriate. If the Agent Clearing Member is unable to adhere to the increased financial requirements, the Board of Directors may, pursuant to Section 9 of proposed Rule 2D, suspend, prohibit or limit the Agent Clearing Member's access to NSCC's services.

and funds in the custody or control of NSCC and for which NSCC is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions.<sup>64</sup>

Section 2(f) of proposed Rule 2D would provide that each Member whose Agent Clearing Member application is approved would sign and deliver to NSCC an agreement between NSCC and the Member and specifies the terms and conditions deemed by NSCC to be necessary in order to protect itself and its participants (“Agent Clearing Member Agreement”) and a related legal opinion in a form satisfactory to NSCC.

Section 2(g) of proposed Rule 2D would provide that each Agent Clearing Member shall submit to NSCC, within the timeframes and in the formats required by NSCC, the reports and information that all Members are required to submit regardless of type of Member and the reports and information required to be submitted for its respective type of Member, all pursuant to Section 2 of Rule 2B (Ongoing Membership Requirements and Monitoring) and, if applicable, Addendum O (Admission of Non-US Entities as Direct NSCC Members).

Section 2(h) of proposed Rule 2D would provide that an Agent Clearing Member’s books and records, insofar as they relate to the Agent Clearing Member Transactions submitted to NSCC, shall be open to the inspection of the duly authorized representatives of NSCC to the same extent provided in Rule 2A (Initial Membership Requirements) for other Members.

Section 2(i) of proposed Rule 2D would provide that an Agent Clearing Member shall promptly inform NSCC, both orally and in writing, if it is no longer in compliance with the relevant standards and qualifications for applying to become an Agent Clearing Member set forth in the proposed Rule 2D. Notification must take place immediately and in no event later than 2 Business Days from the date on which the Agent Clearing Member first learns of its non-compliance. As proposed, NSCC would assess a fine in accordance with the Fine Schedule in Addendum P against any Agent Clearing Member that fails to so notify NSCC.<sup>65</sup> If the Agent Clearing Member fails to remain in compliance with the relevant standards and qualifications, NSCC would, if necessary, undertake appropriate action to determine the status of the Agent Clearing Member and its continued eligibility as such. In addition, NSCC may review the financial responsibility and operational capability of the Agent Clearing Member, and otherwise require from the Agent Clearing Member additional reports of its financial or operational condition at such intervals and in such detail as NSCC shall determine. In addition, if NSCC has reason to believe that an Agent Clearing Member may fail to comply with any of the Rules applicable to Agent Clearing Members, it may require the Agent Clearing Member to provide it, within such timeframe, and in such detail, and pursuant to such manner as NSCC shall

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<sup>64</sup> As an example, NSCC may require an Agent Clearing Member or an Agent Clearing Member applicant to furnish adequate assurances of such Agent Clearing Member or Agent Clearing Member applicant’s financial responsibility and operational capability if NSCC has concerns about such Agent Clearing Member or Agent Clearing Member applicant’s overall financial health or credit rating.

<sup>65</sup> See Addendum P (Fine Schedule), supra note 1.

determine, with assurances in writing of a credible nature that the Agent Clearing Member shall not, in fact, violate any of the Rules.

Section 2(j) of proposed Rule 2D would provide that in the event that an Agent Clearing Member fails to remain in compliance with the relevant requirements of the Rules or the Agent Clearing Member Agreement, NSCC shall have the right to cease to act for the Agent Clearing Member in its capacity as an Agent Clearing Member in accordance with Section 9 of proposed Rule 2D or as a Member more generally, unless the Agent Clearing Member requests that such action not be taken and NSCC determines that, depending upon the specific circumstances and the record of the Agent Clearing Member, it is appropriate instead to establish for such Agent Clearing Member a time period, which shall be determined by NSCC and which shall be no longer than 30 calendar days unless otherwise determined by NSCC, during which the Agent Clearing Member must resume compliance with such requirements. As proposed, in the event that the Agent Clearing Member is unable to satisfy such requirements within the time period specified by NSCC, NSCC shall, pursuant to the Rules, cease to act for the Agent Clearing Member in its capacity as an Agent Clearing Member pursuant to Section 9 of the proposed Rule 2D or as a Member more generally.

Section 2(k) of proposed Rule 2D would provide that if the sum of the Volatility Charges applicable to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account(s) and its other accounts at NSCC exceeds its Net Member Capital, the Agent Clearing Member shall not be permitted to submit activity into its Agent Clearing Member Customer Omnibus Account(s), unless otherwise determined by NSCC in order to promote orderly settlement.<sup>66</sup> As proposed, an "Agent Clearing Member Customer Omnibus Account" would mean a ledger maintained on the books and records of NSCC that reflects the outstanding Agent Clearing Member Transactions that an Agent Clearing Member enters into on behalf of Customers and that have been novated to NSCC, the SFT Positions or SFT Cash associated with those transactions, and any debits or credits of cash associated with such transactions effected pursuant to Rule 12 (Settlement).

Section 2(l) of proposed Rule 2D would provide that an Agent Clearing Member may voluntarily elect to terminate its status as an Agent Clearing Member by providing NSCC with a written notice from an Agent Clearing Member to NSCC that the Agent Clearing Member is voluntarily electing to terminate its status as an Agent Clearing Member ("Agent Clearing Member Voluntary Termination Notice"). The Agent Clearing Member shall specify in the Agent Clearing Member Voluntary Termination Notice a desired date for such termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation

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<sup>66</sup> NSCC selected the Volatility Charges and Net Member Capital as the criteria for purposes of establishing the activity limit for Agent Clearing Members. This is because an Agent Clearing Member's total Volatility Charges being in excess of its Net Member Capital is an important indicator that the Agent Clearing Member's financial resources, as measured by its Net Capital, net assets or equity capital, may be insufficient to meet the largest component of its Required Fund Deposit (i.e., Volatility Charges).

owed by the Agent Clearing Member to NSCC as of the time such Agent Clearing Member Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC.

Section 2(l) of proposed Rule 2D would also provide that such termination would not be effective until accepted by NSCC, which shall be no later than 10 Business Days after the receipt of the Agent Clearing Member Voluntary Termination Notice from such Agent Clearing Member. NSCC's acceptance shall be evidenced by a notice to NSCC's participants announcing the termination of the Agent Clearing Member's status as such and the date on which the termination of the Agent Clearing Member's status as an Agent Clearing Member becomes effective ("Agent Clearing Member Termination Date"). As proposed, after the close of business on the Agent Clearing Member Termination Date, the Agent Clearing Member shall no longer be eligible to submit Agent Clearing Member Transactions. If any Agent Clearing Member Transaction is submitted to NSCC by the Agent Clearing Member that is scheduled to settle after the Agent Clearing Member Termination Date, such Agent Clearing Member's Agent Clearing Member Voluntary Termination Notice would be deemed void, and the Agent Clearing Member would remain subject to the proposed Rule 2D as if it had not given such Agent Clearing Member Voluntary Termination Notice.

Section 2(m) of proposed Rule 2D would provide that an Agent Clearing Member's voluntary termination of its status as such shall not affect its obligations to NSCC, or the rights of NSCC, with respect to Agent Clearing Member Transactions submitted to NSCC before the applicable Agent Clearing Member Termination Date. Any such Agent Clearing Member Transactions that have been novated to NSCC shall continue to be processed by NSCC. The return of the Agent Clearing Member's Clearing Fund deposit shall be governed by Section 7 of Rule 4 (Clearing Fund). If an Event Period were to occur after an Agent Clearing Member has submitted the Agent Clearing Member Voluntary Termination Notice but on or prior to the Agent Clearing Member Termination Date, in order for the Agent Clearing Member to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the Agent Clearing Member would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Agent Clearing Member Voluntary Termination Notice previously submitted by the Agent Clearing Member.

Section 2(n) of proposed Rule 2D would provide that any non-public information furnished to NSCC pursuant to proposed Rule 2D shall be held in confidence as may be required under the laws, rules and regulations applicable to NSCC that relate to the confidentiality of records. Section 2(n) would also provide that each Agent Clearing Member shall maintain DTCC Confidential Information in confidence to the same extent and using the same means it uses to protect its own confidential information, but no less than a reasonable standard of care, and shall not use DTCC Confidential Information or disclose DTCC Confidential Information to any third party except as necessary to perform such Agent Clearing Member's obligations under the Rules or as otherwise required by applicable law. Section 2(n) would further provide that each Agent Clearing Member acknowledges that a breach of its confidentiality obligations under the Rules may result in serious and irreparable harm to NSCC and/or DTCC for which there is no adequate remedy at law. In addition, Section 2(n) would provide that in the event of such a breach by the Agent Clearing Member, NSCC and/or DTCC shall be entitled to seek any

temporary or permanent injunctive or other equitable relief in addition to any monetary damages thereunder.<sup>67</sup>

*Proposed Rule 2D, Section 3 (Compliance with Laws)*

Section 3 of proposed Rule 2D would provide that each Agent Clearing Member shall comply in all material respects with all applicable laws, including applicable laws relating to securities, taxation and money laundering, as well as global sanctions laws, in connection with the use of NSCC's services.

*Proposed Rule 2D, Section 4 (Agent Clearing Member Transactions)*

Section 4 of proposed Rule 2D would provide that an Agent Clearing Member shall be permitted to submit to NSCC on behalf of one or more Customers' Securities Financing Transactions ("Agent Clearing Member Transactions") in accordance with proposed Rule 56, as described below.

*Proposed Rule 2D, Section 5 (Agent Clearing Member Agent Obligations)*

Section 5 of proposed Rule 2D would establish rules-based obligations for Agent Clearing Members and the establishment of Agent Clearing Member Customer Omnibus Accounts.

Section 5(a) of proposed Rule 2D would provide that an Agent Clearing Member shall be permitted to submit to NSCC for novation Agent Clearing Member Transactions entered into by the Agent Clearing Member as agent on behalf of one or more Customers. Any such submission shall be in accordance with proposed Rule 2D. As proposed, subject to the provisions of the Rules, an Agent Clearing Member's clearing of Agent Clearing Member Transactions for Customers ("Customer Clearing Service") may be provided by an Agent Clearing Member to its Customers on any terms and conditions mutually agreed to by the Agent Clearing Member and its Customers; provided, that each Agent Clearing Member shall, before providing Customer Clearing Service to any Customer, enter into an agreement with that Customer that binds the Customer to the provisions of the Rules applicable to Agent Clearing Member Transactions and Customers.

Section 5(b) of proposed Rule 2D would provide that, with respect to an Agent Clearing Member that submits Agent Clearing Member Transactions to NSCC for novation on behalf of its Customers, NSCC shall maintain one or more Agent Clearing Member Customer Omnibus Accounts in the name of the Agent Clearing Member for the benefit of its Customers. Each Agent Clearing Member Customer Omnibus Account would be permitted to contain only (i) SFTs entered into by the Agent Clearing Member, on behalf of a Customer, as Transferor or (ii) SFTs entered into by the Agent Clearing Member, on behalf of a Customer, as a Transferee. An Agent Clearing Member would not be permitted to combine SFTs entered into as Transferee

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<sup>67</sup> Section 2(n) of proposed Rule 2D is designed to be consistent with provisions in the Rules relating to the confidentiality of information furnished by participants. See Rule 2A (Initial Membership Requirements), supra note 1.

and Transferor in the same Agent Clearing Member Customer Omnibus Account. This is designed to ensure that NSCC's volatility-based Clearing Fund deposit requirements represent the sum of each individual Customer's activity (i.e., that the positions are margined on a gross basis).<sup>68</sup>

Section 5(c) of proposed Rule 2D would provide that an Agent Clearing Member shall act solely as agent of its Customers in connection with the clearing of Agent Clearing Member Transactions; provided that the Agent Clearing Member shall remain fully liable for the performance of all obligations to NSCC arising in connection with Agent Clearing Member Transactions; and provided further, that the liabilities and obligations of NSCC with respect to Agent Clearing Member Transactions entered into by the Agent Clearing Member shall extend only to the Agent Clearing Member. Section 5(c) of proposed Rule 2D would further provide that, without limiting the generality of the foregoing, NSCC shall not have any liability or obligation arising out of or with respect to any Agent Clearing Member Transaction to any Customer on behalf of whom an Agent Clearing Member entered into the Agent Clearing Member Transaction.

Section 5(d) of proposed Rule 2D would provide that nothing in the Rules shall prohibit an Agent Clearing Member from seeking reimbursement from a Customer for payments made by the Agent Clearing Member (whether out of Clearing Fund deposits or otherwise) under the Rules, or as otherwise may be agreed between the Agent Clearing Member and the Customer.

*Proposed Rule 2D, Section 6 (Clearing Fund Obligations)*

Section 6 of proposed Rule 2D would set forth the Clearing Fund obligations.

Section 6(a) of proposed Rule 2D would provide that NSCC shall maintain one or more Agent Clearing Member Customer Omnibus Accounts for an Agent Clearing Member. Each Agent Clearing Member shall make and maintain so long as such Member is an Agent Clearing Member a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in its Agent Clearing Member Customer Omnibus Account(s) (the "Agent Clearing Member Required Fund Deposit"). Each Agent Clearing Member, so long as such Member is an Agent Clearing Member, shall also provide SLD to the Clearing Fund, as may be required pursuant to Rule 4A (Supplemental Liquidity Deposits), to support the activity in its Agent Clearing Member Customer Omnibus Account(s). Deposits to the Clearing Fund would be held by NSCC or its designated agents, to be applied as provided in the Rules.

Section 6(b) of proposed Rule 2D would provide that, in the ordinary course, for purposes of satisfying the Agent Clearing Member's Clearing Fund requirements under the Rules for its Member activity, its Agent Clearing Member activity, and, to the extent applicable, its

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<sup>68</sup> If an Agent Clearing Member were permitted to maintain SFTs entered into as both Transferee and Transferor in the same Agent Clearing Member Customer Omnibus Account, the Required Fund Deposit obligations of the Agent Clearing Member could potentially be reduced by offsetting SFT Positions of different Customers in the same SFT Security.

Sponsoring Member activity, the Agent Clearing Member's proprietary accounts, its Agent Clearing Member Customer Omnibus Account(s), and its Sponsored Member Sub-Accounts, if any, shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time and without prior notice to the Agent Clearing Member (but being obligated to give notice to the Agent Clearing Member as soon as possible thereafter) and whether or not the Agent Clearing Member is in default of its obligations to NSCC, treat the Agent Clearing Member's accounts as a single account for the purpose of applying Clearing Fund deposits; apply Clearing Fund deposits made by the Agent Clearing Member with respect to any account as necessary to ensure that the Agent Clearing Member meets all of its obligations to NSCC under any other account(s); and otherwise exercise all rights to offset and net against the Clearing Fund deposits any net obligations among any or all of the accounts, whether or not any other Person is deemed to have any interest in such account.<sup>69</sup>

Section 6(c) of proposed Rule 2D would provide that the Agent Clearing Member Required Fund Deposit for each Agent Clearing Member Customer Omnibus Account shall be calculated separately based on the Agent Clearing Member Transactions in such Agent Clearing Member Customer Omnibus Account, and the Agent Clearing Member shall, as principal, be required to satisfy the Agent Clearing Member Required Fund Deposit for each of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts.

Section 6(d) of proposed Rule 2D would provide that Sections 1, 2, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of Rule 4 (Clearing Fund) shall apply to the Agent Clearing Member Required Fund Deposit with respect to obligations of an Agent Clearing Member under the Rules, including its obligations arising under the Agent Clearing Member Customer Omnibus Account(s), to the same extent as such sections apply to any Required Fund Deposit and any other obligations of a Member. For purposes of Section 1 of Rule 4, obligations and liabilities of a Member to NSCC that shall be secured shall include, without limitation, a Member's obligations as an Agent Clearing Member under the Rules, including, without limitation, any obligation of any such Agent Clearing Member to provide the Agent Clearing Member Required Fund Deposit and such Agent Clearing Member's obligations arising under SFTs established in the Agent Clearing Member Customer Omnibus Accounts of such Agent Clearing Member.

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<sup>69</sup> NSCC believes this is appropriate because the Clearing Fund deposits of an Agent Clearing Member are the proprietary assets of the Agent Clearing Member and NSCC generally has the right to apply the Clearing Fund deposits of a Member to any of the Member's obligations to NSCC, regardless of whether those were the obligations that generated the Clearing Fund deposit requirement. NSCC therefore believes that, consistent with the FICC Sponsoring Member/Sponsored Member Program for the reasons described above in Item 10(iii) "Sponsoring Members and Sponsored Members," an Agent Clearing Member's Clearing Fund deposits should be available to satisfy any of the Agent Clearing Member's obligations to NSCC.

Section 6(e) of proposed Rule 2D would provide that an Agent Clearing Member shall be subject to such fines as may be imposed in accordance with the Rules for any late satisfaction of a Clearing Fund deficiency call.

Proposed Rule 2D, Section 7 (Right of Offset)

Section 7 of proposed Rule 2D would provide that in the ordinary course, with respect to satisfaction of any Agent Clearing Member's obligations under the Rules, the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts, the Agent Clearing Member's proprietary accounts, and the Agent Clearing Member's Sponsored Member Sub-Accounts, if any, at NSCC shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time any obligation of the Agent Clearing Member arises in respect of any Agent Clearing Member Customer Omnibus Account, exercise a right of offset and net any such obligation against any obligations of NSCC to the Agent Clearing Member in respect of such Agent Clearing Member's proprietary accounts at NSCC.

Proposed Rule 2D, Section 8 (Loss Allocation Obligations)

Section 8 of proposed Rule 2D would establish loss allocation obligations for Agent Clearing Members.

Section 8(a) of proposed Rule 2D would provide that, to the extent NSCC incurs a loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event and a loss allocation obligation arises, that would be the responsibility of the Agent Clearing Member Customer Omnibus Account as if the Agent Clearing Member Customer Omnibus Account were a Member, NSCC shall calculate such loss allocation obligation and the Agent Clearing Member shall be, as principal, responsible for satisfying such obligations.

Section 8(b) of proposed Rule 2D would provide that the entire amount of the Required Fund Deposit associated with the Agent Clearing Member's proprietary accounts at NSCC and the entire amount of the Agent Clearing Member Required Fund Deposit may be used to satisfy any amount allocated against an Agent Clearing Member, whether in its capacity as a Member, an Agent Clearing Member, or otherwise. With respect to an obligation to make payment due to any loss allocation amounts assessed on an Agent Clearing Member pursuant to Section 8(a) of proposed Rule 2D, the Agent Clearing Member may instead elect to terminate its membership in NSCC pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Agent Clearing Member, its Required Fund Deposit shall be the sum of its Required Fund Deposits associated with its proprietary accounts at NSCC (including its proprietary SFT Account pursuant to proposed Rule 56), its Agent Clearing Member Required Fund Deposit for each of its Agent Clearing Member Customer Omnibus Accounts, and its Sponsoring Member Required Fund Deposit, if any.

Proposed Rule 2D, Section 9 (Restrictions on Access to Services by an Agent Clearing Member)

Section 9 of proposed Rule 2D would establish the rights of NSCC to restrict an Agent Clearing Member's access to NSCC's services.



Section 9(a) of proposed Rule 2D would provide that the Board of Directors may at any time upon NSCC providing notice to an Agent Clearing Member pursuant to Section 5 of Rule 45 (Notices), suspend an Agent Clearing Member in its capacity as an Agent Clearing Member from any service provided by NSCC either with respect to a particular transaction or transactions or with respect to transactions generally, or prohibit or limit such Agent Clearing Member's access to services offered by NSCC in the event that one or more of the factors set forth in Section 1 of Rule 46 (Restrictions on Access to Services) is present with respect to the Agent Clearing Member.

Section 9(b) of proposed Rule 2D would provide that Rule 46 shall apply with respect to an Agent Clearing Member in the same way as it applies to Members, including the Board of Directors' right to summarily suspend the Agent Clearing Member and to cease to act for such Agent Clearing Member. As under Rule 46, the Board of Directors would need to make the determination of whether to suspend, prohibit or limit an Agent Clearing Member's access to services offered by NSCC on the basis of the factors set forth in that rule.

Section 9(c) of proposed Rule 2D would provide that if NSCC ceases to act for an Agent Clearing Member in its capacity as an Agent Clearing Member, Section 14 of proposed Rule 56 shall apply and NSCC shall decline to accept or process data from the Agent Clearing Member on Agent Clearing Member Transactions and close-out any Agent Clearing Member Transactions that have been novated to NSCC. Section 9(c) would also provide that if NSCC suspends, prohibits or limits an Agent Clearing Member in its capacity as an Agent Clearing Member with respect to such Agent Clearing Member's access to services offered by NSCC, NSCC shall decline to accept or process data from the Agent Clearing Member on Agent Clearing Member Transactions for so long as NSCC is suspending, prohibiting or limiting the Agent Clearing Member. Furthermore, Section 9(c) would state that, in addition, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC.

This is different from how NSCC would treat Sponsored Member Transactions of a Sponsoring Member under Section 10 of proposed Rule 2C if NSCC ceases to act for the Sponsoring Member. With respect to such transactions, NSCC would have the option to either terminate or settle a Sponsored Member's positions after ceasing to act for the Sponsoring Member. The reason for this difference is that NSCC would have the practical and legal capability to make such an election because each Sponsored Member would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customer's novated positions.

*Proposed Rule 2D, Section 10 (Insolvency of an Agent Clearing Member)*

Section 10(a) of proposed Rule 2D would provide that an Agent Clearing Member shall be obligated to immediately notify NSCC that (a) it fails, or is unable, to perform its contracts or

obligations or (b) it is insolvent as required by Section 1 of Rule 20 (Insolvency) for other Members. An Agent Clearing Member shall be treated by NSCC in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where NSCC treats an Agent Clearing Member as insolvent.

Section 10(b) of proposed Rule 2D would provide that in the event that NSCC determines to treat an Agent Clearing Member as insolvent pursuant to Rule 20 (Insolvency), NSCC shall have the right to cease to act for the insolvent Agent Clearing Member pursuant to Section 9 of proposed Rule 2D. If NSCC ceases to act for the insolvent Agent Clearing Member, NSCC shall decline to accept or process data from the Agent Clearing Member, including Agent Clearing Member Transactions. As proposed, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC.

This is different from how NSCC would treat Sponsored Member Transactions. As described above, NSCC would have the option to either terminate or settle a Sponsored Member's novated positions after ceasing to act for the Sponsoring Member. However, with respect to Agent Clearing Member Transactions, NSCC would close-out any such transactions which have been novated to NSCC. This is because NSCC would have the practical and legal capability to make such an election with respect to Sponsored Member Transactions because each Sponsored Member would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customers' novated positions.

*Proposed Rule 2D, Section 11 (Transfer of Agent Clearing Member Transactions in Agent Clearing Member Customer Omnibus Accounts)*

Section 11 of proposed Rule 2D would (i) permit an Agent Clearing Member, upon a default of a Customer and consent of NSCC, to transfer Agent Clearing Member Transactions of the Customer established in one or more of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts from such Agent Clearing Member Customer Omnibus Accounts to the Agent Clearing Member's proprietary account at NSCC as a Member and (ii) govern how the transfer would be effectuated.

Section 11(a) of proposed Rule 2D would clarify the scope to which Section 11 of proposed Rule 2D applies. It would state that Section 11 would not apply if either (i) the relevant Agent Clearing Member is a Defaulting Member or (ii) a Corporation Default has occurred. This is because, as described above with respect to Section 10(b) of proposed Rule 2D, NSCC would close-out all Agent Clearing Member Transactions for which the defaulting Agent Clearing Member was responsible. If a Corporation Default has occurred with respect to

NSCC, each Agent Clearing Member's positions would be closed out in accordance with Section 17 of proposed Rule 56.

Section 11(b) of proposed Rule 2D would set out the process by which an Agent Clearing Member may transfer the Agent Clearing Member Transactions of a defaulting Customer in one or more of Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts. It would provide that, to the extent permitted under applicable laws and regulations, an Agent Clearing Member may, upon a default of a Customer and the consent of NSCC, transfer the Agent Clearing Member Transactions of the Customer established in one or more of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts from such Agent Clearing Member Customer Omnibus Accounts to the Agent Clearing Member's proprietary account at NSCC as a Member. As proposed, any such transfer shall occur by novation, such that the obligations between NSCC and the relevant Customer in respect of the Agent Clearing Member Transactions shall be terminated and replaced with identical obligations between NSCC and the Agent Clearing Member, acting as principal. Section 11(b) would also provide the Agent Clearing Member shall indemnify NSCC, and its employees, officers, directors, shareholders, agents, and Members, for any and all losses, liability, or expenses incurred by them arising from, or in relation to, any such transfer.

*Proposed Rule 2D, Section 12 (Customer Acknowledgments)*

Section 12 of proposed Rule 2D would provide that each Agent Clearing Member on behalf of each of its Customers agrees that such Customer, by participating in and entering into Agent Clearing Member Transactions through the Agent Clearing Member, understands, acknowledges, and agrees that: (a) the service provided by NSCC with regard to the Customer Clearing Service would be subject to and governed by the Rules; (b) the Rules shall govern the novation of Agent Clearing Member Transactions and all transactions between the Customer and its Agent Clearing Member resulting in the novation of such transactions, and at the time of novation of an Agent Clearing Member Transaction, the Customer on whose behalf it was submitted would be bound by the Agent Clearing Member Transaction automatically and without any further action by the Customer or by its Agent Clearing Member, and the Customer agrees to be bound by the applicable provisions of the Rules in all respects; (c) NSCC shall be under no obligation to deal directly with the Customer, and NSCC may deal exclusively with the Customer's Agent Clearing Member; (d) NSCC shall have no obligations to the Customer with respect to any Agent Clearing Member Transactions submitted by an Agent Clearing Member on behalf of the Customer, including with respect to any payment or delivery obligations; and (e) the Customer shall have no right to receive from NSCC, or any right to assert a claim against NSCC with respect to, nor shall NSCC be liable to the Customer for, any payment or delivery obligation in connection with any Agent Clearing Member Transactions submitted by an Agent Clearing Member on behalf of the Customer, and NSCC shall make any such payments or redeliveries solely to the relevant Agent Clearing Member.

**(C) Proposed Rule 56 – Securities Financing Transaction Clearing Service**

NSCC is proposing to add Rule 56, entitled “Securities Financing Transaction Clearing Service.” This new rule would govern the proposed SFT Clearing Service and would be comprised of 18 sections, each of which is described below.

In connection with the proposed SFT Clearing Service, NSCC is proposing to add the following terms and definitions, as described below.

The term “Aggregate Net SFT Close-out Value” would mean, with respect to an SFT Member, the sum of the SFT Close-out Value (as defined below and in the proposed rule change) for each SFT Position to which the SFT Member is a party.

The term “Approved SFT Submitter” would mean a provider of transaction data on an SFT that the parties to the SFT have selected and NSCC has approved, subject to such terms and conditions as to which the Approved SFT Submitter and NSCC may agree.

The term “Bilaterally Initiated SFT” would mean an SFT, the Initial Settlement of which occurred prior to the submission of such SFT to NSCC.

The term “Buy-In Amount” would mean a net amount equal to (x) the Buy-In Costs or Deemed Buy-In Costs (as defined below and in the proposed rule change) of the SFT Securities (as defined below and in the proposed rule change) in respect of which a Transferor has effected a Buy-In, less (y) the amount of the SFT Cash for the relevant SFT (unless the Transferor effected a Buy-In in respect of some, but not all, of the SFT Securities that are the subject of the SFT, in which case (y) shall be the amount of the Corresponding SFT Cash (as defined below and in the proposed rule change)).

The term “Contract Price” would mean, with respect to SFT Securities subject to an SFT, the price of such securities at the time the SFT is submitted to NSCC for novation, which price shall be determined by the SFT Member parties to the relevant SFT and provided by an Approved SFT Submitter to NSCC in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose; provided that if no such price is provided by the time required by NSCC, the “Contract Price” shall be the Current Market Price of the SFT Securities.

The term “Corresponding SFT Cash” would mean (a) in respect of a Recalled SFT (as defined below and in the proposed rule change) for which a Transferor has effected a Buy-In in respect of some, but not all, of the SFT Securities that are the subject of the SFT, the portion of the SFT Cash for such SFT equal to the product of (i) the percentage of the SFT Securities in respect of which the Transferor effected a Buy-In and (ii) the SFT Cash of the SFT; and (b) in respect of a Settling SFT which has a greater quantity of SFT Securities as its subject than the corresponding Linked SFT, the portion of the SFT Cash of the Settling SFT equal to the product of (i) the percentage of the SFT Securities of the Settling SFT that the Linked SFT has as its subject and (ii) the SFT Cash of the Settling SFT.

The term “Deemed Buy-In Costs” would mean the product of the number of SFT Securities subject to the relevant Buy-In and the per-share price therefor on the date of the Buy-In obtained from a generally recognized source or the last bid quotation from such a source at the most recent close of trading for the SFT Security.

The term “Defaulting SFT Member” would mean an SFT Member for which NSCC has ceased to act in accordance with Section 14 of proposed Rule 56, as described below.

The term “Distribution” would mean, with respect to any SFT Security at any time, any cash payment of amounts equivalent to dividends and other distributions on the SFT Security.

The term “Distribution Amount” would mean, in respect of an SFT, an amount of cash equal to the product of: (a) the amount per security in respect of (x) a cash dividend on the SFT Securities that are the subject of the SFT or (y) an exchange of the SFT Securities that are the subject of the SFT for cash; and (b) the number of the relevant SFT Securities subject to the SFT.

The term “Distribution Payment” would mean an amount payable by one party to an SFT to the other party to the SFT during the term of the SFT in respect of a Distribution on the SFT Securities subject to the SFT.

The term “Existing Master Agreement” would mean, in respect of an SFT, a written agreement that (i) exists at the time transaction data for the SFT is submitted to NSCC by an Approved SFT Submitter, (ii) provides for, among other things, terms governing the payment and delivery obligations of the parties and (iii) the parties have established (by written agreement, oral agreement, course of conduct or otherwise) would govern such SFT.

The term “Final Settlement” would mean the exchange of SFT Securities for SFT Cash described in clause (b) of the proposed definition of Securities Financing Transaction.

The term “Final Settlement Date” would mean the Business Day on which the final settlement of a transaction is scheduled to occur. If the transaction is an SFT, the Final Settlement Date means the Business Day on which the Final Settlement of the SFT is scheduled to occur in accordance with proposed Rule 56 or, if the SFT is accelerated in accordance with proposed Rule 56, the date to which the Final Settlement obligations have been accelerated.

The term “Incremental Additional Independent Amount SFT Cash” would mean, (a) in respect of a Linked SFT, the excess, if any, of the Independent Amount SFT Cash of the Linked SFT over the Independent Amount SFT Cash of the Settling SFT; (b) in respect of a Non-Returned SFT, the portion of the Price Differential payable by the Transferee, if any, that is attributable to the Independent Amount SFT Cash of the SFT (which shall be calculated by multiplying such Priced Differential by the excess, if any, of the Independent Amount Percentage (as defined below and in the proposed rule change) over 100%); and (c) in respect of any other SFT, the Independent Amount SFT Cash of such SFT.

The term “Independent Amount Percentage” would mean, in respect of an SFT, a percentage obtained by dividing the SFT Cash of such SFT by the Market Value SFT Cash (as defined below and in the proposed rule change) of such SFT.

The term “Independent Amount SFT Cash” would mean the portion, if any, of the SFT Cash for an SFT equal to the amount by which the SFT Cash for such SFT at the time of the Initial Settlement exceeds the Contract Price of the SFT Securities that are the subject of such SFT.

The term “Ineligibility Date” would mean, with respect to an SFT, the date on which the SFT Security that is the subject of the SFT becomes an Ineligible SFT Security (as defined below and in the proposed rule change).

The term “Ineligible SFT” would mean an SFT that has, as its subject, SFT Securities that have become Ineligible SFT Securities.

The term “Ineligible SFT Security” would mean an SFT Security that is not eligible to be the subject of a novated SFT.

The term “Initial Settlement” would mean the exchange of SFT Securities for SFT Cash described in clause (a) of the proposed definition of Securities Financing Transaction.

The term “Linked SFT” would mean an SFT entered into by the pre-novation SFT Member parties to a Settling SFT that has the same Transferor, Transferee and subject SFT Securities (including CUSIP) as the Settling SFT. As proposed, a Linked SFT would include an SFT that has as its subject fewer SFT Securities than the corresponding Settling SFT but would not include an SFT that has as its subject more SFT Securities than the corresponding Settling SFT.

The term “Market Value SFT Cash” would mean the portion of the SFT Cash for an SFT equal to the amount of the SFT Cash for such SFT minus the Independent Amount SFT Cash of such SFT.

The term “Price Differential” would mean (a) for purposes of the discharge of offsetting Final Settlement and Initial Settlement obligations, (i) the SFT Cash for the Settling SFT (or if the Settling SFT has a greater quantity of SFT Securities as its subject than the corresponding Linked SFT, the Corresponding SFT Cash) minus (ii) the SFT Cash for the Linked SFT; and (b) for all other purposes, (i) the SFT Cash for the SFT minus (ii) the product of the Independent Amount Percentage, if any, and the Current Market Price of the SFT Securities.

The term “Rate Payment” would mean an amount payable from one party to an SFT to the other party to the SFT at the Final Settlement expressed as a percentage of the amount of SFT Cash for the SFT. As an example, if the Rate Payment is specified as 0.02%, the amount payable would be the product 0.02% and the SFT Cash for the SFT.

The term “Recall Date” would mean, in respect of a Recall Notice, the second Business Day following NSCC’s receipt of such Recall Notice.

The term “Recall Notice” would mean a notice that triggers the provisions of Section 9(b) of proposed Rule 56, relating to a Buy-In in respect of an SFT and that is submitted by an Approved SFT Submitter on behalf of a Transferor in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose.

The term “Recalled SFT” would mean an SFT that has been novated to NSCC in respect of which a Recall Notice has been submitted.

The term “Securities Financing Transaction” or “SFT” would mean a transaction between two SFT Members pursuant to which (a) one SFT Member agrees to transfer specified SFT Securities to another SFT Member versus the SFT Cash; and (b) the Transferee agrees to retransfer such specified SFT Securities or equivalent SFT Securities (including quantity and CUSIP) to the Transferor versus the SFT Cash on the following Business Day.

The term “Settling SFT” would mean, as of any Business Day, an SFT that has been novated to NSCC, the Final Settlement of which is scheduled to occur on that Business Day.

The term “SFT Account” would mean a ledger maintained on the books and records of NSCC that reflects the outstanding SFTs that an SFT Member enters into and that have been novated to NSCC, the SFT Positions or SFT Cash associated with those transactions and any debits or credits of cash associated with such transactions effected pursuant to Rule 12 (Settlement). As proposed, the term “SFT Account” would include any Agent Clearing Member Customer Omnibus Account and any Sponsored Member Sub-Account.

The term “SFT Cash” would mean the specified amount of U.S. dollars that the Transferee agrees to transfer to the Transferor at the Initial Settlement of an SFT, (i) plus any Price Differential paid by NSCC to the SFT Member as Transferor or by the SFT Member as Transferee to NSCC during the term of the SFT and (ii) less any Price Differential paid by NSCC to the SFT Member as Transferee or by the SFT Member as Transferor to NSCC during the term of the SFT.

The term “SFT Close-out Value” would mean, with respect to an SFT Position of an SFT Member, an amount equal to: (i) if the SFT Member is the Transferor of the SFT Securities that are the subject of such SFT, (a) the CNS Market Value of the SFT Securities that are the subject of such SFT minus (b) the SFT Cash for such SFT; and (ii) if the SFT Member is a Transferee of the SFT Securities that are the subject of such SFT, (a) the SFT Cash for such SFT minus (b) the CNS Market Value of the SFT Securities that are the subject of such SFT.

The term “SFT Long Position” would mean the number of units of an SFT Security which an SFT Member is entitled to receive from NSCC at Final Settlement of an SFT against payment of the SFT Cash.

The term “SFT Member” would mean any Member, Sponsored Member acting in its principal capacity, Sponsoring Member acting in its principal capacity or Agent Clearing Member acting on behalf of a Customer, in each case that is a party to an SFT, permitted to participate in NSCC’s SFT Clearing Service.

The term “SFT Position” would mean an SFT Member’s SFT Long Position or SFT Short Position (as defined below and in the proposed rule change) in an SFT Security that is the subject of an SFT that has been novated to NSCC.

The term “SFT Security” would mean a security that is eligible to be the subject of an SFT novated to NSCC and is included in the list for which provision is made in proposed Section

1(g) of Rule 3 (Lists to be Maintained), as described below. As proposed, if any new or different security is exchanged for any SFT Security in connection with a recapitalization, merger, consolidation or other corporate action, such new or different security shall, effective upon such exchange, become an SFT Security in substitution for the former SFT Security for which such exchange is made.

The term “SFT Short Position” would mean the number of units of an SFT Security that an SFT Member is obligated to deliver to NSCC at Final Settlement of an SFT against payment of the SFT Cash.

The term “Transferee” would mean the SFT Member party to an SFT that agrees to receive SFT Securities from the other SFT Member party to the SFT in exchange for SFT Cash in connection with the Initial Settlement of the SFT.

The term “Transferor” would mean the SFT Member party to an SFT that agrees to transfer SFT Securities to the other SFT Member party to the SFT in exchange for SFT Cash in connection with the Initial Settlement of the SFT.

Proposed Rule 56, Section 1 (General)

Section 1 of proposed Rule 56 would be a general provision regarding the SFT Clearing Service applicable to Members, Sponsoring Members and Agent Clearing Members that participate in the proposed SFT Clearing Service.

Section 1(a) of proposed Rule 56 would establish that NSCC may accept for novation SFTs entered into between (i) a Member and another Member, (ii) a Sponsoring Member and its Sponsored Member, or (iii) an Agent Clearing Member acting on behalf of a Customer and either (x) a Member or (y) the same or another Agent Clearing Member acting on behalf of a Customer.

Section 1(b) of proposed Rule 56 would provide that any SFT that is submitted to NSCC for novation, and any Member and Sponsored Member that enters into an SFT (and any Customer on behalf of whom an Agent Clearing Member enters into an SFT) shall be subject to the provisions of proposed Rule 56; provided that Sections 15 and 16 of proposed Rule 56 shall only apply to Sponsoring Members, Agent Clearing Members, Sponsored Members and Customers, as applicable.

Section 1(c) of proposed Rule 56 would further provide that any amount of cash described in proposed Rule 56 may be rounded up to the nearest one cent, five cents, 10 cents, 25 cents or dollar according to the rounding convention requested by the SFT Member parties to the relevant SFT as conveyed to NSCC in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose.

Proposed Rule 56, Section 2 (Eligibility for SFT Clearing Service: SFT Member)

Section 2 of proposed Rule 56 would establish the eligibility requirements for using the proposed SFT Clearing Service.



Under Section 2 of proposed Rule 56, NSCC may permit any Member acting in its principal capacity, Sponsored Member acting in its principal capacity, or Agent Clearing Member acting on behalf of a Customer to be an SFT Member and participate in the proposed SFT Clearing Service.

Section 2 of proposed Rule 56 would provide that the rights, liabilities and obligations of SFT Members in their capacity as such shall be governed by the proposed Rule 56. References to a Member would not apply to an SFT Member in its capacity as such, unless specifically noted in the proposed Rule 56 or in such other Rules as applicable to an SFT Member.

Section 2 of proposed Rule 56 would also provide that an SFT Member that participates in NSCC in another capacity pursuant to another Rule, or which has entered into an agreement with NSCC independent from proposed Rule 56, shall continue to have all the rights, liabilities and obligations set forth in such other Rule or pursuant to such agreement, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as an SFT Member, except as contemplated under Sections 15 and 16 of proposed Rule 56, as described below.

*Proposed Rule 56, Section 3 (Membership Documents)*

Section 3 of proposed Rule 56 would govern the documents that SFT Member applicants would be required to complete and deliver to NSCC. Specifically, Section 3 of proposed Rule 56 would provide that to become an SFT Member, each applicant shall complete and deliver to NSCC documents in such forms as may be prescribed by NSCC from time to time and any other information requested by NSCC.

*Proposed Rule 56, Section 4 (Securities Financing Transaction Data Submission)*

Section 4 of proposed Rule 56 would govern the submission of transaction data for SFTs into NSCC for novation by Approved SFT Submitters on behalf of Transferors (e.g., lenders) and Transferees (e.g., borrowers).

Section 4(a) of proposed Rule 56 would provide that in order for an SFT to be submitted to NSCC, the transaction data for the SFT must be submitted to NSCC by an Approved SFT Submitter in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Any such transaction data shall be submitted to NSCC on a locked-in basis. In determining whether to accept transaction data from an Approved SFT Submitter, NSCC may require the Approved SFT Submitter to provide a Cybersecurity Confirmation. This is consistent with the existing requirement in Section 6 of Rule 7 (Comparison and Trade Recording Operation (Including Special Representative/Index Receipt Agent)) for organizations reporting trade data to NSCC.<sup>70</sup>

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<sup>70</sup> Section 6 of Rule 7 (Comparison and Trade Recording Operation (Including Special Representative/Index Receipt Agent)) provides that NSCC may require organizations that deliver trade data to NSCC as described in that Rule to provide a Cybersecurity Confirmation before agreeing to accept such trade data. Supra note 1.

Section 4(b) of proposed Rule 56 would provide that NSCC would not act upon any instruction received from an Approved SFT Submitter in respect of an SFT unless each SFT Member (other than an SFT Member that is a Sponsored Member) designated by the Approved SFT Submitter as a party to such SFT has consented, in a writing delivered to NSCC, to the Approved SFT Submitter acting on behalf of the SFT Member in respect of SFTs.

Section 4(c) of proposed Rule 56 would provide that the obligations reflected in the transaction data on an SFT shall be deemed to have been confirmed and acknowledged by each SFT Member designated by the Approved SFT Submitter as a party thereto and to have been adopted by such SFT Member and, for the purposes of determining the rights and obligations between NSCC and such SFT Member under the proposed Rule 56 and such other Rules applicable to SFTs, shall be valid and binding upon such SFT Member. In addition, Section 4(c) would provide that an SFT Member which has been so designated by an Approved SFT Submitter shall resolve any differences or claims regarding the rights and obligations reflected in the transaction data submitted by the Approved SFT Submitter with the Approved SFT Submitter, and NSCC shall have no responsibility in respect thereof or to adjust its records or the accounts of the SFT Member in any way, other than pursuant to the instructions of the Approved SFT Submitter. Section 4(c) would also provide that any such adjustment shall be in the sole discretion of NSCC.

Section 4(d) of proposed Rule 56 would provide that NSCC makes no representation, whether expressed or implied, as to the complete and timely performance of an Approved SFT Submitter's duties and obligations. Section 4(d) would also provide that NSCC assumes no liability to any SFT Member for any act or failure to act by an Approved SFT Submitter in connection with any information received by NSCC or given to the SFT Member by NSCC via the Approved SFT Submitter, as the case may be.

Section 4(e) of proposed Rule 56 would provide that the submission of each SFT to NSCC and the performance of any obligation under such SFT shall constitute a representation to NSCC and covenant by the Transferor and the Transferee, any Sponsoring Member that is acting on behalf of the Transferor or Transferee and any Agent Clearing Member that is acting on behalf of a Customer in connection with such SFT that its participation in such SFT is in compliance, and would continue to comply, with all applicable laws and regulations, including without limitation Rule 15c3-3 and all other applicable rules and regulations of the Commission, any applicable provisions of Regulation T, Regulation U and Regulation X of the Board of Governors of the Federal Reserve System, and the rules of FINRA and any other regulatory or self-regulatory organization to which the Transferor, the Transferee, any Sponsoring Member that is acting on behalf of the Transferor or Transferee or any Agent Clearing Member that is acting on behalf of a Customer is subject.

Section 4(f) of proposed Rule 56 would provide that the submission of each SFT to NSCC shall constitute an authorization to NSCC by the Transferor, the Transferee and any Agent Clearing Member that is acting on behalf of a Customer for NSCC to give instructions regarding the SFT to DTC in respect of the relevant accounts of the Transferor, Transferee and Agent Clearing Member at DTC.

Proposed Rule 56, Section 5 (Novation of Securities Financing Transactions)

Section 5 of proposed Rule 56 would govern the nature and timing of the novation to NSCC of obligations related to an SFT.

Section 5(a) of proposed Rule 56 would provide that NSCC to only novate an SFT if, at the time of novation, the Final Settlement of such transaction is scheduled to occur one Business Day following the Initial Settlement and the SFT Cash is no less than 100% of the Contract Price of the SFT.

Section 5(b) of proposed Rule 56 would provide that each SFT that is a Bilaterally Initiated SFT, including any Sponsored Member Transaction, and validated pursuant to the Rules shall be novated to NSCC as of the time NSCC provides the Approved SFT Submitter for such SFT a report confirming such novation in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Section 5(b) would also provide that each SFT that is neither a Bilaterally Initiated SFT nor a Sponsored Member Transaction and that is validated pursuant to the Rules shall be novated to NSCC as of the time (x) the Initial Settlement of such SFT has completed by (i) the Transferor instructing DTC to deliver from the relevant DTC account of the Transferor to NSCC's account at DTC the subject SFT Securities versus payment of the amount of the SFT Cash, (ii) NSCC instructing DTC to deliver from NSCC's account at DTC to the relevant DTC account of the Transferee the subject SFT Securities versus payment of the amount of SFT Cash and (iii) DTC processes the deliveries in accordance with the rules and procedures of DTC, or (y) the Initial Settlement obligations of such SFT have been discharged in accordance with Section 8 of proposed Rule 56, as described below. In addition, Section 5(b) would provide that if the Initial Settlement obligations of an SFT that is neither a Bilaterally Initiated SFT nor a Sponsored Member Transaction are not discharged in accordance with clause (x) or (y), then such SFT shall be deemed void *ab initio*.

Section 5(c) of proposed Rule 56 would provide that, subject to Sections 5(d) and 5(e) of proposed Rule 56 as described below, the novation of SFTs shall consist of the termination of the Final Settlement, Rate Payment and Distribution Payment obligations and entitlements between the parties to the SFT with respect to such SFT and their replacement with obligations and entitlements to and from NSCC to perform, in accordance with the Rules, the Final Settlement, Rate Payment, and Distribution Payment obligations and entitlements under the SFT.

Section 5(d) of proposed Rule 56 would govern the novation of SFTs having Incremental Additional Independent Amount SFT Cash and provides when the obligation to return Independent Amount SFT Cash for which an associated Clearing Fund deposit has not been made will be novated away from a Transferor to NSCC. Specifically, Section 5(d)(i) of proposed Rule 56 would provide that if an SFT has Incremental Additional Independent Amount SFT Cash, then, unless the SFT is a Sponsored Member Transaction and the Sponsoring Member is the Transferee,<sup>71</sup> the obligation of the Transferor to return the Incremental Additional

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<sup>71</sup> Where the Transferor is a Sponsored Member receiving Independent Amount SFT Cash, NSCC would not be requiring Independent Amount SFT Cash Deposit Requirement. This is because in the case of the Sponsored Member's default, the party giving the Independent Amount SFT Cash, i.e., Sponsoring Member, is the guarantor of the

Independent Amount SFT Cash to the Transferee shall not be terminated and novated to NSCC (nor shall NSCC otherwise be required to return such Incremental Additional Independent Amount SFT Cash), except to the extent that the Transferor, Sponsoring Member or Agent Clearing Member, as applicable, has satisfied the associated Independent Amount SFT Cash Deposit Requirement. As proposed, to the extent the associated Clearing Fund deposit has not been made in respect of Independent Amount SFT Cash at the time of the Initial Settlement, the obligation to return the Independent Amount SFT Cash would not be novated to NSCC.

Section 5(d)(ii) of proposed Rule 56 would provide that to the extent the Transferor, Sponsoring Member or Agent Clearing Member has not satisfied the associated Independent Amount SFT Cash Deposit Requirement, the Transferor's (or in the case of a Non-Returned SFT, NSCC's) obligation to return the Incremental Additional Independent Amount SFT Cash shall: (1) if the SFT is an Agent Clearing Member Transaction for which the Agent Clearing Member, acting on behalf of the Customer, is the Transferor, be terminated and replaced with an obligation of the Agent Clearing Member, in its capacity as principal, to return the Incremental Additional Independent Amount SFT Cash to the Transferee; or (2) otherwise, remain (or in the context of a Non-Returned SFT, be terminated and replaced with) a bilateral obligation of the Transferor to the Transferee. As proposed, if the associated Clearing Fund deposit has not been made in respect of Independent Amount SFT Cash, the Independent Amount SFT Cash would be owed by the Transferor to the Transferee as a bilateral principal-to-principal obligation, unless the Transferor is a Customer of an Agent Clearing Member, in which case the obligation to return the Independent Amount SFT Cash in respect of which the Clearing Fund has not been made would be novated from the Customer to the Agent Clearing Member, and the Agent Clearing Member would owe the Independent Amount SFT Cash back to the Transferee as principal.<sup>72</sup>

Section 5(d)(iii) of proposed Rule 56 would provide that each SFT Member agrees that any obligation to return Incremental Additional Independent Amount SFT Cash that is novated to an Agent Clearing Member or that remains (or becomes) a bilateral obligation of the Transferor to the Transferee in accordance with Section 5(d)(ii) of proposed Rule 56, is a binding and enforceable obligation of the Agent Clearing Member or Transferor, as applicable, regardless of whether the Transferee has entered into an Existing Master Agreement with the Agent Clearing Member or Transferor. In addition, Section 5(d)(iii) would provide that each SFT Member further agrees that any such obligation shall only be due and payable to the Transferee upon the final discharge of NSCC's Final Settlement obligations to the Transferor under the portion of the SFT that has been novated to NSCC in accordance with Section 5(b) of proposed Rule 56, as described above.

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settlement obligation of the Sponsored Member Independent Amount SFT Cash back to NSCC.

<sup>72</sup> This interim novation is designed to avoid any credit concerns that would manifest if the Customer and the Transferee had to have a principal bilateral obligation to each other for the Independent Amount SFT Cash.

Section 5(d)(iv) of proposed Rule 56 would provide that, until the Transferor, Sponsoring Member or Agent Clearing Member has satisfied in full its Independent Amount SFT Cash Deposit Requirement, the SFT Cash of the SFT shall, for purposes of determining the obligations owing to and from NSCC under such SFT, equal the SFT Cash of the SFT less the Incremental Additional Independent Amount SFT Cash.

Section 5(d)(v) of proposed Rule 56 would provide that once the Transferor, Sponsoring Member or Agent Clearing Member, as applicable, has satisfied in full its Independent Amount SFT Cash Deposit Requirement, the obligation of the Transferor to return the Incremental Additional Independent Amount SFT Cash to the Transferee (or, in the case of an SFT that is an Agent Clearing Member Transaction, any obligation of the Agent Clearing Member to return the Incremental Additional Independent Amount SFT Cash to the Transferee) shall be novated to NSCC, and the SFT Cash of the SFT shall, for purposes of determining the obligations owing to and from NSCC under the SFT, include the full amount of the SFT Cash of such SFT.

Section 5(e) of proposed Rule 56 would govern novation in respect of certain corporate actions and provide that NSCC would (i) have an obligation to pay the cash distribution to the Transferor and the Transferee would have an obligation to pay the cash distribution to NSCC, and (ii) not novate any obligations related to unsupported corporate actions and distributions. Specifically, Section 5(e)(i) of proposed Rule 56 would provide that regardless of anything to the contrary in any Existing Master Agreement (including a provision addressing when an issuer pays different amounts to different security holders due to withholding tax or other reasons), the Distribution Payment obligations and entitlements between NSCC and each party to an SFT that has been novated to NSCC shall be the obligation of NSCC to pay to the Transferor and the obligation of the Transferee to pay to NSCC the Distribution Amount in respect of each Distribution and the corresponding entitlements of the Transferor and NSCC, in each case, in accordance with the Rules.

Section 5(e)(ii) of proposed Rule 56 would provide that NSCC shall maintain a list of corporate actions and distributions that NSCC does not support with respect to SFTs. Section 5(e)(ii) would further provide that no Final Settlement, Rate Payment, Distribution Payment or other obligation resulting from a corporate action or distribution that is not supported by NSCC shall be novated to NSCC. In addition, Section 5(e)(ii) would provide that none of such unsupported corporate action shall modify the Final Settlement, Rate Payment, Distribution Payment or other obligations of NSCC, Transferor and Transferee under an SFT that has been novated to NSCC. Section 5(e)(ii) would also provide that each SFT Member agrees that any obligation under an SFT resulting from a corporate action or distribution not supported by NSCC shall remain a binding and enforceable bilateral obligation between the Transferor and the Transferee, regardless of whether the Transferor and Transferee have entered into an Existing Master Agreement.

Section 5(f) of proposed Rule 56 would provide that the novation of SFTs shall not affect the fundamental substance of the SFT as a transfer of securities by one party in exchange for a transfer of cash by the other party and an agreement by each party to return the property it received and shall not affect the economic obligations or entitlements of the parties under the SFT except that following novation, the Final Settlement, Rate Payment and Distribution

Payment obligations and entitlements shall be owed to and by NSCC rather than the original counterparty under the SFT.

Section 5(g) of proposed Rule 56 would provide that the representations and warranties made by each of the parties to an SFT that has been novated to NSCC under the parties' Existing Master Agreement, if any, shall (x) to the extent that they are inconsistent with the Rules, be eliminated and replaced with the Rules and (y) to the extent that they are not inconsistent with the Rules, remain in effect as between the parties to the original SFT, but shall not impose any additional obligations on NSCC.

*Proposed Rule 56, Section 6 (Rate and Distributions)*

Section 6 of proposed Rule 56 would govern the settlement of Rate Payments and supported Distributions by NSCC for novated SFTs. Section 6(a) of proposed Rule 56 would provide that NSCC shall debit and credit the Rate Payment from and to the SFT Accounts of the SFT Member parties to an SFT that has been novated to NSCC as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service) on the scheduled Final Settlement Date for the SFT, irrespective of whether Final Settlement of such SFT occurs on such date.

Section 6(b) of proposed Rule 56 would provide that if (x) a cash dividend is made on or in respect of an SFT Security that is the subject of an SFT that has been novated to NSCC or (y) cash is exchanged, in whole or in part, for such an SFT Security in a merger, consolidation or similar transaction, and the Transferor under the SFT would have been entitled to a cash payment related to the event described in clause (x) or (y) had it not transferred the SFT Securities that are the subject of the SFT to the Transferee in the Initial Settlement, then NSCC shall, within the time period determined by NSCC from time to time, credit the Distribution Amount to the Transferor's SFT Account and debit the Distribution Amount from the Transferee's SFT Account as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII. Section 6(b) would further provide that if cash is exchanged in whole for such an SFT Security, then the completion of the actions described in the preceding sentence shall discharge NSCC's Final Settlement obligations to the relevant Transferor and the Transferee's Final Settlement obligations to NSCC.

*Proposed Rule 56, Section 7 (Final Settlement of Securities Financing Transactions)*

Section 7 of proposed Rule 56 would govern the mechanics of Final Settlement of SFTs by providing that, subject to Section 11 of proposed Rule 56, as described below, the Final Settlement of an SFT that has been novated to NSCC shall be scheduled to occur on the Business Day immediately following the date the SFT was novated to NSCC. Section 7 would further provide that unless the Final Settlement obligations under such an SFT are discharged in accordance with Section 8 of proposed Rule 56, as described below, Final Settlement of the SFT shall occur by (x) NSCC instructing DTC to (i) deliver from the relevant DTC account of the Transferee to NSCC's account at DTC the subject SFT Securities versus payment of the amount of SFT Cash and (ii) deliver from NSCC's account at DTC to the relevant DTC account of the Transferor the subject SFT Securities versus payment of the amount of SFT Cash, and (y) the processing of such deliveries by DTC in accordance to the rules and procedures of DTC;

provided that if such transfers do not occur and a Buy-In does not occur in respect of the SFT, then the Final Settlement Date shall be rescheduled for the following Business Day as described in Section 9 of proposed Rule 56, as described below. The obligation of a Transferor (or a Sponsoring Member that guarantees to NSCC the obligation of a Transferor or an Agent Clearing Member that is responsible for the performance of the obligation under an SFT that is an Agent Clearing Member Transaction to return SFT Cash to NSCC) in respect of the Final Settlement of an SFT that has been novated to NSCC shall be to pay the SFT Cash and, if applicable, the Rate Payment to NSCC against the transfer of the relevant SFT Securities by NSCC. The obligation of a Transferee (or a Sponsoring Member that guarantees to NSCC the obligation of a Transferee or an Agent Clearing Member that is responsible for the performance of the obligation under an SFT that is an Agent Clearing Member Transaction to return SFT Securities to NSCC) in respect of the Final Settlement of an SFT that has been novated to NSCC shall be to transfer the SFT Securities and, if applicable, the Rate Payment to NSCC against the transfer of SFT Cash by NSCC.

Section 7 of proposed Rule 56 would also provide that an SFT, or a portion thereof, shall be deemed complete and final upon Final Settlement of the SFT, or such portion, whether pursuant to Sections 7, 8, 9(d) or 13(c) of proposed Rule 56. Section 7 would also provide that from and after the Final Settlement of an SFT, or a portion thereof, pursuant to any Sections 7, 8, 9(d) or 13(c) of proposed Rule 56, NSCC shall be discharged from its obligations to the Transferor and the Transferee, and NSCC shall have no further obligation in respect of the SFT or such portion. This is to make it clear to SFT Members the point at which settlement of an SFT is deemed to be complete and final.<sup>73</sup>

*Proposed Rule 56, Section 8 (Discharge of Offsetting Final Settlement and Initial Settlement Obligations)*

Section 8 of proposed Rule 56 would govern the “roll” (i.e., pair off or offset) process whereby the Final Settlement obligations on one SFT (i.e., the Settling SFT) between two parties can be offset with the Initial Settlement obligations on another SFT between the same parties (i.e., the Linked SFT) through the debiting and crediting of the difference in cash collateral between the two offsetting SFTs (i.e., the Price Differential).

Section 8(a) of proposed Rule 56 would provide that, subject to the provisions of Section 13(c) of proposed Rule 56, as described below, if, on any Business Day, the pre-novation SFT Member parties to a Settling SFT enter into a Linked SFT and the Approved SFT Submitter provides an appropriate instruction to NSCC in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose, the Final Settlement obligations of the parties to the Settling SFT and the Initial Settlement obligations of the parties

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<sup>73</sup> With respect to an SFT between a Sponsoring Member and its Sponsored Member, the SFT would settle on the books of the Sponsoring Member because the Sponsored Member are not participants at DTC and thus would not have accounts at DTC. Accordingly, the finality of the settlement of such SFT would occur when the Sponsoring Member credits the securities and cash on its or the relevant custodian’s books and records.

to the Linked SFT shall be discharged once NSCC has instructed DTC to debit and credit the relevant DTC accounts, of the SFT Member parties, as described below in Section 8(b) of proposed Rule 56, and DTC processes such debits and credits in accordance with the rules and procedures of DTC. To the extent the Price Differential is not processed by DTC in accordance with the rules and procedures of DTC, NSCC shall debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service). If the Price Differential is positive, NSCC shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account. If the Price Differential is negative, NSCC shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account. However, if the Linked SFT has as its subject fewer SFT Securities than the Settling SFT, then only the following Final Settlement obligations under the Settling SFT shall be discharged in accordance with Section 8 of proposed Rule 56: (i) the Transferee's and NSCC's Final Settlement obligations in respect of a quantity of SFT Securities equal to the quantity of SFT Securities that are the subject of the Linked SFT and (ii) the Transferor's and NSCC's Final Settlement obligations in respect of the Corresponding SFT Cash.

Section 8(b) of proposed Rule 56 would provide that if the Price Differential is positive, NSCC shall (x) instruct DTC to debit an amount equal to the Price Differential from NSCC's account at DTC and credit such amount to the relevant DTC account of the Transferee and (y) instruct DTC to debit an amount equal to the Price Differential from the relevant DTC account of the Transferor and credit such amount to NSCC's account at DTC. If the Price Differential is negative, NSCC shall (x) instruct DTC to debit an amount equal to the absolute value of the Price Differential from NSCC's account at DTC and credit such amount to the relevant DTC account of the Transferor and (y) instruct DTC to debit an amount equal to the absolute value of the Price Differential from the relevant DTC account of the Transferee and credit such amount to NSCC's account at DTC.

*Proposed Rule 56, Section 9 (Non-Returned Securities Financing Transactions and Recalls)*

Section 9 of proposed Rule 56 would govern the processing of a novated SFT for which the Final Settlement obligations have not been discharged either through Final Settlement in accordance with Section 7 of proposed Rule 56 (as described above) or a pair off in accordance with Section 8 of proposed Rule 56 (as described above), and the recall and buy-in process for such an SFT.

Specifically, Section 9(a) of proposed Rule 56 would provide that if (x) the Transferee does not satisfy its Final Settlement obligations in respect of an SFT that has been novated to NSCC on the Final Settlement Date, (y) such Final Settlement obligations have not been discharged in accordance with the provisions of Section 8 of proposed Rule 56, as described above, and (z) a Buy-In has not occurred in respect of such SFT or a portion thereof (such SFT, a "Non-Returned SFT"), the Final Settlement Date of the Non-Returned SFT shall be rescheduled for the following Business Day, and NSCC shall instruct DTC to debit and credit the relevant DTC accounts of the SFT Member parties, as described in subsection (b) of Section 8 above. To



the extent the Price Differential is not processed by DTC in accordance with the rules and procedures of DTC, NSCC shall debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the Non-Returned SFT as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service). Section 9(a) would further provide that if the Price Differential is positive, NSCC shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account; if the Price Differential is negative, NSCC shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account. This process would continue until Final Settlement, a pair off in accordance with Section 8 of proposed Rule 56 (as discussed above), or a Buy-In.

Section 9(b) of proposed Rule 56 would provide that if NSCC receives a Recall Notice in respect of an SFT that has been novated to NSCC and the Transferee does not satisfy its Final Settlement obligations by the Recall Date for the Recall Notice, the Transferor may, in a commercially reasonable manner,<sup>74</sup> purchase some or all of the SFT Securities that are the subject of the SFT<sup>75</sup> or elect to be deemed to have purchased the SFT Securities, in each case in accordance with such timeframes and deadlines as established by NSCC for such purpose (a "Buy-In"); provided that in the case of a Default-Related SFT (as defined below and in the proposed rule change), the commercial reasonableness of a Buy-In shall be determined by NSCC based on whether, in the opinion of NSCC, such Buy-In would create a disorderly market in the relevant SFT Security. Following such purchase or deemed purchase, the Transferor shall (x) give written notice to NSCC of the Transferor's costs to purchase the relevant SFT Securities (including the price paid by the Transferor and any broker's fees and commissions and reasonable out-of-pocket transaction costs, fees or interest expenses incurred in connection with such purchase) (such costs, the "Buy-In Costs") or, if the Transferor elects to be deemed to have purchased the SFT Securities, the Deemed Buy-In Costs, and (y) indemnify NSCC, and its employees, officers, directors, shareholders, agents and Members (collectively the "Buy-In Indemnified Parties"), for any and all losses, liability or expenses of a Buy-In Indemnified Party arising from any claim disputing the calculation of the Buy-In Costs, the Deemed Buy-In Costs or the method or manner of effecting the Buy-In. Section 9(b) would further provide that each SFT Member acknowledges and agrees that each SFT Security is of a type traded in a recognized market and that, in the absence of a generally recognized source for prices or bid or offer quotations for any SFT Security, the Transferor may, for purposes of a Buy-In, establish the source therefor in its commercially reasonable discretion. In addition, Section 9(b) would

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<sup>74</sup> The requirement that a party exercising buy-in rights do so in a "commercially reasonable manner" is market standard. *See, e.g.,* Section 13.1 of the Master Securities Loan Agreement published by Securities Industry and Financial Markets Association ("SIFMA"). NSCC has proposed to include this language in order to align the standards applicable to an exercise of remedies in relation to SFTs with those applicable in the bilateral uncleared space. NSCC believes that such alignment will increase certainty for SFT Members and allow them to follow standards with which they are familiar.

<sup>75</sup> The Transferor would purchase these securities from one or more third parties.

provide that each SFT Member further acknowledges and agrees that NSCC would not calculate any Buy-In Costs or Deemed Buy-In Costs and shall have no liability for any such calculation. Section 9(b) would also provide that NSCC would assign to any Transferee whose SFT is subject to a Buy-In any rights it may have against the Transferor to dispute the Transferor's calculation of the Buy-In Costs or Deemed Buy-In Costs.

Section 9(c) of proposed Rule 56 would provide that on the Business Day following NSCC's receipt of written notice of the Transferor's Buy-In Costs, NSCC shall debit and credit the Buy-In Amount from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service). Section 9(c) would provide that if the Buy-In Amount is positive, NSCC would (x) credit the value of the Buy-In Amount to the Transferor's SFT Account and (y) debit the value of the Buy-In Amount from the Transferee's SFT Account. Section 9(c) would further provide that if the Buy-In Amount is negative, NSCC would (x) credit the value of the Buy-In Amount to the Transferee's SFT Account and (y) debit the value of the Buy-In Amount from the Transferor's SFT Account.

Section 9(d) of proposed Rule 56 would provide that following the application of such Buy-In Amount, the Final Settlement obligations under the SFT shall be discharged; provided that if the Transferor effected a Buy-In in respect of some but not all of the SFT Securities that are the subject of an SFT, then only the following obligations shall be discharged: (i) the Transferee's and NSCC's Final Settlement obligations in respect of the SFT Securities for which the Transferor effected the Buy-In and (ii) the Transferor's and NSCC's Final Settlement obligations in respect of the Corresponding SFT Cash.

Section 9(e) of proposed Rule 56 would provide that a Recalled SFT shall be treated as a Non-Returned SFT by NSCC until the earlier of the time that the SFT settles or a Buy-In is processed by NSCC in accordance with Section 9 of proposed Rule 56, except that the additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of proposed Rule 56, as described below, shall not apply. Section 9(e) would further provide that if the Transferor effects the Buy-In in respect of some, but not all, of the SFT Securities that are the subject of a Recalled SFT, the Final Settlement obligations of the Recalled SFT that are not discharged in accordance with Section 9(d) of proposed Rule 56 shall be treated as a Non-Returned SFT until the SFT settles or a Buy-In is processed by NSCC in accordance with Section 9 of proposed Rule 56, and the additional SFT Deposit required under Section 12(c) of proposed Rule 56, as described below, for Non-Returned SFTs shall apply.

*Proposed Rule 56, Section 10 (Cancellation, Modification and Termination of Securities Financing Transactions)*

Section 10 of proposed Rule 56 would govern the process for cancellations, modifications and terminations of SFTs in NSCC's systems.

Section 10(a) of proposed Rule 56 would provide that transaction data on an SFT that has not been novated to NSCC may be cancelled upon receipt by NSCC of appropriate instructions from the Approved SFT Submitter with respect to such SFT on behalf of both SFT Member parties thereto, submitted in accordance with the communication links, formats, timeframes and

deadlines established by NSCC for such purpose. Section 10(a) would further provide that an SFT that is so cancelled by NSCC would be deemed to be void *ab initio*.

Section 10(b) of proposed Rule 56 would provide the Rate Payment on an SFT that has been novated to NSCC may be modified upon receipt by NSCC of appropriate instructions from the Approved SFT Submitter with respect to such SFT, submitted in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Section 10(b) would further provide that any instructions submitted by an Approved SFT Submitter to modify the Rate Payment of an SFT must be submitted on behalf of both SFT Member parties to the SFT.

Section 10(c) of proposed Rule 56 would provide an SFT that has been novated to NSCC in accordance with Section 5 of proposed Rule 56, as described above, may be terminated upon receipt by NSCC of appropriate instructions from the Approved SFT Submitter with respect to such SFT on behalf of both SFT Member parties thereto, submitted in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purposes. Section 10(c) would further provide that following any such termination, no amounts or further obligations shall be owing in respect of the SFT between NSCC and Transferor or NSCC and the Transferee.

*Proposed Rule 56, Section 11 (Accelerated Final Settlement)*

Section 11 of proposed Rule 56 would allow a Transferee (i.e., the borrower) to do a same day return of borrowed securities, if necessary, to satisfy its regulatory purpose requirements by accelerating the Final Settlement of an SFT that has been novated to NSCC. Specifically, Section 11 would provide that the Transferee may accelerate the scheduled Final Settlement of an SFT that has been novated to NSCC upon receipt by NSCC of appropriate instruction from the Approved SFT Submitter with respect to such SFT, submitted in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Section 11 would further provide that such accelerated Final Settlement shall be effected by NSCC in accordance with the provisions of Section 7 of proposed Rule 56, as described above.

*Proposed Rule 56, Section 12 (Clearing Fund Obligations)*

Section 12 of proposed Rule 56 would set out the Clearing Fund obligations for SFT Members with respect to their SFT activity.

Section 12(a) of proposed Rule 56 would provide each SFT Member, other than an SFT Member that is a Sponsored Member, shall make and maintain on an ongoing basis a deposit to the Clearing Fund with respect to its SFT Positions (the “SFT Deposit”). Section 12(a) would provide that, for the avoidance of doubt, the SFT Positions for an SFT Member that is a Sponsoring Member shall include all SFT Positions held in its Sponsored Member Sub-Account(s) in addition to its proprietary account(s).

Section 12(b) of proposed Rule 56 would provide that the SFT Deposit shall be held by NSCC or its designated agents as part of the Clearing Fund, to be applied as provided in Sections 1 through 12 of Rule 4 (Clearing Fund).

Section 12(c) of proposed Rule 56 would provide that NSCC shall calculate the amount of each such SFT Member's required deposit for SFT Positions, subject to a \$250,000<sup>76</sup> minimum (excluding the minimum contribution to the Clearing Fund as required by Procedure XV (Clearing Fund Formula and Other Matters), Section II.(A)), by applying the Clearing Fund formula for CNS Transactions in Sections I.(A)(1)(a), (b), (c), (e) (f), (g) of Procedure XV as well as the additional Clearing Fund formula in Section I.(B)(5) (Intraday Mark-to-Market Charge) of Procedure XV, except as noted otherwise, in the same manner as such sections apply to CNS Transactions submitted to NSCC for regular way settlement, plus, with respect to any Non-Returned SFT, an additional charge that is calculated by (x) multiplying the Current Market Price of the SFT Securities that are the subject of such Non-Returned SFTs by the number of such SFT Securities that are the subject of the SFT and (y) multiplying such product by (i) 5% for SFT Members rated 1 through 4 on the Credit Risk Rating Matrix, (ii) 10% for SFT Members rated 5 or 6 on the Credit Risk Rating Matrix, or (iii) 20% for SFT Members rated 7 on the Credit Risk Rating Matrix shall be applied to each SFT Member that is a party thereto<sup>77</sup> (collectively and includes any and all Independent Amount SFT Cash Deposit Requirements, the "Required SFT Deposit"); provided, however, notwithstanding anything to the contrary, (A) a minimum of 40% of an SFT Member's Required SFT Deposit shall be made in the form of cash and/or Eligible Clearing Fund Treasury Securities and (y) the lesser of \$5,000,000 or 10% of an SFT Member's Required SFT Deposit, with a minimum of \$250,000, must be made and

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<sup>76</sup> Supra note 29.

<sup>77</sup> The Required SFT Deposit multipliers proposed for Non-Returned SFTs are identical to the Required Fund Deposit multipliers applied to CNS Fails Positions. See Procedure XV (Clearing Fund Formula and Other Matters), Section I.(A)(1)(d)), supra note 1. While the concept of a "fail" does not exist in the securities lending market in the same manner as it does in the cash market, to the extent that the Final Settlement of an SFT is scheduled on a particular date but does not occur, whether directly or through a pair off as described in Section 8 of proposed Rule 56 (as discussed above), that could potentially be a result of a "squeeze" or other market dislocation whereby NSCC may face increased market risk in the event of the default of either the Transferor or the Transferee. As a result, NSCC believes it is prudent to apply the same Required Fund Deposit multiplier to a Non-Returned SFT as it does to CNS Fails Positions.

The Credit Risk Rating Matrix is a financial model utilized by NSCC in its ongoing monitoring of Members based on various risk criteria. Each Member is rated by the Credit Risk Rating Matrix on a 7-point rating system, with "1" being the strongest credit rating and "7" being the weakest credit rating. As described above, to the extent that the Final Settlement of an SFT is scheduled on a particular date but does not occur, NSCC, as a central counterparty, is exposed to market risks. Such exposures generally increase when the SFT Member's risk of default increases, as reflected by the SFT Member's Credit Risk Rating Matrix credit rating. As such, the Required SFT Deposit multipliers proposed for Non-Returned SFTs vary based on the SFT Member's credit rating to reflect the potential increase in market risk from SFT Members with higher risk of default.

maintained in cash;<sup>78</sup> provided, further, the additional Clearing Fund formula in Sections I.(B)(1) (Additional Deposits for Members on the Watch List); (2) (Excess Capital Premium); (3) (Backtesting Charge); (4) (Bank Holiday Charge); Minimum Clearing Fund and Additional Deposit Requirements in Sections II.(A)1(a) – (b), II.(B), II.(C), and II.(D); as well as Section III (Collateral Value of Eligible Clearing Fund Securities) of Procedure XV shall apply to SFT Members in the same manner as such sections apply to Members. As noted in the proposed rule text, for the purpose of applying Section I.(A)(1)(a)(i) of Procedure XV (Value-at-Risk (VaR) charge), the volatility of an SFT Member’s SFT Positions shall be the sum of (a) the highest resultant value between Section I.(A)(1)(a)(i)I. (Core Parametric Estimation) and Section I.(A)(1)(a)(i)III. (Margin Floor) and (b) the resultant value of Section I.(A)(1)(a)(i)II. (Gap Risk Measure). Also, as noted in the proposed rule text, for the purpose of applying Section I.(A)(1)(g) of Procedure XV (Margin Liquidity Adjustment (MLA) charge), SFT Positions shall be aggregated with Net Unsettled Positions, as defined in Rule 1,<sup>79</sup> in the same asset group or subgroup; provided, however, in the event such aggregation results in a reduction of the aggregate positions in the relevant asset group or subgroup, NSCC shall apply the greater of (a) the sum of MLA charges separately calculated for SFT Positions and Net Unsettled Positions in the asset group or subgroup and (b) the MLA charge calculated from aggregating the SFT Positions and the Net Unsettled Positions in the asset group or subgroup.

Section 12(d) of proposed Rule 56 would provide that NSCC shall have the discretion to require an SFT Member to post its Required SFT Deposit in proportion of cash higher than as required under subsection (c) of proposed Section 12, as determined by NSCC from time to time in view of market conditions and other financial and operational capabilities of the SFT Member. Section 12(d) would further provide that NSCC shall make any such determination based on such factors as NSCC determines to be appropriate from time to time.

Section 12(e) of proposed Rule 56 would provide that if an SFT has Incremental Additional Independent Amount SFT Cash, the Transferor shall make an additional deposit to the Clearing Fund that equals the amount of the Incremental Additional Independent Amount SFT Cash for such SFT (“Independent Amount SFT Cash Deposit, and such requirement the “Independent Amount SFT Cash Deposit Requirement”). Section 12(e) would also provide that the Independent Amount SFT Cash Deposit Requirement must be satisfied in cash and may, at the discretion of NSCC, be satisfied using Independent Amount SFT Cash Deposits that have previously been made by the Transferor in respect of SFTs with the same Transferee that have since settled.<sup>80</sup> Section 12(e) would further provide that the Transferor shall satisfy any

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<sup>78</sup> Supra note 31.

<sup>79</sup> Supra note 30.

<sup>80</sup> This could occur in a situation in which an existing SFT settles and then the Transferor enters into a new SFT with the same Transferee (e.g., in a pair off as described in Section 8 of proposed Rule 56, discussed above). In that situation, if the Transferee (or Sponsoring Member or Agent Clearing Member) has not yet called back the Independent Amount SFT Cash Deposit it posted in respect of the Settling SFT, then NSCC may

Independent Amount SFT Cash Deposit Requirement in respect of an SFT on the date that the SFT is novated to NSCC pursuant to the timeframes and deadlines established by NSCC for such purpose. In addition, Section 12(e) would provide that if, on a given day, the Transferor satisfies its Independent Amount SFT Cash Deposit Requirement for some, but not all, SFTs novated to NSCC on that day, NSCC will consider the Transferor to have satisfied its Independent Amount SFT Cash Deposit Requirement for none of the SFTs that were novated to NSCC on that day.

Section 12(f) of proposed Rule 56 would provide that each SFT Member, other than an SFT Member that is a Sponsored Member, so long as such Member is an SFT Member, shall also provide Supplemental Liquidity Deposits to the Clearing Fund, as may be required pursuant to Rule 4A. In addition, Section 12(f) would also provide that references to Clearing Fund in the other Rules shall include and apply to SFT Deposit, and references to Required Fund Deposit shall include and apply to Required SFT Deposit, unless specifically noted otherwise in proposed Rule 56 or in such other Rules.

*Proposed Rule 56, Section 13 (Ineligible SFT Securities and Supported Corporate Actions)*

Section 13 of proposed Rule 56 would govern the processing of SFTs where the underlying securities become ineligible SFT Securities and the processing of SFTs in the context of supported corporate actions.

Specifically, Section 13(a) of proposed Rule 56 would provide that NSCC would remove an Ineligible SFT Security from the list maintained by NSCC as set forth in Rule 3 (Lists to be Maintained); provided that NSCC may not be able to identify that an SFT Security is an Ineligible SFT Security and remove such SFT Security from the list maintained by NSCC if the reason for the ineligibility is that the SFT Security is undergoing a corporate action or distribution not supported by NSCC and NSCC is not in receipt of reasonably advanced notice of such corporate action or distribution.

Section 13(b) of proposed Rule 56 would provide that notwithstanding Section 12 of proposed Rule 56, as described above, if an SFT Security becomes an Ineligible SFT Security because the Current Market Price of the SFT Security falls below the threshold established by NSCC from time to time, the Required SFT Deposit of each SFT Member party to an SFT which has such Ineligible SFT Security as its subject shall include an additional amount equal to the product of 100% of the Current Market Price of such Ineligible SFT Security and the number of such Ineligible SFT Securities that the SFT has as its subject.<sup>81</sup> The threshold that would be established by NSCC is currently \$5.00, which could be modified by NSCC<sup>82</sup> at a later date after

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apply the deposit to the Independent Amount SFT Cash Deposit obligation associated with the new SFT.

<sup>81</sup> If the Current Market Price of the SFT Security falls below the threshold established by NSCC from time to time, NSCC would assess the additional amount as part of the Required SFT Deposit.

<sup>82</sup> Supra note 20.

NSCC gains more experience with the nature of the SFT portfolios submitted for clearing, as discussed above.

Section 13(c) of proposed Rule 56 would provide that if NSCC declares that an SFT Security has or would become an Ineligible SFT Security because the security is or would become ineligible for processing or is or would be undergoing a corporate action or distribution that is not supported by NSCC, the Final Settlement of all SFTs that have been novated to NSCC and have such SFT Security as their subject must occur before the Ineligibility Date.<sup>83</sup> In addition, Section 13(c) would provide that if following such declaration the Transferee does not satisfy its Final Settlement obligations in respect of any such SFT as provided in Section 7 of proposed Rule 56, as described above, by the Ineligibility Date, NSCC shall, unless NSCC has previously debited and credited the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT in accordance with Section 8 of proposed Rule 56, as described above, on Ineligibility Date, debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service).<sup>84</sup> Section 13(c) would further provide that if the Price Differential is positive, NSCC shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account. Section 13(c) would also provide that if the Price Differential is negative, NSCC shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account. Furthermore, Section 13(c) would provide that following the application of Price Differential to an Ineligible SFT on or after the relevant Ineligibility Date, all rights and

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<sup>83</sup> The duration between the declaration and Ineligibility Date would vary. If the ineligibility is because the SFT Security will become ineligible for processing (i.e., no longer CNS eligible), the duration would depend on the timing of the CNS ineligibility triggering event (e.g., compliance with regulatory orders, risk concerns, trading suspension, etc.).

If the ineligibility is because the SFT Security will be undergoing an unsupported corporate action or distribution, then it would depend on when the issuer of the relevant SFT Security announces the particular corporate action or distribution event and the record date for such corporate action or distribution. Specifically, when announcements from the issuers are received by DTC, DTC would announce the corporate action or distribution event. NSCC would notify Members of such event when it is announced by DTC and would generally tie the Ineligibility Date to shortly before or on the record date for the corporate action or distribution.

<sup>84</sup> NSCC is proposing this simplified process for applying Price Differentials to Ineligible SFTs because NSCC anticipates such instances would occur on a much less frequent basis than those in connection with Linked SFTs pursuant to Section 8(a) of proposed Rule 56 and Non-Returned SFTs pursuant to Section 9(a) of proposed Rule 56.

obligations as between NSCC and the SFT Member parties thereto with respect to such SFT shall be discharged.

Section 13(d) of proposed Rule 56 would provide that if a corporate action supported by NSCC in respect of the SFT Securities that are the subject of an SFT is scheduled to occur, NSCC may cease to permit the discharge of the SFT's Final Settlement obligations, whether pursuant to Section 8 of proposed Rule 56, as described above, or otherwise, and treat the SFT as a Non-Returned SFT for such period of time determined by NSCC as necessary to process the corporate action, except that the additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of proposed Rule 56, as described above, shall not apply. Section 13(d) would further provide that notwithstanding the foregoing, NSCC shall not limit the ability of a Member to accelerate the Final Settlement of an SFT in accordance with Section 11 of proposed Rule 56, as described above, provided that any Price Differential for the SFT has settled in accordance with Section 9(a) of proposed Rule 56, as described above, and that such accelerated Final Settlement is permitted in accordance with the rules and procedures of DTC.

*Proposed Rule 56, Section 14 (Cease to Act Procedures for SFT Members with Open Securities Financing Transactions)*

Section 14 of proposed Rule 56 would establish NSCC's procedures for when it ceases to act for an SFT Member with open SFTs, including recalling a non-defaulting SFT Member that is a Transferee and liquidating the Defaulting SFT Member's SFT Positions by deeming NSCC to have bought in or sold out some or all the SFT Securities that are the subject of such SFTs at prevailing market price or by crossing.

Section 14(a) of proposed Rule 56 would provide that the provisions of Rule 18 (Procedures for When the Corporation Ceases to Act) shall not apply to the SFTs except for Sections 1 and 8 of Rule 18.

Section 14(b) of proposed Rule 56 would provide that if NSCC has ceased to act for an SFT Member and subject to Section 14 of proposed Rule 2C, as described above:

(i) Except as otherwise may be determined by the Board of Directors, any SFT entered into by the SFT Member that, at the time NSCC ceased to act for such SFT Member, has not been novated to NSCC pursuant to proposed Rule 56, shall be excluded from all operations of NSCC applicable to such SFT.

(ii) NSCC may decline to act upon any instructions, transaction data or notices submitted by such SFT Member or an Approved SFT Submitter on behalf of such SFT Member.

(iii) NSCC shall close-out such SFT Member's proprietary SFT Positions as well as any SFT Positions established in the SFT Member's Agent Clearing Member Customer Omnibus Account by (x) buying in or selling out, as applicable, some or all of the SFT Securities that are the subject of each SFT of the SFT Member that has been novated to NSCC but for which the Final Settlement has not occurred, (y) deeming NSCC to have bought in or sold out some or all such SFT Securities at the bid or ask price therefor, respectively, from a generally recognized source or at such price or prices as NSCC is able to purchase or sell, respectively, some such SFT Securities, or (z) otherwise liquidating such SFT Member's SFT Positions.



(iv) Any Sponsored Member Transactions for which a Defaulting SFT Member is the Sponsoring Member and which have been novated to NSCC shall continue to be processed by NSCC. NSCC, in its sole discretion, would determine whether to close-out the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts (if any), which close out shall be effected in accordance with the provisions of Section 14(b)(iii), as described above, or instead permit the relevant Sponsored Members to complete settlement of the relevant Sponsored Member Transactions.

(v) If, in the aggregate, the close-out of a Defaulting SFT Member's proprietary SFT Positions results in a profit to NSCC, such profit shall be applied to any loss to NSCC arising from the closing out of such Defaulting SFT Member (including losses arising from closing out the SFT Positions established in any of the Defaulting SFT Member's Agent Clearing Member Customer Omnibus Accounts or Sponsored Member Sub-Accounts or losses arising from closing out any Net Close Out Positions of the Defaulting SFT Member). If, in the aggregate, the close-out of a Defaulting SFT Member's proprietary SFT Positions results in a loss to NSCC, such loss shall be netted against, or otherwise applied to, any amounts owed by NSCC to such SFT Member in its proprietary capacity and thereafter debited from such Defaulting SFT Member's Clearing Fund deposit at NSCC.

(vi) If, in the aggregate, the close-out of the SFT Positions established in the Agent Clearing Member Customer Omnibus Accounts of a Defaulting SFT Member results in a profit to NSCC, such profit shall be credited to the Agent Clearing Member Customer Omnibus Accounts. If, in the aggregate, the close-out of the SFT Positions established in the Agent Clearing Member Customer Omnibus Accounts of a Defaulting SFT Member results in a loss to NSCC, such loss shall be netted against, or otherwise applied to, any amounts owed by the NSCC to such SFT Member in its proprietary capacity, and thereafter debited from the Defaulting SFT Member's Clearing Fund deposit at NSCC.

(vii) If, in the aggregate, the close-out of the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts results in a profit to NSCC, such profit shall be credited to the Sponsored Member Sub-Accounts. If, in the aggregate, the closing out of the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts results in a loss to NSCC, such loss shall be netted against, or otherwise applied to, any amounts owed by NSCC to such SFT Member in its proprietary capacity and thereafter debited from such Defaulting SFT Member's Clearing Fund deposit at NSCC.

(viii) The Final Settlement Date of each SFT that has been novated to NSCC and that, prior to novation, was with a Defaulting SFT Member (each, a "Default-Related SFT") shall be the Business Day following the day on which NSCC ceased to act for the Defaulting SFT Member.

(ix) Until Final Settlement, each Default-Related SFT shall be treated as a Non-Returned SFT, and NSCC would pay and collect the Price Differential amounts described in Section 9(a) of proposed Rule 56, as described above. NSCC shall have all of the rights of a Transferor in relation to any Default-Related SFT in respect of which the Defaulting SFT Member was the Transferor, including the ability to deliver a Recall Notice in relation to such Default-Related SFT and to effect a Buy-In, and all of the rights of a Transferee in relation to any Default-

Related SFT in respect of which the Defaulting SFT Member was the Transferee, including the ability to accelerate the scheduled Final Settlement Date of the Default-Related SFT. However, no additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of proposed Rule 56, as described above, shall apply to any Default-Related SFT, and no Rate Payments shall accrue on Default-Related SFTs after the date on which NSCC ceases to act for the Defaulting SFT Member.

*Proposed Rule 56, Section 15 (Sponsored Member SFT Clearing)*

Section 15 of proposed Rule 56 would govern the requirements for Sponsored Member participation in the proposed SFT Clearing Service.

Section 15(a) of proposed Rule 56 would provide that a Sponsoring Member shall be permitted to submit, either directly as an Approved SFT Submitter or via another Approved SFT Submitter, to NSCC Sponsored Member Transactions between itself and its Sponsored Member in accordance with the provisions of proposed Rule 56 and proposed Rule 2C.

Section 15(b) of proposed Rule 56 would provide that NSCC shall maintain for the Sponsoring Member one or more Sponsored Member Sub-Accounts. Section 15(b) would further provide that the SFT Deposits for each Sponsored Member Sub-Account shall be calculated separately based on the SFT Positions in such Sponsored Member Sub-Account, and the Sponsoring Member, as principal, shall be required to satisfy the SFT Deposits for each of the Sponsoring Member's Sponsored Member Sub-Accounts.

Section 15(c) of proposed Rule 56 would provide that settlement of the Final Settlement, Rate Payment, Price Differential, Distribution Payment and other obligations of a Sponsored Member Transaction that have been novated to NSCC shall be effected by the Sponsoring Member, as settlement agent for the relevant Sponsored Member, crediting and debiting the account the Sponsoring Member maintains for the Sponsored Member on the Sponsoring Member's books and records.

*Proposed Rule 56, Section 16 (Customer SFT Clearing)*

Section 16 of proposed Rule 56 would govern the requirements for participation by Agent Clearing Members and their Customers in the proposed SFT Clearing Service.

Section 16(a) of proposed Rule 56 would provide that an Agent Clearing Member shall be permitted to submit, either directly as an Approved SFT Submitter or via another Approved SFT Submitter, to NSCC for novation SFTs that are Agent Clearing Member Transactions. Section 16(a) would further provide that any such submission shall be in accordance with proposed Rule 56 and proposed Rule 2D.

Section 16(b) of proposed Rule 56 would provide that with respect to an Agent Clearing Member that submits SFTs to NSCC for novation on behalf of its Customers, NSCC shall maintain one or more Agent Clearing Member Customer Omnibus Accounts in the name of the Agent Clearing Member for the benefit of its Customers in which all SFT Positions and SFT Cash carried by the Agent Clearing Member on behalf of its Customers are reflected; provided, that each Agent Clearing Member Customer Omnibus Account may only contain activity where

the Agent Clearing Member is acting as Transferor on behalf of its Customers, or as Transferee on behalf of its Customers, but not both.

Section 16(c) of proposed Rule 56 would provide that with respect to SFTs entered into on behalf of its Customers and maintained in the Agent Clearing Member Customer Omnibus Account, the Agent Clearing Member shall act solely as agent of its Customers in connection with the clearing of such SFTs; provided, that the Agent Clearing Member shall remain fully liable for the performance of all obligations to NSCC arising in connection with such SFTs; and provided further, that the liabilities and obligations of NSCC with respect to such SFTs entered into by the Agent Clearing Member on behalf of its Customers shall extend only to the Agent Clearing Member. Without limiting the generality of the foregoing, NSCC shall not have any liability or obligation arising out of or with respect to any SFT to any Customer of an Agent Clearing Member.

Section 16(d) of proposed Rule 56 would provide the SFT Deposits for each Agent Clearing Member Customer Omnibus Account shall be calculated separately based on the SFT Positions in such Agent Clearing Member Customer Omnibus Account, and the Agent Clearing Member shall, as principal, be required to satisfy the SFT Deposit for each of Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts.

*Proposed Rule 56, Section 17 (Corporation Default)*

Section 17 of proposed Rule 56 would govern the close-out netting process that would apply with respect to SFTs that have been novated to NSCC in the event of a default of NSCC.

Section 17(a) of proposed Rule 56 would provide that if a "Corporation Default" occurs pursuant to Section 2 of Rule 41 (Corporation Default), all SFTs that have been novated to NSCC but not yet settled, and all obligations and rights arising thereunder which have been assumed by NSCC pursuant to proposed Rule 56, shall be immediately terminated, and the Board of Directors shall determine the Aggregate Net SFT Close-out Value owed by or to each SFT Member with respect to each of its SFT Positions.

Section 17(b) of proposed Rule 56 would provide that for purposes of Section 17 of proposed Rule 56, a Member shall be considered a different SFT Member in respect of each of (i) its proprietary SFT Positions; (ii) the SFT Positions established in its Agent Clearing Member Customer Omnibus Accounts (if any); and (iii) the SFT Positions established in its Sponsored Member Sub-Accounts (if any).

Section 17(c) of proposed Rule 56 would provide that each SFT Member's Aggregate Net SFT Close-out Value shall be netted and offset as described in Section 14(b)(v) through Section 14(b)(vii) of proposed Rule 56, as though NSCC had ceased to act for each SFT Member.

Section 17(d) of proposed Rule 56 would provide that the Board of Directors shall notify each SFT Member of the Aggregate SFT Close-out Value, taking into account the netting and offsetting provided for above. SFT Members that have been notified that they owe an amount to NSCC shall pay that amount on or prior to the date specified by the Board of Directors, subject to any applicable setoff rights. SFT Members who have a net claim against NSCC shall be

entitled to payment thereof along with other Members' and any other creditors' claims pursuant to the underlying contracts with respect thereto, the Rules and applicable law. Section 17(d) would further provide that nothing therein shall limit the rights of NSCC upon an SFT Member default (including following a Corporation Default), including any rights under any Clearing Agency Cross-Guaranty Agreement or otherwise.

Proposed Rule 56, Section 18 (Other Applicable Rules, Procedures, and Addendums)

Section 18 of proposed Rule 56 would establish certain other Rules as being applicable to SFTs and SFT Members, unless expressly stated otherwise.

Specifically, Section 18 of proposed Rule 56 would provide that Rule 1 (Definitions and Descriptions), Rule 2 (Members, Limited Members and Sponsored Members), Rule 5 (General Provisions), Rule 12 (Settlement), Rule 13 (Exception Processing), Rule 17 (Fine Payments), Rule 19 (Miscellaneous Rights of the Corporation), Rule 21 (Honest Broker), Rule 22 (Suspension of Rules), Rule 23 (Action by the Corporation), Rule 24 (Charges for Services Rendered), Rule 26 (Bills Rendered), Rule 27 (Admission to Premises of the Corporation - Powers of Attorney, Etc.), Rule 28 (Forms), Rule 29 (Qualified Securities Depositories), Rule 32 (Signatures), Rule 33 (Procedures), Rule 34 (Insurance), Rule 35 (Financial Reports), Rule 36 (Rule Changes), Rule 37 (Hearing Procedures), Rule 38 (Governing Law and Captions), Rule 39 (Reliance on Instructions), Rule 40 (Wind-Down of a Member, Fund Member or Insurance Carrier/Retirement Services Member), Rule 41 (Corporation Default), Rule 42 (Wind-down of the Corporation), Rule 45 (Notice), Rule 47 (Interpretation of Rules), Rule 48 (Disciplinary Proceedings), Rule 49 (Release of Clearing Data and Clearing Fund Data), Rule 55 (Settling Banks and AIP Settling Banks), Rule 58 (Limitations on Liability), Rule 60 (Market Disruption and Force Majeure), Rule 60A (Systems Disconnect: Threat of Significant Impact to the Corporation's Systems), Rule 63 (SRO Regulatory Reporting), Procedure I (Introduction), Procedure VIII (Money Settlement Service), Procedure XII (Time Schedule), Procedure XIII (Definitions), Procedure XIV (Forms, Media and Technical Specifications), Procedure XV (Clearing Fund Formula and Other Matters), Addendum B (Qualifications and Standards of Financial Responsibility, Operational Capability and Business History), Addendum H (Interpretation of the Board of Directors Release of Clearing Data), Addendum L (Statement of Policy Pertaining to Information Sharing), and Addendum P (Fine Schedule) shall apply to SFTs and SFT Members, unless the context otherwise requires.

**(D) Other Rule Changes**

In connection with proposed Rules 2C, 2D and 56, NSCC is also proposing to make conforming and technical changes to the following Rules to accommodate the proposed introduction of the new membership categories and the proposed SFT Clearing Service.

Rule 1 (Definitions and Descriptions)

In connection with proposed Rules 2C, 2D and 56, NSCC is proposing to add the following defined terms to Rule 1, in alphabetical order: Agent Clearing Member, Agent Clearing Member Agreement, Agent Clearing Member Customer Omnibus Account, Agent Clearing Member Required Fund Deposit, Agent Clearing Member Termination Date, Agent

Clearing Member Transaction, Agent Clearing Member Voluntary Termination Notice, Aggregate Net SFT Close-out Value, Approved SFT Submitter, Bilaterally Initiated SFT, Buy-In, Buy-In Amount, Buy-In Costs, Buy-In Indemnified Parties, Contract Price, Corresponding SFT Cash, Customer, Customer Clearing Service, Deemed Buy-In Costs, Defaulting SFT Member, Default-Related SFT, Distribution, Distribution Amount, Distribution Payment, Existing Master Agreement, Final Net Settlement Position, Final Settlement, Final Settlement Date, Former Sponsored Member, Incremental Additional Independent Amount SFT Cash, Independent Amount Percentage, Independent Amount SFT Cash, Independent Amount SFT Cash Deposit, Independent Amount SFT Cash Deposit Requirement, Ineligibility Date, Ineligible SFT, Ineligible SFT Security, Initial Settlement, Linked SFT, Market Value SFT Cash, Net Capital, Net Member Capital, Net Worth, Non-Returned SFT, Price Differential, Rate Payment, Recall Date, Recall Notice, Recalled SFT, Required SFT Deposit, Securities Financing Transaction or SFT, Securities Financing Transaction Clearing Service or SFT Clearing Service, Settling SFT, SFT Account, SFT Cash, SFT Close-out Value, SFT Deposit, SFT Long Position, SFT Member, SFT Position, SFT Security, SFT Short Position, Sponsored Member, Sponsored Member Agreement, Sponsored Member Liquidation Amount, Sponsored Member Sub-Account, Sponsored Member Termination Date, Sponsored Member Transaction, Sponsored Member Voluntary Termination Notice, Sponsoring Member, Sponsoring Member Agreement, Sponsoring Member Guaranty, Sponsoring Member Liquidation Amount, Sponsoring Member Required Fund Deposit, Sponsoring Member Settling Bank Omnibus Account, Sponsoring Member Termination Date, Sponsoring Member Voluntary Termination Notice, Sponsoring/Sponsored Membership Program Indemnified Parties or SMP Indemnified Parties, Transferee, Transferor and Volatility Charge.

In addition, NSCC is proposing to add three defined terms: “CNS Market Value”, which is already defined in Rule 41 (Corporation Default), “CNS Transaction”, which is already defined in Rule 11 (CNS System), and “Corporation Default”, which is already defined in Rule 41 (Corporation Default).

NSCC is also proposing to add the defined term “FICC” to mean Fixed Income Clearing Corporation. The term “FICC” is already used in Addendum P (Fine Schedule) but has not been defined.

Furthermore, NSCC is proposing to reorder the defined term Index Receipt Agent so it would be in alphabetical order.

In connection with proposed Rules 2C, 2D and 56, NSCC is also proposing to modify the definitions for the following defined terms in Rule 1, in alphabetical order: Clearing Fund, FFI Member, Qualified Securities Depository, and Required Fund Deposit. Specifically, NSCC is proposing to expand the definition of Clearing Fund to include SFT Deposit, unless noted otherwise in the Rules. NSCC is also proposing to revise the definition of FFI Member and the definition of Tax Certification<sup>85</sup> to add references to Sponsored Members. Furthermore, NSCC

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<sup>85</sup> NSCC recently added Tax Certification as a defined term in Rule 1 (Definitions and Descriptions). See Securities Exchange Act Release No. 92682 (August 17, 2021), 86 FR 47172 (August 23, 2021) (SR-NSCC-2021-009).

is proposing to revise the definition of Qualified Securities Depository to include a reference to transfer of securities in respect of the proposed SFT Clearing Service. Lastly, NSCC is proposing to expand the definition of Required Fund Deposit to include Sponsoring Member Required Fund Deposit, the Agent Clearing Member Required Fund Deposit, and the Required SFT Deposit, unless noted otherwise in the Rules.

Rule 2 (Members and Limited Members)

NSCC is proposing to revise the title of Rule 2 to include a reference to Sponsored Members. As proposed, Rule 2 would be retitled as “Members, Limited Members and Sponsored Members”.

NSCC is also proposing to revise Section 2 of Rule 2. Specifically, NSCC is proposing to clarify in Section 2(i) that a Member shall include a Member in its capacity as a Sponsoring Member to the extent specified in proposed Rule 2C and an Agent Clearing Member to the extent specified in proposed Rule 2D. In addition, NSCC is proposing to add a new subsection (iii) to Section 2 that would describe Sponsored Members as any Person that has been approved by NSCC to become a Sponsored Member and only participates in NSCC’s SFT Clearing Service as provided for in proposed Rule 56. In addition, NSCC is proposing to add references to Sponsored Members in the last paragraph of Section 2, Sections 4(i) and 4(ii).

Rule 2B (Ongoing Membership Requirements and Monitoring)

NSCC is proposing to add references to Sponsored Member in Section 5<sup>86</sup> of Rule 2B.

Rule 3 (Lists to be Maintained)

NSCC is proposing to add subsection (g) to Section 1 of Rule 3 to provide that NSCC shall maintain a list of the securities that may be the subject of a novated SFT and may from time to time add securities to such list or remove securities therefrom.

NSCC is also proposing to modify Sections 3(b) and 4 of Rule 3 to include references to Sponsored Members.

Rule 4 (Clearing Fund)

NSCC is proposing to modify Section 1 of Rule 4 in order to make it clear that the minimum Required Fund Deposit amount provided therein shall not include Required SFT Deposit, which is subject to a separate minimum \$250,000 deposit requirement pursuant to Section 12(c) of proposed Rule 56, as described above.

Rule 5 (General Provisions)

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<sup>86</sup> NSCC recently added Section 5 to Rule 2B (Ongoing Membership Requirements and Monitoring). See Securities Exchange Act Release No. 93278 (October 8, 2021), 86 FR 57229 (October 14, 2021) (SR-NSCC-2021-007).

NSCC is proposing to modify Section 1 of Rule 5 in order to provide that delivery of SFT Securities and SFT Cash to NSCC shall be made through the facilities of a Qualified Securities Depository. In addition, NSCC is also proposing changes in Section 1 of Rule 5 to provide that delivery and payment with respect to SFT Securities and SFT Cash shall be effected as prescribed in the Rules and regulations as NSCC may from time to time adopt.

Rule 24 (Charges for Services Rendered)

NSCC is proposing to modify Section 1 of Rule 24 to include a reference to Sponsored Members. In addition, NSCC is proposing to add an additional paragraph in Section 1 to clarify that Members shall be responsible for all fees pertaining to their respective Sponsoring Member activity or Agent Clearing Member activity, if applicable, as set forth in NSCC's Fee Structure.<sup>87</sup>

Rule 26 (Bills Rendered)

NSCC is proposing to modify the first paragraph of Rule 26 to include a reference to Sponsored Members. In addition, NSCC is proposing to add a sentence in that paragraph to clarify that Members shall receive bills for their respective aggregate Sponsoring Member activity and Agent Clearing Member activity, if applicable, as set forth in NSCC's Fee Structure.<sup>88</sup>

Rule 32 (Signatures)

NSCC is proposing to modify Rule 32 to include a reference to Sponsored Member. Specifically, NSCC is proposing to modify Rule 32 to provide that the use of an electronic signature shall have the same validity and effect as the use of a signature affixed by hand with respect to any and all agreements and other documents entered into between a Sponsored Member and NSCC.

Rule 38 (Governing Law and Captions)

NSCC is proposing to modify Section 1 of Rule 38 to include a reference to Sponsored Member. Specifically, NSCC is proposing to modify Section 1 of Rule 38 to provide that Rules and all agreements and other documents entered into between a Sponsored Member and NSCC or otherwise delivered to or by NSCC pursuant to the Rules, and the rights and obligations under the Rules thereunder, shall be governed by, and construed in accordance with, the laws of the State of New York applicable to contracts executed and performed therein, unless otherwise provided.

Rule 39 (Reliance on Instructions)

NSCC is proposing to modify Rule 39 to include references to Sponsored Member and Approved SFT Submitter, where applicable. Specifically, NSCC is proposing to modify the first

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<sup>87</sup> See Addendum A (Fee Structure), supra note 1.

<sup>88</sup> Id.

paragraph of Rule 39 to provide that NSCC may accept or rely upon instructions given to NSCC by a Sponsored Member or Approved SFT Submitter, in addition to the various participant types currently provided in Rule 39. Similarly, NSCC is proposing to add references to Approved SFT Submitter in the second and last paragraphs of Rule 39 so that those paragraphs would also apply to instructions submitted by an Approved SFT Submitter.

Rule 42 (Wind-Down of the Corporation)

NSCC is proposing to modify Rule 42 to include references to Sponsored Members. Specifically, for purposes of Rule 42, NSCC is proposing to revise the defined term “Limited Member” to include Sponsored Members.

Rule 49 (Release of Clearing Data and Clearing Fund Data)

NSCC is proposing to modify Rule 49 to clarify that NSCC would release Clearing Data of a Sponsored Member to its Sponsoring Member upon the Sponsoring Member’s written request. Specifically, as proposed, Section (a) of Rule 49 would provide that if the participant is a Sponsored Member, NSCC would also release Clearing Data relating to transactions of such participant to such participant’s Sponsoring Member upon the Sponsoring Member’s written request.

Rule 58 (Limitations on Liability)

NSCC is proposing to modify Rule 58 to clarify that NSCC would not be responsible for the completeness or accuracy of the transaction data received from the Approved SFT Submitters, nor shall NSCC, absent gross negligence on NSCC’s part, be responsible for any errors, omissions or delays that may occur in the transmission of transaction data from an Approved SFT Submitter.

Rule 64 (DTCC Shareholders Agreement)

The proposed changes to Section 4 of Rule 64 and footnote 1 thereto would provide that Rule 64 would not be applicable to a Sponsored Member. However, if the Sponsored Member is also a member or participant of another clearing agency subsidiary of DTCC, the Sponsored Member may be a Mandatory Purchaser Participant or a Voluntary Purchaser Participant pursuant to the terms of the Shareholders Agreement and the rules and procedures of such other subsidiary.

Procedure XV (Clearing Fund Formula and Other Matters)

NSCC is proposing to modify subsection A of Section II (Minimum Clearing Fund and Additional Deposit Requirements) in Procedure XV in order to make it clear that the minimum contribution amount provided therein shall not include Required SFT Deposit, which is subject to a separate minimum \$250,000 deposit requirement pursuant to Section 12(c) of proposed Rule 56, as described above. In addition, NSCC is proposing to modify Section II.A of Procedure XV to make it clear that calculation of a Member’s Required Fund Deposit amount that must be in cash shall exclude the Required SFT Deposit, which is subject to a separate \$250,000 minimum cash requirement pursuant to Section 12(c) of proposed Rule 56, as described above.



Addendum B (Qualifications and Standards of Financial Responsibility, Operational Capability and Business History)

NSCC is proposing an additional section for the Sponsored Members. Specifically, NSCC is proposing to add Section 12 to Addendum B that would describe the qualification and operational capability that NSCC would require from Sponsored Members.

In addition, NSCC is proposing a conforming change to replace “net worth” in Section 3.B.4. with “Net Worth” to reflect the proposed defined term in Rule 1 (Definitions).

Addendum P (Fine Schedule)

NSCC is proposing to modify paragraph (2) of Addendum P to reflect the proposed notification obligations of Sponsoring Members, Sponsored Members and Agent Clearing Members as proposed under Sections 2(i) and 3(d) of proposed Rule 2C and Section 2(i) of proposed Rule 2D.

**(vii) Impact of the Proposed SFT Clearing Service on Various Persons**

The proposed SFT Clearing Service would be voluntary. Institutional firm clients that wish to become Sponsored Members, and Members that wish to participate in the proposed SFT Clearing Service would have an opportunity to review the proposed rule change and determine if they would like to participate. Choosing to participate would make these entities subject to all of the rule changes that would be applicable to the proposed SFT Clearing Service and membership type, as described below.

The proposed SFT Clearing Service would affect institutional firm clients that choose to become Sponsored Members because it would impose various requirements on them. These requirements include, but are not limited to, proposed Rule 56 and the following sections of proposed Rule 2C: (1) eligibility, approval process and on-going membership requirements as specified in Sections 3 and 4, (2) requirements related to restriction on access to NSCC services in Section 11, (3) requirements related to insolvency of a Sponsored Member in Section 13, and (4) requirements related to liquidation of positions resulting from Sponsored Member Transactions in Section 14. Specific details on the requirements and the manner in which the proposed SFT Clearing Service would affect institutional firm clients that choose to become Sponsored Members can be found above in Item 10(vi)(A) – Proposed Rule Changes – Proposed Rule 2C – Sponsoring Members and Sponsored Members.

The proposed SFT Clearing Service would affect Members that choose to participate in the service because it would impose various requirements on them, depending on whether they are participating in the service as a Sponsoring Member, an Agent Clearing Member and/or as a Member. These requirements include, but are not limited to, the requirements specified in proposed Rule 2C for Members participating in the service as a Sponsoring Member; the requirements specified in proposed Rule 2D for Members participating in the service as an Agent Clearing Member; and for all Members participating in the service, the requirements specified in proposed Rule 56. Specific details on these requirements and the manner in which the proposed SFT Clearing Service would affect Members that choose to participate in the proposed SFT Clearing Service are described above in Sections 10(vi)(A) – Proposed Rule Changes – Proposed

Rule 2C – Sponsoring Members and Sponsored Members, (vi)(B) – Proposed Rule Changes – Proposed Rule 2D – Agent Clearing Members, and (vi)(C) – Proposed Rule Changes – Proposed Rule 56 – Securities Financing Transaction Clearing Service.

The proposed SFT Clearing Service would not materially affect existing Members that do not choose to participate in it. First, the proposed SFT Clearing Service would not materially affect the operation of CNS or any other services offered by NSCC. In addition, SFT Members would be subject to the same or higher credit standards and market risk management requirements as those applicable to Members that choose not to participate in the proposed SFT Clearing Service, as described above. Moreover, although Members who choose not to participate in the proposed SFT Clearing Service would be subject to potential loss allocation in the event of an SFT Member default (just as SFT Members would be subject to potential loss allocation in the event of the default of a Member that chooses not to participate in the proposed SFT Clearing Service), the underlying securities that would be subject of any such default-related liquidation of an SFT Member are a subset of the same CNS-eligible securities with respect to which NSCC today guarantees settlement in the cash equity market, thus not materially affecting the nature of the loss allocation risk applicable to Members.

*Expected Effect on, and Management of, Risks to the Clearing Agency, Its Participants and the Market*

NSCC expects certain market, liquidity, credit and operational risks may be presented by the establishment of the proposed SFT Clearing Service and the additional membership categories proposed in connection therewith. Accordingly, NSCC proposes to address and manage each of these risks as detailed below.

*Market Risk*

The proposal is structured in a manner that allows NSCC to protect itself from associated market risk. Specifically, as described above, except with respect to the VaR charge, SFT activity would be risk managed by NSCC in a manner consistent with Members' CNS positions. Moreover, except with respect to the MLA charge, all SFT Positions would be margined independently of the Member's other positions, i.e., Required SFT Deposit. The Required SFT Deposit would generally be calculated using the same procedure applicable to CNS positions, but with a separate \$250,000 minimum.<sup>89</sup>

As described above, consistent with the manner in which clearing fund requirements are satisfied by members of FICC for their cleared securities financing transactions, NSCC would require that (i) a minimum of 40% of an SFT Member's Required SFT Deposit consist of a combination of cash and Eligible Clearing Fund Treasury Securities and (ii) the lesser of \$5,000,000 or 10% of an SFT Member's Required SFT Deposit (but not less than \$250,000)

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<sup>89</sup> Supra note 29.

consist of cash.<sup>90,91</sup> NSCC would also have the discretion to require a Member to post its Required SFT Deposit in proportion of cash higher than would otherwise be required.<sup>92</sup> NSCC's determination to impose any such requirement would be made in view of market conditions and other financial and operational capabilities of the relevant SFT Member.

Furthermore, NSCC would require additional Clearing Fund deposits to address two situations that may present unique risk. First, if the share price of underlying securities of an SFT that has already been novated to NSCC falls below the threshold established by NSCC from time to time, NSCC would require both pre-novation counterparties to the SFT to post Clearing Fund equal to 100% of the market value of such underlying securities until such time as the per share price of the underlying securities equals or exceeds such threshold.<sup>93</sup> Second, in the event an SFT is subject to a collateral haircut (i.e., the SFT Cash exceeds the market value of the securities), NSCC would require the Transferor (or in the case of an Agent Clearing Member Transaction, the Agent Clearing Member) to post Clearing Fund equal to such excess.<sup>94</sup>

Additionally, the Sponsoring Member Required Fund Deposits and Agent Clearing Member Required Fund Deposits would each be calculated on a gross basis, and no offsets for netting of positions as between different Sponsored Members or different Customers, as applicable, would be permitted. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above).

NSCC is also proposing to limit the SFTs eligible for clearing to overnight transactions on securities that are CNS-eligible equity securities with a share price that equals or exceeds the threshold established by NSCC from time to time and that are fully collateralized by cash. NSCC believes these limitations, in addition to the Clearing Fund requirements, would limit the potential market risk associated with SFTs.

### Liquidity Risk

The proposal is also structured in a manner that allows NSCC to protect itself from associated liquidity risk. Specifically, the proposal would provide that the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>95</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk

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<sup>90</sup> Supra note 31.

<sup>91</sup> Supra note 32.

<sup>92</sup> See Section 12(d) of proposed Rule 56.

<sup>93</sup> See Section 13(b) of proposed Rule 56.

<sup>94</sup> See Section 12(e) of proposed Rule 56.

<sup>95</sup> Supra note 24.

controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member, on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>96</sup> NSCC would take into account such Price Differential payment obligations, as well as any Final Settlement obligations to non-defaulting SFT Members, when calculating the amount of liquidity resources that NSCC may require in the event of the default of the participant family that would generate the largest aggregate payment obligation for NSCC in extreme but plausible market conditions.<sup>97,98</sup> By continuing to process these Price Differential payments until Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact are generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT Deposit and any SLD that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>99</sup>

### Credit Risk

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<sup>96</sup> See proposed Rule 56, Section 14(b)(ix)

<sup>97</sup> Id.

<sup>98</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>99</sup> Supra note 36.

The proposal is also structured in a manner that allows NSCC to protect itself from associated credit risk. In addition to the Clearing Fund requirements discussed above, any Member that elects to participate in the proposed SFT Clearing Service would be subject to the same initial membership requirements and ongoing membership requirements and monitoring as any other Member. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above) in addition to an approval process that is separate from its original Member applications, as well as ongoing credit surveillance in its capacity as a Sponsoring Member or Agent Clearing Member, as applicable.

### Operational Risk

The proposal is also structured in a manner that allows NSCC to protect itself from associated operational risk. NSCC proposes to utilize to a significant extent the same processes and infrastructure as it has used for many years to clear and settle cash market transactions for purposes of clearing and settling SFTs. NSCC staff is well versed in such processes and infrastructure and has been actively involved in the development of the proposed SFT Clearing Service, thereby allowing for ready integration of support for the proposed SFT Clearing Service into NSCC staff's current workflows.

Accordingly, NSCC believes that, taken as a whole, the proposal would not have any risks to NSCC, its Members and the market overall that cannot be prudently managed or mitigated.

### Consistency with the Clearing Supervision Act

The proposed rule change would be consistent with Section 805(b) 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").<sup>100</sup> The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.<sup>101</sup>

NSCC believes that the proposal would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.

### *Promoting Robust Risk Management and Promoting Safety and Soundness.*

NSCC believes that the proposal is consistent with promoting robust risk management and promoting safety and soundness, particularly management of market risks, liquidity risks, credit risks and operational risks presented to NSCC.

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<sup>100</sup> 12 U.S.C. 5464(b).

<sup>101</sup> Id.

The proposal is structured in a manner that allows NSCC to protect itself from associated market risk. SFT activity would, except as otherwise noted above, be risk managed by NSCC in a manner consistent with Members' CNS positions. Moreover, except with respect to the MLA charge, all SFT Positions would be margined independently of the Member's other positions, i.e., Required SFT Deposit. The Required SFT Deposit would generally be calculated using the same procedure applicable to CNS positions, but with a separate \$250,000 minimum.<sup>102</sup>

As described above, consistent with the manner in which clearing fund requirements are satisfied by members of FICC for their cleared securities financing transactions, NSCC would require that (i) a minimum of 40% of an SFT Member's Required SFT Deposit consist of a combination of cash and Eligible Clearing Fund Treasury Securities and (ii) the lesser of \$5,000,000 or 10% of an SFT Member's Required SFT Deposit (but not less than \$250,000) consist of cash.<sup>103,104</sup> NSCC would also have the discretion to require a Member to post its Required SFT Deposit in proportion of cash higher than would otherwise be required.<sup>105</sup> NSCC's determination to impose any such requirement would be made in view of market conditions and other financial and operational capabilities of the relevant SFT Member.

Furthermore, NSCC would require additional Clearing Fund deposits to address two situations that may present unique risk. First, if the share price of underlying securities of an SFT that has already been novated to NSCC falls below the threshold established by NSCC from time to time, NSCC would require both pre-novation counterparties to the SFT to post Clearing Fund equal to 100% of the market value of such underlying securities until such time as the per share price of the underlying securities equals or exceeds such threshold.<sup>106</sup> Second, in the event an SFT is subject to a collateral haircut (i.e., the SFT Cash exceeds the market value of the securities), NSCC would require the Transferor (or in the case of an Agent Clearing Member Transaction, the Agent Clearing Member) to post Clearing Fund equal to such excess.<sup>107</sup>

Additionally, the Sponsoring Member Required Fund Deposits and Agent Clearing Member Required Fund Deposits would each be calculated on a gross basis, and no offsets for netting of positions as between different Sponsored Members or different Customers, as applicable, would be permitted. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above).

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<sup>102</sup> See Section 12(c) of proposed Rule 56.

<sup>103</sup> Supra note 31.

<sup>104</sup> Supra note 32.

<sup>105</sup> See Section 12(d) of proposed Rule 56.

<sup>106</sup> See Section 13(b) of proposed Rule 56.

<sup>107</sup> See Section 12(e) of proposed Rule 56.

NSCC is also proposing to limit the SFTs eligible for clearing to overnight transactions on securities that are CNS-eligible equity securities with a share price that equals or exceeds the threshold established by NSCC from time to time and that are fully collateralized by cash. NSCC believes these limitations, in addition to the Clearing Fund requirements, would limit the potential market risk associated with SFTs.

The proposal is also structured in a manner that allows NSCC to protect itself from associated liquidity risk. Specifically, the proposed rule change would provide that the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>108</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member, on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>109</sup> NSCC would take into account such Price Differential payment obligations, as well as any Final Settlement obligations to non-defaulting SFT Members, when calculating the amount of liquidity resources that NSCC may require in the event of the default of the participant family that would generate the largest aggregate payment obligation for NSCC in extreme but plausible market conditions.<sup>110,111</sup> By continuing to process these Price Differential payments until Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is

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<sup>108</sup> Supra note 24.

<sup>109</sup> See proposed Rule 56, Section 14(b)(ix).

<sup>110</sup> Id.

<sup>111</sup> 17 CFR 240.17Ad-22(e)(7).

because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact are generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT Deposit and any SLD that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>112</sup>

The proposal is also structured in a manner that allows NSCC to protect itself from associated credit risk. In addition to the Clearing Fund requirements discussed above, any Member that elects to participate in the proposed SFT Clearing Service would be subject to the same initial membership requirements and ongoing membership requirements and monitoring as any other Member. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above) in addition to an approval process that is separate from its original Member applications, as well as ongoing credit surveillance in its capacity as a Sponsoring Member or Agent Clearing Member, as applicable.

The proposal is also structured in a manner that allows NSCC to protect itself from associated operational risk. NSCC proposes to utilize to a significant extent the same processes and infrastructure as it has used for many years to clear and settle cash market transactions for purposes of clearing and settling SFTs. NSCC staff is well versed in such processes and infrastructure and has been actively involved in the development of the proposed SFT Clearing Service, thereby allowing for ready integration of support for the proposed SFT Clearing Service into NSCC staff's current workflows.

For these reasons NSCC believes the proposal would help promote robust risk management at NSCC, consistent with the objective and principles of Section 805(b) of the Clearing Supervision Act.

*Reducing Systemic Risks and Supporting the Stability of the Broader Financial System.*

NSCC also believes that the proposal is consistent with reducing systemic risks and supporting the stability of the broader financial system. As described above, the proposal would lower the risk of liquidity drain in the U.S. equity securities financing market by lessening counterparties' likely inclination to unwind transactions in a stressed market scenario. NSCC would use its risk management resources to provide confidence to market participants that they will receive back their cash or securities, as applicable, which should limit the propensity for market participants to seek to unwind their transactions in a stressed market scenario.

In addition, the proposal would protect against fire sale risk. As described above, in the event of a default, NSCC would conduct a centralized, orderly liquidation of the defaulter's SFT Positions. Such an organized liquidation should result in substantially less price depreciation and market disruption than multiple independent non-defaulting parties racing against one another to

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<sup>112</sup> Supra note 36.



liquidate the positions. In addition, NSCC would only need to liquidate the defaulter's net positions. Limiting the positions that need to be liquidated to the defaulter's net positions should reduce the volume of required sales activity, which in turn should limit the price and market impact of the close-out of the defaulter's positions. NSCC would also use its risk management resources to provide confidence to market participants that they will receive back their cash or securities, as applicable, which should limit the propensity for market participants to seek to unwind their transactions in a stressed market scenario. By lowering the risk of liquidity drain in the U.S. equity securities financing market and protecting against fire sale risk, NSCC believes the proposal would help reduce systemic risks, which in turn helps support the stability of the broader financial system, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.

NSCC also believes that the proposed rule change is consistent with Rules 17Ad-22(e)(7), 17Ad-22(e)(8), and 17Ad-22(e)(18), promulgated under the Act,<sup>113</sup> for the reasons stated below.

Rule 17Ad-22(e)(7) under the Act requires NSCC to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency.<sup>114</sup> NSCC believes that the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(7) because, as described above, the proposal is structured in a manner that allows NSCC to protect itself from associated liquidity risk. Specifically, the proposal would provide that the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>115</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member, on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the

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<sup>113</sup> 17 CFR 240.17Ad-22(e)(7), (e)(8), and (e)(18).

<sup>114</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>115</sup> Supra note 24.

Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>116</sup> NSCC would take into account such Price Differential payment obligations, as well as any Final Settlement obligations to non-defaulting SFT Members, when calculating the amount of liquidity resources that NSCC may require in the event of the default of the participant family that would generate the largest aggregate payment obligation for NSCC in extreme but plausible market conditions.<sup>117,118</sup> By continuing to process these Price Differential payments until Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact is generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT Deposit and any SLD that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>119</sup> Therefore, NSCC believes that the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(7) under the Act.<sup>120</sup>

Rule 17Ad-22(e)(8) under the Act<sup>121</sup> requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to define the point at which settlement is final to be no later than the end of the day on which the payment or obligation is due. NSCC believes that the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(8)<sup>122</sup> because, as described above, the proposal would make it clear to SFT Members the point at which settlement is final with respect to SFTs cleared through NSCC. Specifically, Section 7 in the proposed Rule 56 (Securities Financing Transaction Clearing Service) provides that an SFT, or a portion thereof, shall be deemed complete and final upon Final Settlement of the SFT, or such portion. Having clear provisions in this regard would

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<sup>116</sup> See proposed Rule 56, Section 14(b)(ix).

<sup>117</sup> Id.

<sup>118</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>119</sup> Supra note 36.

<sup>120</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>121</sup> 17 CFR 240.17Ad-22(e)(8).

<sup>122</sup> Id.

enable SFT Members to better identify the point at which settlement is final with respect to their SFTs. As such, NSCC believes the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(8) under the Act.<sup>123</sup>

Rule 17Ad-22(e)(18) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation.<sup>124</sup> NSCC believes the proposed changes to establish new membership categories and requirements for Sponsoring Members and Sponsored Members would establish objective, risk-based, and publicly disclosed criteria for participation in NSCC as Sponsoring Members and Sponsored Members. Specifically, as proposed, in order for an applicant to become a Sponsoring Member, the applicant would be required to satisfy a number of objective and risk-based eligibility criteria. First, the applicant must be a Member. In addition, if the applicant is a Registered-Broker-Dealer, then it would be required to have (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the applicant's designated examining authority) of at least \$10 million. Likewise, in order for an applicant to become a Sponsored Member, the applicant would be required to meet certain objective, risk-based eligibility criteria. Specifically, an applicant would be eligible to apply to become a Sponsored Member if it is either a "qualified institutional buyer" as defined by Rule 144A<sup>125</sup> under the Securities Act,<sup>126</sup> or a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act, satisfies the financial requirements necessary to be a "qualified institutional buyer" as specified in that paragraph. If approved, the requirements for proposed new Sponsoring Member and Sponsored Member membership categories would become part of the Rules, which are publicly available on DTCC's website ([www.dtcc.com](http://www.dtcc.com)), and market participants would be able to review them in connection with their evaluation of potential participation in NSCC as Sponsoring Members and Sponsored Members. Therefore, NSCC believes that the proposed changes to establish new membership categories and requirements for Sponsoring Members and Sponsored Members are consistent with Rule 17Ad-22(e)(18) under the Act.<sup>127</sup>

Similarly, NSCC believes the proposed changes to establish new a membership category and requirements for Agent Clearing Members would establish objective, risk-based, and publicly disclosed criteria for participation in NSCC as Agent Clearing Members. Specifically, as proposed, in order for an applicant to become an Agent Clearing Member, the applicant would be required to satisfy a number of objective and risk-based eligibility criteria. First, the applicant

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<sup>123</sup> Id.

<sup>124</sup> 17 CFR 240.17Ad-22(e)(18).

<sup>125</sup> 17 CFR 230.144A.

<sup>126</sup> 15 U.S.C. 77a et seq.

<sup>127</sup> 17 CFR 240.17Ad-22(e)(18).

must be a Member. In addition, if the applicant is a Registered-Broker-Dealer, then it would be required to have (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the applicant's designated examining authority) of at least \$10 million. If approved, the requirements for proposed new Agent Clearing Member membership category would become part of the Rules, which are publicly available on DTCC's website ([www.dtcc.com](http://www.dtcc.com)), and market participants would be able to review them in connection with their evaluation of potential participation in NSCC as Agent Clearing Members. Therefore, NSCC believes that the proposed changes to establish a new membership category and requirements for Agent Clearing Members are consistent with Rule 17Ad-22(e)(18) under the Act.<sup>128</sup>

## 11. Exhibits

Exhibit 1 – Not applicable.

Exhibit 1A – Notice of advance notice for publication in the Federal Register.

Exhibit 2 – Not applicable.

Exhibit 3a – NSCC's response to a Request for Additional Information issued on August 30, 2021 with respect to an earlier version of the proposal. **Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3a pursuant to 17 CFR 240.24b-2 being requested.**

Exhibit 3b – NSCC's response to a Second Request for Additional Information issued on February 28, 2022 with respect to an earlier version of the proposal. **Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3b pursuant to 17 CFR 240.24b-2 being requested.**

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the Rules.

**EXHIBIT 1A**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-[\_\_\_\_\_]; File No. SR-NSCC-2022-801)

[DATE]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Advance Notice to Establish the Securities Financing Transaction Clearing Service and Make Other Changes

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”) <sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”),<sup>2</sup> notice is hereby given that on March \_\_, 2022, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice as described in Items I, II and III below, which Items have been prepared by the clearing agency.<sup>3</sup> 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 proposed modifications to the NSCC Rules & Procedures (“Rules”)<sup>4</sup> that would (i) establish new membership categories and

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> NSCC filed this advance notice as a proposed rule change (SR-NSCC-2022-003) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder, 17 CFR 240.19b-4. A copy of the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

<sup>4</sup> Capitalized terms not defined herein are defined in the Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

requirements for sponsoring members and sponsored members whereby existing Members would be permitted to sponsor certain institutional firms into membership, (ii) establish a new membership category and requirements for agent clearing members whereby existing Members would be permitted to submit, on behalf of their customers, transactions to NSCC for novation, (iii) establish the securities financing transaction clearing service (“Securities Financing Transaction Clearing Service” or “SFT Clearing Service”) to make central clearing available at NSCC for equity securities financing transactions, which are, broadly speaking, transactions where the parties exchange equity securities against cash and simultaneously agree to exchange the same securities and cash, plus or minus a rate payment, on a future date (collectively, “Securities Financing Transactions” or “SFTs”), and (iv) make other amendments and clarifications to the Rules, as described in greater detail below.

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 reviewed the proposal with various Members and market participants (e.g., agent lenders, brokers, matching service providers, and books and records service providers) in order to benefit from their expertise and industry knowledge. Written comments relating to this proposal have not been received from Members or any other

person. If any written comments are received, they will be publicly filed as an Exhibit 2 to this filing, as required by Form 19b-4 and the General Instructions thereto.

Persons submitting comments are cautioned that, according to Section IV (Solicitation of Comments) of the Exhibit 1A in the General Instructions to Form 19b-4, the Commission does not edit personal identifying information from comment submissions. Commenters should submit only information that they wish to make available publicly, including their name, email address, and any other identifying information.

All prospective commenters should follow the Commission's instructions on how to submit comments, available at <https://www.sec.gov/regulatory-actions/how-to-submit-comments>. General questions regarding the rule filing process or logistical questions regarding this filing should be directed to the Main Office of the Commission's Division of Trading and Markets at [tradingandmarkets@sec.gov](mailto:tradingandmarkets@sec.gov) or 202-551-5777.

NSCC reserves the right not to respond to any comments received.

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

Nature of the Proposed Change

The purpose of this proposed rule change is to (i) establish new membership categories and requirements for sponsoring members and sponsored members whereby existing Members would be permitted to sponsor certain institutional firms into membership, (ii) establish a new membership category and requirements for agent clearing members whereby existing Members would be permitted to submit, on behalf of their customers, transactions to NSCC for novation, (iii) establish the SFT Clearing

Service to make central clearing available at NSCC for SFTs, and (iv) make other amendments and clarifications to the Rules, as described in greater detail below.

**(i) Background**

NSCC is proposing to introduce central clearing for SFTs, which are, broadly speaking, securities lending transactions where parties exchange equity securities against cash and simultaneously agree to exchange the same securities and cash, plus or minus a rate payment, on a future date. In particular, the proposed SFT Clearing Service would expand central clearing at NSCC to include SFTs with a one Business Day term (i.e., overnight SFTs) in eligible equity securities that are entered into by Members, institutional firms that are sponsored into NSCC by a Sponsoring Member (as defined below and in the proposed rule change), or Agent Clearing Members (as defined below and in the proposed rule change) on behalf of Customers (as defined below and in the proposed rule change), as applicable.

SFTs involve the owner of securities (typically a registered investment company, pension plan, sovereign wealth fund or other institutional firm) transferring those securities temporarily to a borrower (typically a hedge fund). SFTs are often facilitated and intermediated by broker-dealers and agent lenders (i.e., custodial banks or other institutions that lend out securities as agent on behalf of institutional firms). In return for the lent securities, the borrower transfers collateral, and a net rate payment is typically transferred to either the lender or the borrower that reflects the liquidity of the lent securities, as well as interest on any cash collateral.<sup>5</sup> NSCC understands that SFTs

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<sup>5</sup> This rate payment is typically calculated in a manner similar to interest on the principal balance of a loan and accrues on a daily basis. As a result, the rate payment is typically calculated as the product of a specified balance (typically the



provide liquidity to markets and facilitates the ability of market participants to make delivery on short-sales, and thereby avoid failures to deliver, “naked” shorts, and similar situations. On a typical Business Day, The Depository Trust Company (“DTC”), an NSCC affiliate, processes deliver orders related to securities lending transactions on securities having a value of approximately \$150 billion.

*Capital Efficiency Opportunities*

The Basel III<sup>6</sup> capital and leverage requirements, as implemented by the U.S. banking regulators, constrain the ability of agent lenders and brokers to intermediate and facilitate SFTs.<sup>7</sup> NSCC believes central clearing of SFTs would be able to address these constraints, which may otherwise impair market participants’ ability to engage in SFTs.

For example, NSCC believes it is uniquely positioned to create balance sheet netting opportunities for market participants (i.e., the ability to offset cash payables and receivables versus NSCC) by becoming the legal counterparty to both pre-novation counterparties to an SFT through novation. Specifically, market participants that borrow securities through NSCC and then onward lend those securities, or other securities, to

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amount of cash collateral unless the collateral consists of securities) and a specified rate (reflecting both the liquidity of the securities and the ability of the lender to re-use the cash collateral), divided by 360 or a similar day count fraction.

<sup>6</sup> Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007 – 2009.

<sup>7</sup> See, e.g., 12 C.F.R. Part 3 (Office of the Comptroller of the Currency – Capital Adequacy Standards); 12 C.F.R. Part 217 (Federal Reserve – Capital Adequacy of Bank Holding Companies, Savings and Loan Holding Companies, and State Member Banks); 12 C.F.R. Part 252, Subpart Q (Single Counterparty Credit Limits); 12 C.F.R. Part 324 (Federal Deposit Insurance Corporation – Capital Adequacy of FDIC-Supervised Institutions).

another NSCC Member through the proposed SFT Clearing Service may have the ability to net down the cash collateral return obligations and entitlements related to such SFTs. By contrast, for bilateral SFTs, market participants may be required to record those payables and receivables on their balance sheets on a gross (rather than netted) basis. A netted balance sheet can create significant capital benefits for market participants because it can reduce the amount of regulatory capital they must hold against SFTs under the U.S. “supplementary leverage ratio” and other capital requirements that favor a netted balance sheet.<sup>8</sup>

In addition, under Basel III, bank holding companies that have broker-dealer subsidiary borrowers are required to reserve capital against their exposures to institutional firm lenders of securities in relation to the cash collateral posted by such borrowers. Those capital requirements can vary depending on the credit profile of the institutional firm lender, and generally are well in excess of those applied to exposures to qualifying central counterparties, such as NSCC.<sup>9</sup> The counterparty risk weight of a qualifying central counterparty, like NSCC, is 2%,<sup>10</sup> which may result in considerable capital savings to these bank holding companies, to the extent they participate in central clearing.

Moreover, agent lending banks and bank holding company parents of broker-dealer borrowers that participate in central clearing could receive beneficial treatment

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<sup>8</sup> See 12 C.F.R. § 217.10(c)(4)(ii)(E)-(F).

<sup>9</sup> See 12 C.F.R. §§ 217.32 and 217.37 generally.

<sup>10</sup> See 12 C.F.R. § 217.35(c)(3).

under the single counterparty credit limits, which exempt exposures to qualifying central counterparties.<sup>11</sup>

In light of the potential for central clearing to alleviate the aforementioned capital constraints otherwise applicable to bilateral SFTs, NSCC believes that central clearing of SFTs may increase the capacity of market participants to engage in SFTs.<sup>12</sup>

*Fire Sale Risk Mitigation*

In addition to creating capital efficiency opportunities for market participants, NSCC believes that broadening the scope of central clearing at NSCC to SFTs would also reduce the potential for market disruption from fire sales.

In the case of securities lending transactions, the primary risk of fire sales<sup>13</sup> relates to the reinvestment of cash collateral by institutional firms that are the lenders in securities lending transactions. Those institutional firms will typically reinvest the cash collateral they receive from the borrower into other securities. If the borrower of the securities thereafter defaults, the institutional firm lenders generally need to quickly liquidate the securities representing the reinvestment in order to raise cash to purchase the originally lent security. A substantial number of disconnected and competing liquidations by multiple lenders can create fire sale conditions for the securities being liquidated, which can harm not only the institutional firm lenders by potentially lowering

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<sup>11</sup> See 12 C.F.R. § 252.77(a)(3).

<sup>12</sup> Members should discuss this matter with their accounting and regulatory capital experts.

<sup>13</sup> Fire sale risk is the risk of rapid sales of assets in large amounts that temporarily depress market prices of such assets and create financial instability.

the amount of cash they can raise in the sale of such securities, but also create market losses for all holders of such securities.<sup>14</sup>

Moreover, if an institutional firm lender should default and fail to return the cash collateral back to its borrowers, the borrowers would typically be looking to liquidate the borrowed securities in order to make themselves whole for the cash collateral they delivered to the institutional firm lender. Competing and disconnected sales of such securities could similarly create fire sale conditions and not only harm the borrowers to the extent the value of the securities decline, but also create market losses for all holders of the borrowed securities.

NSCC believes that broadening the scope of central clearing at NSCC to SFTs would reduce the potential for market disruption from fire sales for a number of reasons. First, in the event of a default, NSCC would conduct a centralized, orderly liquidation of the defaulter's SFT Positions (as defined below and in the proposed rule change). Such an organized liquidation should result in substantially less price depreciation and market disruption than multiple independent non-defaulting parties racing against one another to liquidate the positions. Second, NSCC would only need to liquidate the defaulter's net positions. By contrast, in the context of a default by a broker-dealer intermediary that runs a matched book in the bilateral securities market, both the ultimate lender and the

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<sup>14</sup> See Financial Stability Board, *Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*, at 5 (August 29, 2013) available at [https://www.fsb.org/wp-content/uploads/r\\_130829b.pdf?page\\_moved=1](https://www.fsb.org/wp-content/uploads/r_130829b.pdf?page_moved=1). See also United States Securities and Exchange Commission, *Securities Lending and Short Sale Roundtable Transcript* (September 29, 2009), Former Chairman Schapiro's Remarks, at 2-3, available at <https://www.sec.gov/news/openmeetings/2009/roundtable-transcript-092909.pdf>.

ultimate borrower need to liquidate the defaulter's gross positions. Limiting the positions that need to be liquidated to the defaulter's net positions should reduce the volume of required sales activity, which in turn should limit the price and market impact of the close-out of the defaulter's positions. Lastly, NSCC would use its risk management resources to provide confidence to market participants that they will receive back their cash or securities, as applicable, which should limit the propensity for market participants to seek to unwind their transactions in a stressed market scenario.

*Liquidity Drain Risk Mitigation*

Liquidity risk may also arise if, in the context of a stressed market scenario, borrowers or lenders concerned about their counterparties' creditworthiness seek to unwind their securities lending transactions and obtain the return of their cash collateral or securities. This occurred to a certain extent in 2008, when borrowers began demanding to return borrowed securities in exchange for the cash collateral the borrowers had posted to institutional firm lenders.<sup>15</sup> These "runs" may require institutional firm lenders to quickly sell off securities that are the subject of their cash reinvestments to raise cash to return to the borrowers, thereby also creating potential fire sale conditions with respect to the reinvestment securities, as described above. Similarly, borrowers may need to purchase or re-borrow securities in stressed market conditions, leading to potentially significant losses.

NSCC believes that having SFTs be centrally cleared by NSCC would lower the risk of a liquidity drain in a stress scenario. Specifically, NSCC believes that having it clear SFT activity would provide confidence to borrowers and lenders that they will

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<sup>15</sup> See, e.g., id.

receive back their cash or securities and thereby lessen parties' inclination to rush to unwind their transactions in a stressed market scenario.

*Addition of New Membership Categories for Institutional Firm SFT Activity*

When evaluating the opportunity to expand its cleared offerings to SFTs, NSCC engaged in extensive discussions with numerous market participants, including agent lenders, brokers, institutional firms, and critical third parties, such as matching service providers and books and records service providers. NSCC also organized several industry working groups to discuss the possibility of clearing SFTs. Each constituency has a unique perspective on the proposed SFT Clearing Service. By capturing their differing viewpoints in the design, NSCC has sought to ensure that the proposed SFT Clearing Service would reflect their needs and facilitate industry adoption of the proposed SFT Clearing Service.

There was a considerable amount of discussion between NSCC and market participants regarding the appropriate model(s) through which institutional firms should access central clearing. Some market participants expressed interest in allowing Members to sponsor institutional firms into NSCC membership in a manner similar to that provided for under the sponsoring member/sponsored member program at the Government Securities Division ("GSD") of Fixed Income Clearing Corporation ("FICC"), an NSCC affiliate ("FICC's Sponsoring Member/Sponsored Member Program").<sup>16</sup> Under FICC's Sponsoring Member/Sponsored Member Program, sponsoring members may submit to FICC transactions entered into on a principal-to-

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<sup>16</sup> See Rule 3A (Sponsoring Members and Sponsored Members) of the FICC GSD Rulebook ("GSD Rules"), available at [http://dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_gov\\_rules.pdf](http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf).

principal basis between the sponsoring member and the sponsored member.<sup>17</sup> On the other hand, certain other market participants, including in particular certain agent lending banks, requested that the central clearing service accommodate agent-style trading (i.e., where the agent lender enters into the transaction on behalf of the institutional firm, rather than as principal counterparty). As NSCC understands it, agent-style trading is the way such agent lenders are typically approved to transact in securities lending transactions on behalf of their institutional firm clients today.<sup>18</sup>

NSCC considered all of this input, as well as the recent experiences of FICC in expanding the suite of both transactions and participants eligible for FICC's Sponsoring Member/Sponsored Member Program,<sup>19</sup> and ultimately decided to incorporate both the sponsoring/sponsored membership type (to facilitate principal style trading for institutional firms and their sponsoring members) as well as the Agent Clearing Member membership type (to facilitate agent-style trading by agent lenders on behalf of

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<sup>17</sup> FICC's Sponsoring Member/Sponsored Member Program also allows sponsoring members to submit to FICC transactions entered into between a sponsored member and a third-party netting member. However, based on feedback from market participants, NSCC has decided to address this type of trading via the proposed agent clearing model for SFT.

<sup>18</sup> In addition, certain other agent lenders who are not themselves banks or broker-dealers (and so are not eligible to become Members of NSCC) preferred a model where the institutional firm client becomes the direct member of NSCC with no obligations running between the agent lender and the clearing agency.

<sup>19</sup> See Securities Exchange Act Release Nos. 80563 (May 1, 2017), 82 FR 21284 (May 5, 2017) (SR-FICC-2017-003) (Expand the types of entities that are eligible to participate in FICC as Sponsored Members), 85470 (March 29, 2019), 84 FR 13328 (April 4, 2019) (SR-FICC-2018-013) (Expand Sponsoring Member Eligibility in the GSD Rulebook), and 88262 (February 21, 2020), 85 FR 11401 (February 27, 2020) (SR-FICC-2019-007) (Close-Out and Funds-Only Settlement Processes Associated with the Sponsoring Member/Sponsored Member Service).

institutional firm clients) into the proposed SFT Clearing Service.<sup>20</sup> NSCC expects these proposed new membership types would help expand access to central clearing for institutional firms and facilitate industry adoption of the proposed SFT Clearing Service.

The proposed SFT Clearing Service would also allow for the submission of broker-to-broker activity as well as client-to-client activity (credit intermediated by Sponsoring Members and/or Agent Clearing Members) into the NSCC system.

**(ii) Key Parameters of the Proposed SFT Clearing Service**

*Overnight SFTs*

NSCC is proposing central clearing for SFTs with a one Business Day term (i.e., overnight SFTs) in eligible equity securities that are entered into by Members, institutional firms that are sponsored into NSCC by Sponsoring Members, or Agent Clearing Members on behalf of customers. NSCC has determined that overnight term SFTs with a daily pair off option are more appropriate for the proposed SFT Clearing Service than open transactions with mark-to-market collections. This is because, as NSCC understands it, open transactions are not eligible for balance sheet netting given they do not have a scheduled off-leg/settlement date. As described above, the proposed SFT Clearing Service is designed to offer both balance sheet netting and capital efficiency opportunities to market participants. NSCC therefore finds it appropriate to

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<sup>20</sup> NSCC decided at this time not to incorporate a direct model for institutional firm clearing into the proposed SFT Clearing Service because in its experience with a similar model in FICC (the CCIT Service), the requirements that a clearing agency, such as NSCC, would be required to apply to an institutional firm that participated as a direct member (e.g., Clearing Fund and loss allocation) would, as a general matter, not likely be compatible with the regulatory requirements and investment guidelines applicable to many of the regulated institutional firms that NSCC anticipates would be interested in participating in the proposed SFT Clearing Service.



make overnight term SFTs with a scheduled date for Final Settlement (as defined below and in the proposed rule change) of the next Business Day, rather than open transactions, eligible for central clearing through the proposed SFT Clearing Service.

For example, assume that a Transferor (as defined below and in the proposed rule change) and Transferee (as defined below and in the proposed rule change) enter into an SFT pursuant to which: (i) in the Initial Settlement (as defined below and in the proposed rule change) on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. In the Final Settlement on Tuesday, the Transferee will return 100 shares of security X to the Transferor for \$100 per share. The Rate Payment (as defined below and in the proposed rule change) would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process.

#### *SFT Counterparties*

The proposed SFT Clearing Service would only be available for SFTs entered into between (i) a Member and another Member, (ii) a Sponsoring Member and its Sponsored Member (as defined below and in the proposed rule change), and (iii) an Agent Clearing Member acting on behalf of a Customer and either (x) a Member or (y) the same or another Agent Clearing Member acting on behalf of a Customer. As used in the Rules, "Member" includes full-service NSCC clearing members, but not Sponsored Members.<sup>21</sup>

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<sup>21</sup> As defined in Rule 1 (Definitions and Descriptions), the term "Member" means any Person specified in Section 2.(i) of Rule 2 who has qualified pursuant to the

In addition, as proposed, the only SFTs entered into by Sponsored Members that would be eligible for novation to NSCC would be SFTs between the Sponsored Member and its Sponsoring Member.<sup>22</sup>

*Approved SFT Submitters*

Consistent with the manner in which NSCC accepts cash market transactions, SFTs would be required to be submitted to NSCC on a locked-in/matched basis by an Approved SFT Submitter (as defined below and in the proposed rule change) in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Approved SFT Submitters would be selected by the SFT Members (as defined below and in the proposed rule change), subject to NSCC's approval. An Approved SFT Submitter could either be a Member or a third-party vendor. SFTs submitted to NSCC by an Approved SFT Submitter would be valid and binding obligations of each SFT Member designated by the Approved SFT Submitter as a party thereto.

*Eligible Equity Securities and Per Share Price Minimum*

NSCC will maintain eligibility criteria for the securities that may underlie an SFT that NSCC will accept for novation. Consistent with NSCC's general approach to eligibility for securities, the eligibility criteria would not be a rule, but a separate document maintained by NSCC and available to Members. It is currently contemplated

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provisions of Rule 2A. As such, the term "Member" does not include a Sponsored Member. Supra note 4.

<sup>22</sup> See Section 5 of proposed Rule 56, which provides that a Sponsoring Member shall be permitted to submit to NSCC SFTs between itself and its Sponsored Members.

that eligible securities for SFTs in the proposed SFT Clearing Service will be limited to CNS-eligible securities.

In light of the fact that central clearing of SFTs would be a new service for NSCC, and market participants would be able to elect which of their eligible SFTs to novate to NSCC (i.e., central clearing of SFTs would not be mandatory for Members), NSCC is not able to anticipate at this time the size and composition of the SFT portfolios that would be novated to NSCC. Due to this lack of history, NSCC would, as an initial matter, provide proposed SFT Clearing Service for only those SFTs where the underlying securities are CNS-eligible equity securities that have a per share price of \$5 or more. NSCC selected \$5 as the per share price minimum for underlying equity securities that could be the subject of a novated SFT because \$5 is a common share price minimum adopted in brokerage margin eligibility schedules.

This proposed share price limitation would be implemented systemically by NSCC as one of the eligibility criteria for determining whether an equity security is eligible to be the subject of a novated SFT (rather than as a rule), and such per share price limitation could be modified by NSCC<sup>23</sup> at a later date after NSCC gains more experience with the nature of the SFT portfolios submitted for clearing. In addition, if the share price of underlying securities of an SFT that has already been novated to NSCC falls below \$5, such SFT would continue to be novated to NSCC, but the Required SFT Deposit (as defined below and in the proposed rule change) for the affected Members

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<sup>23</sup> The per share price limitation could be modified by NSCC without any regulatory filings; however, any change in the per share price limitation would be announced by NSCC via an Important Notice posted to its website.

would include an amount equal to 100% of the market value of such underlying securities until such time as the per share price of the underlying securities equals or exceeds \$5.

*Cash Collateral*

Consistent with the cash market transactions NSCC clears today where cash is used to satisfy Members' purchase obligations in eligible securities, cash would likewise be the only eligible form of collateral for novated SFTs under the proposed SFT Clearing Service.<sup>24</sup> More specifically, NSCC would limit the SFTs that it is willing to novate to SFTs that have SFT Cash (as defined below and in the proposed rule change) equal to or greater than 100% market value of the lent securities, and would not novate any obligations to return collateral consisting of securities.<sup>25</sup>

NSCC would novate the Final Settlement obligations of an SFT as of the time the Initial Settlement of such SFT is completed, unless the SFT is a Bilaterally Initiated SFT (as defined below and in the proposed rule change) or a Sponsored Member Transaction (as defined below and in the proposed rule change), in which case novation of the Final Settlement obligations would occur upon NSCC reporting to the Approved SFT Submitter that the SFT has been validated and novated to NSCC.

As described above, each SFT would be collateralized by cash equal to no less than 100% of the market value of the lent securities. In addition, in order to address regulatory and investment guideline requirements applicable to certain institutional

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<sup>24</sup> This is referred to as "SFT Cash" in the proposed rule text.

<sup>25</sup> See Section 5(a) of proposed Rule 56 and the definition of "Securities Financing Transaction".

firms,<sup>26</sup> a Member would be permitted (but not required) to transfer an additional cash haircut above 100% (e.g., 102%) to such institutional firms, i.e., Independent Amount SFT Cash (as defined below and in the proposed rule change), as part of the Initial Settlement of the SFT. The Sponsoring Member or Agent Clearing Member, as applicable, that receives the Independent Amount SFT Cash in the Initial Settlement would also receive a commensurate Clearing Fund call, i.e., an Independent Amount SFT Cash Deposit Requirement (as defined below and in the proposed rule change), from NSCC to reflect the value received by such Member above the market price of the equity security lent. NSCC's novation of Final Settlement obligations related to Independent Amount SFT Cash would be tied to the time the Sponsoring Member or Agent Clearing Member, as applicable, satisfies the related Independent Amount SFT Cash Deposit Requirement in cash.

*RVP/DVP Settlement at DTC*

The Final Settlement obligations of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle receive-versus-payment/delivery-versus-payment ("RVP/DVP") at DTC.<sup>27</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk

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<sup>26</sup> As an example, a registered investment company that lends securities through an agent may be required under Section 17(f) of the Investment Company Act of 1940 and Rule 17f-2 thereunder to collect cash collateral equal to no less than 102% of the market value of the lent securities. See, e.g., The Adams Express Company, SEC No-Action Letter (Oct. 8, 1984). Other institutional firms may be subject to similar requirements under their established investment guidelines or applicable rules, regulations or guidance.

<sup>27</sup> As described below, the Final Settlement and other obligations of each Sponsored Member Transaction would, at the direction of NSCC, settle on the books and records of the relevant Sponsoring Member.

controls. DTC would accept delivery instructions for an SFT from NSCC, as agent for DTC participants that are SFT Members.<sup>28</sup>

Pre-novation counterparties to an SFT that is due to settle may elect to pair off (i.e., offset) the Final Settlement obligations of such SFT against the Initial Settlement obligations of a new SFT between the same parties on the same securities. NSCC believes that such offsets would minimize the operational burden of settling overnight obligations. NSCC would calculate and process the difference in cash collateral between the paired off SFTs, i.e., Price Differential (as defined below and in the proposed rule change). Price Differential would also be processed in accordance with DTC rules and procedures, including provisions relating to risk controls. DTC would accept Price Differential payment orders for an SFT from NSCC, as agent for DTC participants that are SFT Members.

Settlement of the Rate Payment obligations and payment obligations arising from certain mandatory corporate actions and cash dividends would be processed as part of NSCC's end-of-day final money settlement process.

As an example of an SFT with a full pair off (i.e., offset), assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the

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<sup>28</sup> On March 28, 2022, DTC submitted a proposed rule change to provide DTC participants that are also NSCC Members with settlement services in connection with NSCC's proposed SFT Clearing Service. See SR-DTC-2022-002, which was filed with the Commission but has not yet been published in the Federal Register. A copy of this proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to pair off the parties' Final Settlement obligations on the Settling SFT (as defined below and in the proposed rule change) with a Linked SFT (as defined below and in the proposed rule change) pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 100 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 100 shares of security X to the Transferor against \$99 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in connection with the pair off. In addition, the Rate Payment for the Settling SFT would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process. In the Final Settlement on Wednesday, the Transferee will return 100 shares of security X to the Transferor for \$99 per share. The Rate Payment for the Linked SFT would be passed by NSCC as between the Transferor and Transferee on Wednesday as part of NSCC's end-of-day final money settlement process.

As an example of an SFT with a partial pair off (i.e., offset), assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share.

After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to partially pair off the parties' Final Settlement obligations on the Settling SFT with a Linked SFT pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 25 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 25 shares of security X to the Transferor against \$99 per share. In the Final Settlement on Tuesday for the remaining Settling SFT, the Transferee will return 75 shares of security X to the Transferor for \$100 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in relation to the shares subject to pair off (i.e., 25 shares of security X). In addition, the Rate Payment for the Settling SFT (i.e., 100 shares of security X) would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process. In the Final Settlement on Wednesday for the Linked SFT, the Transferee will return 25 shares of security X to the Transferor for \$99 per share. The Rate Payment on the Linked SFT (i.e., 25 shares of security X) would be passed by NSCC as between the Transferor and Transferee on Wednesday as part of NSCC's end-of-day final money settlement process.

*Buy-In, Recall and Accelerated Settlement*

It is occasionally the case in the securities lending market that a borrower is solvent and able to satisfy its general obligations as they become due but unable to deliver the lent securities to the lender within the timeline requested by the lender. The



contractual remedy that has developed in the bilateral securities lending market for these situations is a “buy-in.” Under this remedy, the lender may purchase securities equivalent to the borrowed securities in the market and charge the borrower for the cost of this purchase. This serves to benefit the lender because it allows the lender to recover the securities within its required timeline, and it benefits the borrower by avoiding a situation in which the borrower’s failure to perform under a single transaction results in an event of default and close-out of all of its securities lending transactions (and potentially other positions through a cross-default). Similarly, in the bilateral space, securities borrowers may have the need to accelerate settlement of securities lending transactions if they lose a “permitted purpose” for such loans under Regulation T. The proposed SFT Clearing Service would seek to retain the buy-in and acceleration mechanisms, as they ensure the smooth functioning of securities markets without causing unnecessary and disorderly defaults or regulatory violations.<sup>29</sup>

Consistent with their rights under industry-standard documentation for bilateral SFTs, as proposed, Transferors would have the right to submit a Recall Notice (as defined below and in the proposed rule change) to NSCC in respect of a novated SFT for which Final Settlement obligations have not yet been satisfied. If the Transferee does not return the lent securities by the Recall Date (as defined below and in the proposed rule change) specified in such notice, and the Transferor would be eligible to Buy-In (as

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<sup>29</sup> NSCC does not believe retaining the buy-in and acceleration mechanisms would undermine novation because NSCC would remain the obligor and obligee in respect of the Final Settlement, Rate Payment, and Distribution Payment (as defined below and in the proposed rule change) entitlements and obligations. These mechanisms simply affect the timing and manner in which those obligations are discharged.

defined below and in the proposed rule change), in accordance with such timeframes and deadlines as established by NSCC for such purpose, such securities.

For example, assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to pair off (i.e., offset) the parties' Final Settlement obligations on the Settling SFT with a Linked SFT pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 100 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 100 shares of security X to the Transferor against \$99 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in connection with the pair off. In addition, the Rate Payment for the Settling SFT would be passed by NSCC as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process.

Later in the day on Tuesday, the Transferor determines it now needs 100 shares of security X back in its inventory, and so the Approved SFT Submitter submits a Recall Notice to NSCC, prior to the deadline established by NSCC, on behalf of the Transferor for 100 shares of security X with a Recall Date of Thursday. At the end of day on

Tuesday, the share price of security X is \$98 per share. Upon receipt of the Recall Notice, the SFT would be treated as a Non-Returned SFT (as defined below and in the proposed rule change) by NSCC pursuant to Section 9(e) of proposed Rule 56 (Securities Financing Transaction Clearing Service). Accordingly, pursuant to Section 9(a) of proposed Rule 56, the Final Settlement Date (as defined below and in the proposed rule change) of the SFT would be rescheduled to Thursday, and NSCC would, on Wednesday collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee on the Non-Returned SFT. The Rate Payment for the Non-Returned SFT would also be passed by NSCC as between the Transferor and Transferee on Wednesday as part of NSCC's end-of-day final money settlement process.

Assume further that the Transferee does not transfer the 100 shares of security X on Wednesday and that the end of day price of security X on Wednesday is \$97 per share. On Thursday, NSCC would again collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee on the Non-Returned SFT. The Rate Payment for the Non-Returned SFT would also be passed by NSCC as between the Transferor and Transferee on Thursday as part of NSCC's end-of-day final money settlement process. In addition, since the Recall Notice specified Thursday as the Recall Date, the Transferor would be entitled to purchase (or deem itself to have purchased) 100 shares of security X in accordance with the provisions of Section 9(b) of proposed Rule 56. Assuming that the Transferor paid a price of \$95 per share for security X and submitted a written notice to NSCC of its Buy-In Costs (as defined below and in the proposed rule change) on Thursday, the Transferor would owe NSCC a Buy-In Amount (as defined below and in the proposed rule change) of \$2 per share (\$100 per

share of SFT Cash received by the Transferor at the Initial Settlement of the SFT, less the \$95 per share Buy-In Costs of the Transferor, minus \$3 per share Price Differential paid by the Transferor to NSCC), and such Buy-In Amount would be debited by NSCC from the Transferor and credited to the Transferee as part of NSCC's end-of-day final money settlement process on Friday.

Similarly, consistent with their rights under industry-standard documentation for bilateral SFTs, Transferees would have the right to accelerate the scheduled Final Settlement of a novated SFT through notice from the Approved SFT Submitter to NSCC of such accelerated settlement.

For example, assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. After the Initial Settlement occurs on Monday, the Final Settlement of the SFT is novated to NSCC. At the end of day on Monday, the share price of security X is \$99 per share. On Tuesday, the Approved SFT Submitter, on behalf of the Transferor and the Transferee, instructs NSCC to net the parties' Final Settlement obligations on the Settling SFT with a Linked SFT pursuant to which (i) in the Initial Settlement on Tuesday, the Transferor will transfer 100 shares of security X to the Transferee against \$99 per share; and (ii) in the Final Settlement on Wednesday, the Transferee will transfer 100 shares of security X to the Transferor against \$99 per share. NSCC would, on Tuesday, collect \$1 per share in Price Differential from the Transferor and pay \$1 per share in Price Differential to the Transferee in connection with the pair off. Later in the

day on Tuesday, the Transferee loses permitted purpose under Regulation T for the borrowing of 100 shares of security X. Therefore, pursuant to Section 11 of proposed Rule 56 (Securities Financing Transaction Clearing Service), the Approved SFT Submitter submits a notice to NSCC on behalf of the Transferee to accelerate the Final Settlement of the Linked SFT to Tuesday. The Transferee then on Tuesday returns 100 shares of security X to NSCC for \$99 per share, and NSCC returns 100 shares of security X to the Transferor for \$99 per share. The Rate Payment would be passed by NSCC for the Settling SFT as between the Transferor and Transferee on Tuesday as part of NSCC's end-of-day final money settlement process.

*Risk Management of SFT Positions*

Under the proposal, NSCC is requiring a deposit to the Clearing Fund<sup>30</sup> for SFT Positions, i.e., Required SFT Deposit. From a market risk standpoint, SFT activity would, except as otherwise noted below, be risk managed by NSCC in a manner consistent with Members' CNS positions but would be margined independently of the Member's other positions,<sup>31</sup> and a Required SFT Deposit would be collected by NSCC for all SFT activity of an SFT Member, subject to a \$250,000 minimum deposit.<sup>32</sup>

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<sup>30</sup> As currently defined in Rule 1 (Definitions and Descriptions), the term "Clearing Fund" means the fund created pursuant to Rule 4. Supra note 4.

<sup>31</sup> NSCC is not proposing at this time to portfolio margin a Member's SFT Positions with any CNS positions of the Member, except with respect to the MLA charge. NSCC may reconsider this position after it obtains a reasonable amount of experience observing the nature and volume of SFT activity submitted by Members to NSCC for novation through the proposed SFT Clearing Service.

<sup>32</sup> This \$250,000 minimum deposit is a requirement that is separate from a Member's minimum (non-SFT) Clearing Fund deposit requirement, although it is designed to be consistent with such requirement.

Specifically, NSCC is proposing to calculate an SFT Member's Required SFT Deposit by applying the sections of Procedure XV (Clearing Fund Formula and Other Matters) specified in Section 12 of proposed Rule 56 (i.e., Sections I.(A)(1)(a), (b), (c), (e), (f), (g) of Procedure XV as well as the additional Clearing Fund formula in Section I.(B)(5) (Intraday Mark-to-Market Charge) of Procedure XV as such sections apply to CNS Transactions, and the additional Clearing Fund formula in Sections I.(B)(1) (Additional Deposits for Members on the Watch List); (2) (Excess Capital Premium), (3) (Backtesting Charge), (4) (Bank Holiday Charge); Minimum Clearing Fund and Additional Deposit Requirements in Sections II.(A)1(a) – (b), II.(B), II.(C), and II.(D); as well as Section III (Collateral Value of Eligible Clearing Fund Securities) of Procedure XV, as such sections apply to Members). Furthermore, NSCC would require an additional Required SFT Deposit for Non-Returned SFTs that is intended to mirror the premium charged for CNS Fails Positions. NSCC would also apply the Independent Amount SFT Cash Deposit Requirement for SFTs that have Incremental Additional Independent Amount SFT Cash.

For the purpose of applying Section I.(A)(1)(a)(i) of Procedure XV (Value-at-Risk (VaR) charge), unlike the current calculation of the volatility of a Member's Net Unsettled Positions<sup>33</sup> in CNS Transactions, NSCC is proposing that the volatility of an SFT Member's SFT Positions shall be the sum of (a) the highest resultant value between Section I.(A)(1)(a)(i)I. (Core Parametric Estimation) and Section I.(A)(1)(a)(i)III.

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<sup>33</sup> "Net Unsettled Positions" means a Member's net of unsettled Regular Way, When-Issued and When-Distributed positions in CNS Securities that have not yet passed Settlement Date and net positions in CNS Securities that did not settle on Settlement Date. See Rule 1, supra note 4.

(Margin Floor) and (b) the resultant value of Section I.(A)(1)(a)(i)II. (Gap Risk Measure). This proposed change is designed to capture idiosyncratic risk associated with an SFT Member's portfolio by enabling NSCC to apply the Gap Risk Measure more frequently.

NSCC is also proposing that, for the purpose of applying Section I.(A)(1)(g) of Procedure XV (Margin Liquidity Adjustment (MLA) charge), SFT Positions shall be aggregated with Net Unsettled Positions in the same asset group or subgroup; provided, however, in the event such aggregation results in a reduction of the aggregate positions in the relevant asset group or subgroup, NSCC shall apply the greater of (a) the sum of MLA charges separately calculated for SFT Positions and Net Unsettled Positions in the asset group or subgroup and (b) the MLA charge calculated from aggregating the SFT Positions and the Net Unsettled Positions in the asset group or subgroup. This proposed change is designed to enable NSCC to better risk manage the SFT activity by assessing the MLA charge in a circumstance where the combined SFT Positions and Net Unsettled Positions in total trigger the applicable MLA charge thresholds, whereas, if calculated separately, the MLA charge would not be triggered.

In addition, NSCC is proposing that each SFT Member, other than an SFT Member that is a Sponsored Member, so long as such Member is an SFT Member, would provide Supplemental Liquidity Deposits to the Clearing Fund, as may be required pursuant to Rule 4A (Supplemental Liquidity Deposits).

Consistent with the manner in which clearing fund requirements are satisfied by members of FICC for their cleared securities financing transactions, NSCC would require that (i) a minimum of 40% of an SFT Member's Required SFT Deposit consist of a

combination of cash and Eligible Clearing Fund Treasury Securities and (ii) the lesser of \$5,000,000 or 10% of an SFT Member's Required SFT Deposit (but not less than \$250,000) consist of cash.<sup>34, 35</sup> NSCC would also have the discretion to require an SFT Member to post its Required SFT Deposit in proportion of cash higher than would otherwise be required as described above. NSCC's determination to impose any such requirement would be made in view of market conditions and other financial and operational capabilities of the relevant SFT Member. For example, as proposed in Section 12 of Rule 56, if NSCC had specific concerns about a particular SFT Member's financial or operational capabilities, but NSCC had not yet come to the determination that ceasing to act for the SFT Member would be appropriate (but could potentially become appropriate within the near term), NSCC may request that a greater portion of the SFT Member's Required SFT Deposit to the Clearing Fund be in the form of cash in order to simplify any potential close-out liquidation required in the event of that SFT Member's

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<sup>34</sup> This \$250,000 minimum cash deposit requirement is designed to be consistent with the minimum amount of cash that must be used to satisfy a Member's (non-SFT) Clearing Fund deposit requirement. NSCC believes a \$250,000 minimum cash deposit would serve to strengthen NSCC's liquidity resources. Cash may also be easier to access upon a Member's default, further reducing the risk of losses and using non-defaulting Member's securities or funds, or NSCC funds.

<sup>35</sup> These requirements are designed to be consistent with FICC GSD's clearing fund requirements of its members given that NSCC anticipates that there would be considerable overlap between the membership of FICC GSD that participate in FICC for purposes of clearing their securities financing transaction activity (including in particular sponsored repo activity) and the Members that would elect to participate in the proposed SFT Clearing Service. Specifically, FICC GSD Rule 4, Section 3 requires (i) a minimum of 40 percent of a member's required fund deposit to be in the form of cash and/or eligible clearing fund treasury securities and (ii) the lesser of \$5,000,000 or 10 percent of the required fund deposit, with a minimum of \$100,000, be made and maintained in cash. See Rule 4 (Clearing Fund and Loss Allocation) of the FICC GSD Rulebook, supra note 16.



default. Separately, pursuant to Section II.(A)1(a) of Procedure XV, if an SFT Member's deposit of Eligible Clearing Fund Agency Securities or Eligible Clearing Fund Mortgage-Backed Securities is in excess of 25% of the SFT Member's Required Fund Deposit, NSCC would subject the deposit to an additional haircut.

The Sponsoring Member Required Fund Deposits (as defined below and in the proposed rule change) and Agent Clearing Member Required Fund Deposits (as defined below and in the proposed rule change) would each be calculated on a gross basis, and no offsets for netting of positions as between different Sponsored Members or different Customers,<sup>36</sup> as applicable, would be permitted. This is to ensure that NSCC's volatility-based Clearing Fund deposit requirements represent the sum of each individual institutional firm's activity.

As proposed and as described above, the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>37</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from and to the SFT Accounts (as defined below and in the proposed rule

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<sup>36</sup> See Section 7(c) of proposed Rule 2C and Section 6(c) of proposed 2D.

<sup>37</sup> Supra note 27.

change) of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member (as defined below and in the proposed rule change), on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>38</sup> By continuing to process these Price Differential payments until Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact is generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT

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<sup>38</sup> See proposed Rule 56, Section 14(b)(ix).

Deposit and any Supplemental Liquidity Deposits (“SLD”) that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>39,40</sup> In addition, NSCC would anticipate being in regular

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<sup>39</sup> See Securities Exchange Act Release Nos. 82377 (December 21, 2017), 82 FR 61617 (December 28, 2017) (File No. SR-NSCC-2017-005); 90649 (December 11, 2020), 85 FR 81961 (December 17, 2020) (File No. SR-NSCC-2020-021). This framework sets forth the manner in which NSCC measures, monitors and manages the liquidity risks that arise in or are borne by it, and the qualifying liquidity resources that NSCC maintains in order to cover those risks. Such resources include, for example, cash deposits to the Clearing Fund and SLD that may be collected, when applicable.

<sup>40</sup> For example, assume that a Transferor and Transferee enter into an SFT pursuant to which: (i) in the Initial Settlement on Monday, the Transferor will transfer 100 shares of security X to the Transferee against \$100 per share; and (ii) in the Final Settlement on Tuesday, the Transferee will transfer 100 shares of security X to the Transferor against \$100 per share. Assume further that at midnight on Monday, NSCC ceases to act for the Transferor.

On Tuesday, NSCC executes a sale of 100 shares of security X for \$99 per share. In accordance with the normal settlement cycle for purchases and sales of equity securities, this sale will settle on Thursday.

Pursuant to Section 14(b)(viii) of proposed Rule 56 (Securities Financing Transaction Clearing Service), NSCC would likewise settle the Final Settlement obligations of the defaulting Transferor’s SFT with the non-defaulting Transferee on Thursday.

Assume further that the end-of-day price of security X on Tuesday is \$99 per share. On Wednesday, NSCC would pay \$1 per share in Price Differential to the non-defaulting Transferee pursuant to Section 14(b)(ix) of proposed Rule 56. Assume further that the end-of-day price of security X on Wednesday is \$98 per share.

On Thursday, NSCC would pay an additional \$1 per share in Price Differential to the non-defaulting Transferee pursuant to Section 14(b)(ix) of proposed Rule 56. The Transferee would then return 100 shares of security X to NSCC and receive \$98 per share (i.e., the current market price for security X) from NSCC. As such, the non-defaulting Transferee would be made whole by NSCC for the \$100 per share it transferred in the Initial Settlement of the Defaulted-Related SFT (as defined below

communication with the non-defaulting SFT Members as to the timing of the satisfaction of any Final Settlement obligations related to a defaulting SFT Member.

**(iii) Sponsoring Members and Sponsored Members**

NSCC is proposing a sponsored membership program to allow Members to play the role of pre-novation counterparty and credit intermediary for their institutional firm clients in clearing.

NSCC has modeled a number of the aspects of the proposed sponsored member program, including the eligibility criteria and many of the risk management requirements, on FICC's Sponsoring Member/Sponsored Member Program. FICC's Sponsoring Member/Sponsored Member Program allows an FICC Netting Member to sponsor an entity that satisfies certain requirements and submit to FICC for novation certain securities transactions between the Netting Member and the sponsored entity. These securities transactions generally include the off-leg of repurchase transactions on U.S. government or agency securities or straight purchase and sales of such securities. Such transactions present similar risk management, legal, accounting, and operation considerations to SFTs, as both involve an obligation of a sponsored member and a sponsoring member to exchange cash against securities. Since 2005, FICC has worked with its members to improve its Sponsoring Member/Sponsored Member Program to

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and in the proposed rule change) since NSCC would have transferred to it \$98 per share in Final Settlement plus an additional \$2 per share in Price Differential.

NSCC would incur a net loss of \$1 per share in this example since it would have sold security X for \$99 per share and paid the non-defaulting Transferee a total of \$100 per share (i.e., \$98 per share in Final Settlement proceeds plus \$2 per share in Price Differential). NSCC would be entitled to deduct this amount from the defaulted Transferor's Clearing Fund deposits (including its SFT Deposit).

address these considerations. Based on feedback from Members and its own internal assessments, NSCC believes that leveraging the provisions of FICC's Sponsoring Member/Sponsored Member program and the learning over the past decade and a half would allow NSCC to provide a sponsored member program that has a solid risk management, accounting, legal and operational foundation.

### *Sponsoring Members*

Under the proposal, all Members would be eligible to apply to become Sponsoring Members in NSCC, subject to credit criteria that are designed to be substantially similar to those applicable to category 2 sponsoring members in FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members."<sup>41</sup> A Member whose

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<sup>41</sup> If a Member is a Registered Broker-Dealer, then such Member would only be eligible to apply to become a Sponsoring Member if it satisfies the credit criteria in proposed Rule 2C (Sponsoring Members and Sponsored Members) (i.e., if it has (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million). Such credit criteria are comparable to the credit criteria applicable to category 2 sponsoring members that are registered broker-dealers in FICC's Sponsoring Member/Sponsored Member Program. A Sponsoring Member applicant would be viewed and surveilled as the credit counterparty to NSCC in respect to its Sponsored Member Sub-Account(s) (as defined below and in the proposed rule change) in light of its responsibility to NSCC as the processing agent and unconditional guarantor of its Sponsored Members' performance to NSCC.

In addition, NSCC may require that a Person be a Member for a time period deemed necessary by NSCC before that Person may be considered to become a Sponsoring Member. This requirement may be imposed by NSCC on a new Member that has yet to demonstrate a track record of financial responsibility and operational capability.

Furthermore, as proposed, the application of a Member to be a Sponsoring Member at NSCC that is an Agent Clearing Member or an existing FICC sponsoring member would not be required to be approved by the NSCC Board of

application to become a Sponsoring Member has been approved by the Board of Directors or NSCC, as applicable, pursuant to proposed Rule 2C (“Sponsoring Member”) would be permitted to sponsor their institutional firm clients into membership as Sponsored Members. Such Sponsoring Members would then be able to facilitate their institutional firm clients’ cleared activity via two back-to-back principal SFTs, i.e., client-to-Sponsoring Member and Sponsoring Member-to-broker (or to another institutional firm client that the Sponsoring Member has sponsored into membership), and each of such transactions would be eligible for novation to NSCC.

Consistent with the requirements applicable to sponsoring members in FICC’s Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) “Sponsoring Members and Sponsored Members,” a Sponsoring Member would be responsible for (i) submitting data on its Sponsored Members’ SFTs to NSCC or appointing a third-party Approved SFT Submitter to do so, (ii) posting to NSCC all of the Clearing Fund associated with the SFT activity of its Sponsored Members, which would be calculated on a gross basis (i.e., SFT activity would not be netted across Sponsored Members for Clearing Fund purposes), (iii) providing an unconditional guaranty to NSCC for its Sponsored Members’ Final Settlement and other obligations to NSCC, and

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Directors. NSCC believes this approach to Board of Director’s approval for Sponsoring Members is appropriate in light of the fact that the critical components of the FICC sponsoring member application as well as the NSCC Sponsoring Member and Agent Clearing Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar. Nonetheless, NSCC would apply the same rigorous counterparty credit review process to any Member applying to be a Sponsoring Member at NSCC, whether or not the Member is an existing FICC sponsoring member.

(iv) covering any default loss allocable to its Sponsored Members (in addition to its own default loss allocation as a Member).

Specifically, as proposed, a Sponsoring Member would be permitted to submit to NSCC for novation Sponsored Member Transactions, subject to an activity limit designed to be substantially similar to that applicable to category 2 sponsoring members in FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members." Under the proposal, if the sum of the Volatility Charges (as defined below and in the proposed rule change) applicable to a Sponsoring Member's Sponsored Member Sub-Accounts (as defined below and in the proposed rule change) and its other accounts at NSCC exceeds its Net Member Capital (as defined below and in the proposed rule change), the Sponsoring Member would not be permitted to submit activity into its Sponsored Member Sub-Accounts, unless otherwise determined by NSCC in order to promote orderly settlement. As defined in Section 5 of proposed Rule 2C, Sponsored Member Transactions are SFTs between a Sponsoring Member and its Sponsored Members.

The Sponsoring Member would establish one or more accounts at NSCC for its Sponsored Members' positions arising from such Sponsored Member Transactions, i.e., Sponsored Member Sub-Accounts, which would be separate from the Sponsoring Member's proprietary accounts. For operational and administrative purposes, NSCC would interact solely with the Sponsoring Member as agent of its Sponsored Members.

Sponsoring Members would be responsible for providing NSCC with a Sponsoring Member Guaranty (as defined below and in the proposed rule change) whereby the Sponsoring Member guarantees to NSCC the payment and performance by

its Sponsored Members of their obligations under the Sponsored Member Transactions submitted by the Sponsoring Member for novation. Although Sponsored Members are principally liable to NSCC for their own settlement obligations under such transactions in accordance with the Rules, the Sponsoring Member Guaranty requires the Sponsoring Member to satisfy those settlement obligations on behalf of a Sponsored Member if the Sponsored Member defaults and fails perform its settlement obligations.

In addition, a Sponsoring Member would be responsible for posting to NSCC all of the Clearing Fund associated with the Sponsored Member Transactions (which would not be netted across Sponsored Members for Clearing Fund purposes) and covering any default loss allocable to its Sponsored Members, as well as its own default loss allocation as a Member.<sup>42</sup>

As proposed, consistent with FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members," NSCC would also provide a mechanism by which a Sponsoring Member may cause the termination and liquidation of a Sponsored Member's positions

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<sup>42</sup> The following example illustrates how loss allocation would occur with respect to Sponsoring Members and Sponsored Members: Assume NSCC incurs a \$100 million aggregate loss from a Defaulting Member Event. In addition, assume that the Corporate Contribution amount that NSCC would first apply to any loss from a Defaulting Member Event is \$25 million. This means NSCC would allocate the remaining \$75 million losses (i.e., \$100 million minus \$25 million) to Members pursuant to Section 4 of Rule 4 (Clearing Fund), including Sponsored Member Sub-Accounts as if each were a Member. If the allocated losses to a Sponsoring Member's Sponsored Member Sub-Accounts is \$1 million and the allocated losses to its Sponsoring Member in its capacity as a Member is \$2 million, the Sponsoring Member would be responsible for a total of \$3 million loss allocation (\$1 million for its Sponsored Member Sub-Account loss allocation amount and \$2 million for its own default loss allocation as a Member).



arising from Sponsored Member Transactions between the Sponsoring Member and such Sponsored Member that have been novated to NSCC.<sup>43</sup>

*Sponsored Members*

Consistent with the requirements applicable to sponsored members in FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members," any Person that has been approved by NSCC to be sponsored into membership by a Sponsoring Member pursuant to proposed Rule 2C ("Sponsored Member") would be required to be either a "qualified institutional buyer" as defined by Rule 144A<sup>44</sup> under the Securities Act of 1933, as amended ("Securities Act"),<sup>45</sup> or a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act, satisfies the financial requirements necessary to be a "qualified institutional buyer" as specified in that paragraph.

**(iv) Agent Clearing Members and Customers**

NSCC is proposing an agent clearing membership designed to allow Members to play the role of agent and credit intermediary for their institutional firm clients in clearing. This membership type is being proposed in response to the request of certain market participants, including in particular certain agent lending banks, that the proposed SFT Clearing Service accommodate agent-style trading (i.e., where the agent lender

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<sup>43</sup> See Section 14 of proposed Rule 2C (Sponsoring Members and Sponsored Members).

<sup>44</sup> 17 CFR 230.144A.

<sup>45</sup> 15 U.S.C. 77a et seq.

enters into the transactions on behalf of its institutional firm clients with a third-party market participant, rather than acting as its institutional firm clients' principal prenovation counterparty). Agent-style trading is the manner in which such agent lenders are typically approved to transact in securities lending transactions on behalf of their institutional firm clients. Under the proposal, a Member that enters into transactions on behalf of its institutional firm clients in accordance with the provisions of proposed Rule 2D ("Agent Clearing Member") would be permitted to submit SFTs executed by it (as agent on behalf of its institutional firm clients, with each such client referred to as a "Customer") with a Member participating in the proposed SFT Clearing Service (which could include a Member acting in a proprietary capacity within the proposed SFT Clearing Service as well as an Agent Clearing Member).

All Members would be eligible to apply to become Agent Clearing Members in NSCC, subject to credit criteria that are substantially similar to those applicable to Sponsoring Members as well as category 2 sponsoring members in FICC's Sponsoring Member/Sponsored Member Program.<sup>46</sup>

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<sup>46</sup> If a Member is a Registered Broker-Dealer, then such Member would only be eligible to apply to become an Agent Clearing Member if it satisfies the credit criteria in proposed Rule 2D (i.e., if it has (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million). Such credit criteria are comparable to the credit criteria applicable to sponsoring members that are registered broker-dealers in FICC's Sponsoring Member/Sponsored Member Program. Similar to the review of a Sponsoring Member applicant, an Agent Clearing Member applicant would also be viewed and surveilled as the credit counterparty to NSCC in light of its role as the Member with respect to its Agent Clearing Member Customer Omnibus Account(s).

In addition, NSCC may require a Person be a Member for a time period deemed necessary by NSCC before that Person may be considered to become an Agent Clearing Member. This requirement may be imposed by NSCC on a new

Under the proposal, the requirements to be imposed on Agent Clearing Members would largely mirror those imposed on Sponsoring Members. However, NSCC is not proposing to impose the same types of requirements on an Agent Clearing Member's Customers as it does on Sponsored Members because a Customer would not be a direct member of NSCC.

Specifically, as proposed, an Agent Clearing Member would be permitted to submit to NSCC for novation Agent Clearing Member Transactions (as defined below and in the proposed rule change), on behalf of one or more of its Customers, subject to an activity limit. Specifically, under the proposal, if the sum of the Volatility Charges applicable to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account(s) (as defined below and in the proposed rule change) and its other accounts at NSCC exceeds its Net Member Capital, the Agent Clearing Member would not be permitted to submit activity into its Agent Clearing Member Customer Omnibus Account(s), unless otherwise determined by NSCC in order to promote orderly settlement. As defined in Section 4 of proposed Rule 2D, Agent Clearing Member

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Member that has yet to demonstrate a track record of financial responsibility and operational capability.

Furthermore, as proposed, the application of a Member to be an Agent Clearing Member at NSCC that is a Sponsoring Member or an existing FICC sponsoring member would not be required to be approved by the NSCC Board of Directors. NSCC believes this approach to the Board of Director's approval for Agent Clearing Members is appropriate in light of the fact that the critical components of the FICC sponsoring member application as well as the NSCC Sponsoring Member and Agent Clearing Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar. Nonetheless, NSCC would apply the same rigorous counterparty credit review process to any Member applying to be an Agent Clearing Member at NSCC, whether or not the Member is an existing FICC sponsoring member.

Transactions are SFTs that an Agent Clearing Member submits to NSCC on behalf of one or more Customers.

The Agent Clearing Member would establish one or more accounts at NSCC for its Customers' positions, i.e., an Agent Clearing Member Customer Omnibus Account, that would be in the name of the Agent Clearing Member for the benefit of its Customers; however, each Agent Clearing Member Customer Omnibus Account may only contain activity where the Agent Clearing Member is acting as Transferor on behalf of its Customers, or as Transferee on behalf of its Customers, but not both (i.e., activity would not be netted across Customers for Clearing Fund purposes). Under the proposal, the Agent Clearing Member would act solely as agent of its Customers in connection with the clearing of Agent Clearing Member Transactions; however, the Agent Clearing Member would remain fully liable for the performance of all obligations to NSCC arising in connection with Agent Clearing Member Transactions.

In addition, as proposed under the sponsoring/sponsored membership model, the Agent Clearing Member would be responsible for posting to NSCC all of the Clearing Fund and any applicable SLD associated with the activity of its Customers and covering any default loss allocable to its Customers, as well as its own default loss allocation as a Member;<sup>47</sup> however, unlike a Sponsoring Member, an Agent Clearing Member would not

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<sup>47</sup> The following example illustrates how loss allocation would occur with respect to Agent Clearing Members: Assume NSCC incurs a \$100 million aggregate loss from a Defaulting Member Event. In addition, assume that the Corporate Contribution amount that NSCC would first apply to any loss from a Defaulting Member Event is \$25 million. This means NSCC would allocate the remaining \$75 million losses (i.e., \$100 million minus \$25 million) to Members pursuant to Section 4 of Rule 4 (Clearing Fund), including Agent Clearing Member Customer Omnibus Accounts as if each were a Member. If the allocated losses to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account is \$1

be required to provide an unconditional guaranty to NSCC for its Customer's obligations. This is because, as described above, the Agent Clearing Member would be fully liable for all obligations of its Customers under the Agent Clearing Member Transactions that it submitted to NSCC as the Member.

As proposed, NSCC would also provide a mechanism by which an Agent Clearing Member may, upon a default of a Customer and consent of NSCC, transfer Agent Clearing Member Transactions of the Customer established in one or more of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts from such Agent Clearing Member Customer Omnibus Accounts to the Agent Clearing Member's proprietary account at NSCC as a Member.<sup>48</sup>

**(v) Sponsoring Member/Sponsored Member vs. Agent Clearing Member/Customers**

The direct costs of central clearing (i.e., Clearing Fund, loss allocation, fees and performance on behalf of an institutional firm clients) would be largely equivalent as between what NSCC proposes to apply to a Sponsoring Member and what NSCC proposes to apply to an Agent Clearing Member. Likewise, the capital costs to Sponsoring Members and Agent Clearing Members of intermediating institutional firm activity as between the two buy-side clearing models would be largely equivalent. That being said, because Sponsoring Members would be required to ensure that (i) each of

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million and the allocated losses to the Agent Clearing Member in its capacity as a Member is \$2 million, the Agent Clearing Member would be responsible for a total of \$3 million loss allocation (\$1 million for its Agent Clearing Member Customer Omnibus Account loss allocation amount and \$2 million for its own default loss allocation as a Member).

<sup>48</sup> See Section 11 of proposed Rule 2D (Agent Clearing Members).

their clients separately onboards with NSCC as a Sponsored Member (which NSCC understands is generally required from an accounting perspective in order for the Sponsoring Member to net on its balance sheet its SFTs with Sponsored Members against the Sponsoring Member's other NSCC-cleared SFTs),<sup>49</sup> (ii) each of their client's SFTs is individually submitted to NSCC for clearing, and (iii) each Sponsored Member continues to remain in compliance with the financial standards applicable to Sponsored Members throughout the course of its membership, Sponsoring Members may incur more legal, onboarding, operational and ongoing administrative costs than Agent Clearing Members with respect to their institutional firm clearing activity.

However, the sponsoring/sponsored membership model allows for principal-style trading between a Sponsoring Member and its Sponsored Member where the Sponsoring Member and Sponsored Member are pre-novation counterparties, which would generally create the opportunity for a Sponsoring Member to make an economic spread between its trade with its Sponsored Member and its offsetting trades with other NSCC Members or Sponsored Members. The opportunity for such economic spread and the ability of a Sponsoring Member to achieve balance sheet netting and capital efficiency on such trading activity through the novation of SFTs to NSCC could, for some market participants, offset the indirect additional costs associated with acting as a Sponsoring Member, rather than acting as an Agent Clearing Member.

On the other hand, as NSCC understands it, for some market participants, particularly agent lenders, their business models are not typically predicated on principal-style trading. Rather, these agency businesses typically charge fees for their services

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<sup>49</sup> Supra note 12.

(rather than taking economic spreads) and their business models and their agreed upon investment guidelines with their institutional firm customers may only permit agented (rather than principal-style) trading for securities lending transactions. So, for such market participants, participating in clearing at NSCC as an Agent Clearing Member may be a better fit for their overall business model.

From the perspective of an institutional firm client, the costs of clearing that may be passed through to it by its intermediary (depending on their commercial arrangements) would be largely equivalent. That said, some institutional firms that engage in securities lending may be prohibited from acting as Sponsored Members and engaging in principal-style trading with their intermediary in clearing for regulatory and/or investment guideline reasons. For those institutional firms, being able to transact SFTs as a Customer within an Agent Clearing Member Customer Omnibus Account would offer them a means to access central clearing that would otherwise not be available to them if the sponsoring/sponsored membership model were the only model available for buy-side clearing.

**(vi) Proposed Rule Changes**

**(A) Proposed Rule 2C – Sponsoring Members and Sponsored Members**

NSCC is proposing to add Rule 2C, entitled “Sponsoring Members and Sponsored Members.” This new rule would govern the proposed sponsored membership and would be comprised of 14 sections, each of which is described below.

*Proposed Rule 2C, Section 1 (General)*

Section 1 of proposed Rule 2C would be a general provision regarding the Rules applicable to Sponsoring Members and Sponsored Members.

Section 1 of proposed Rule 2C would provide that NSCC will permit the establishment of a sponsored membership relationship between a Member that is approved as a Sponsoring Member and one or more Persons that are accepted by NSCC as Sponsored Members of that particular Sponsoring Member. Section 1 of proposed Rule 2C would further provide that the rights, liabilities and obligations of Sponsoring Members and Sponsored Members shall be governed by proposed Rule 2C, and that references to the term “Member” in other Rules would not apply to Sponsoring Members and to Sponsored Members, in their respective capacities as such, unless specifically noted as such in proposed Rule 2C or in such other Rules.

Section 1 of proposed Rule 2C would also provide that a Sponsoring Member shall continue to have all of the rights, liabilities and obligations as set forth in the Rules and in any agreement between it and NSCC pertaining to its status as a Member, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as a Sponsoring Member except as contemplated under Sections 7, 8 and 9 of proposed Rule 2C and under the Sponsoring Member Guaranty.

*Proposed Rule 2C, Section 2 (Qualifications of Sponsoring Members, the Application Process and Continuance Standards)*

Section 2 of proposed Rule 2C would establish the eligibility requirements for Members that wish to become Sponsoring Members, the membership application process that would be required of each Member to become a Sponsoring Member, the on-going membership requirements that would apply to Sponsoring Members, as well as the requirements regarding a Sponsoring Member’s election to voluntarily terminate its membership.



Under Section 2(a) of proposed Rule 2C, any Member would be eligible to apply to become a Sponsoring Member; however, if a Member is a Registered Broker-Dealer, such Member would only be permitted to apply to become a Sponsoring Member if it has (1) Net Worth (as defined below and in the proposed rule change) of at least \$25 million and (2) excess net capital over the minimum net capital requirement imposed by the Commission (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million.<sup>50</sup> In connection therewith, NSCC is proposing "Net Worth" to mean, as of a particular date, the amount equal to the excess of the assets of a Person over the liabilities of such Person, computed in accordance with generally accepted accounting principles, and for Registered Broker-Dealers, Net Worth shall include liabilities that are subordinated to the claims of creditors pursuant to a satisfactory subordination agreement, as defined in Appendix D to Rule 15c3-1 of the Act.<sup>51</sup> As proposed, NSCC may require that a Person be a Member for a

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<sup>50</sup> NSCC is proposing these financial minimums for Registered Broker-Dealer Sponsoring Member applicants to reflect the additional responsibility that the applicant would undertake as a Sponsoring Member. These financial minimums are determined based on NSCC's assessment of the minimum capital that would be necessary for a broker-dealer to conduct meaningful level of NSCC-cleared activity while serving as a credit counterparty in respect of others' trades. In its assessment, NSCC considered various factors, such as the amount of a Registered Broker-Dealer Member's capital and its impact on such Member's financial responsibility and operational capability, comparability with the financial requirements of other clearing agencies, and the desire to strike a balance between credit risk mitigation and member accessibility. For the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members," these financial minimums are also designed to be consistent with the requirements applicable to registered broker/dealers that are sponsoring members in FICC's Sponsoring Member/Sponsored Member Program.

<sup>51</sup> 17 CFR 240.15c3-1d.

certain time period before that Person may be considered to become a Sponsoring Member.

Section 2(b) of proposed Rule 2C would provide that each Member applicant to become a Sponsoring Member would be required to provide an application and other information requested by NSCC. Sponsoring Member applications shall first be reviewed by NSCC and would require the Board of Directors' approval, unless the Member applicant is already an Agent Clearing Member under proposed Rule 2D or a sponsoring member of FICC.<sup>52</sup> NSCC believes this approach to the Board of Director's approval for Sponsoring Members is appropriate in light of the fact that the critical components of the FICC sponsoring member application as well as the NSCC Sponsoring Member and Agent Clearing Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar.

Under Section 2(c) of proposed Rule 2C, if the Sponsoring Member application is denied, such denial would be handled in accordance with Section 1 of Rule 2A (Initial Membership Requirements).

As proposed in Section 2(d) of proposed Rule 2C, NSCC may impose additional financial requirements on a Sponsoring Member applicant based upon the level of the anticipated positions and obligations of such applicant, the anticipated risk associated with the volume and types of transaction such applicant proposes to process through

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<sup>52</sup> It is NSCC's understanding that FICC is evaluating a change to the GSD Rules to provide that the application of an FICC sponsoring member applicant that is already an NSCC Sponsoring Member or Agent Clearing Member would not require approval of FICC's board of directors.

NSCC as a Sponsoring Member and the overall financial condition of such applicant. Under the proposal, with respect to an application of a Member to become a Sponsoring Member that requires the Board of Directors' approval, the Board of Directors shall also approve any increased financial requirements imposed by NSCC in connection with the approval of the application, and NSCC would thereafter regularly review such Sponsoring Member regarding its compliance with the increased financial requirements.<sup>53</sup>

In addition, under Section 2(e) of proposed Rule 2C, NSCC may require each Sponsoring Member or any Sponsoring Member applicant to furnish adequate assurances of such Sponsoring Member or Sponsoring Member applicant's financial responsibility and operational capability within the meaning of Rule 15 (Assurances of Financial Responsibility and Operational Capability), as NSCC may at any time or from time to time deem necessary or advisable in order to protect NSCC, its participants, creditors or investors, to safeguard securities and funds in the custody or control of NSCC and for which NSCC is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions.<sup>54</sup>

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<sup>53</sup> If the increased financial requirements are imposed in connection with a Sponsoring Member application that does not require the Board of Directors' approval, the increased financial requirements would not be subject to the Board of Directors' approval. Nonetheless, once a Sponsoring Member application is approved with increased financial requirements, NSCC would thereafter regularly review such Sponsoring Member regarding its continued adherence to such increased financial requirements as well as determine whether such increased financial requirements are still appropriate. If the Sponsoring Member is unable to adhere to the increased financial requirements, the Board of Directors may, pursuant to Section 10 of proposed Rule 2C, suspend, prohibit or limit the Sponsoring Member's access to NSCC's services.

<sup>54</sup> As an example, NSCC may require a Sponsoring Member or a Sponsoring Member applicant to furnish adequate assurances of such Sponsoring Member or

Section 2(f) of proposed Rule 2C would provide that each Member whose Sponsoring Member application is approved would sign and deliver to NSCC (i) an agreement between NSCC and the Member and specifies the terms and conditions deemed by NSCC to be necessary in order to protect itself and its participants (“Sponsoring Member Agreement”), (ii) a guaranty, in the form and substance acceptable to NSCC, whereby the Member, in its capacity as a Sponsoring Member, guarantees to NSCC the payment and performance by its Sponsored Members of their obligations under the Rules in respect of the Sponsoring Member’s Sponsored Member Sub-Accounts, including, without limitation all of the settlement obligations of its Sponsored Members in respect of such Sponsored Member Sub-Accounts (“Sponsoring Member Guaranty”), and a related legal opinion in a form satisfactory to NSCC. In addition, Section 2(f) of proposed Rule 2C would provide that nothing in the Rules shall prohibit a Sponsoring Member from seeking reimbursement from a Sponsored Member for payments made by the Sponsoring Member (whether pursuant to the Sponsoring Member Guaranty, out of Clearing Fund deposits or otherwise) with respect to obligations as to which the Sponsored Member is a principal obligor under the Rules, or as otherwise may be agreed by the Sponsored Member and Sponsoring Member.

Section 2(g) of proposed Rule 2C would provide that each Sponsoring Member shall submit to NSCC, within the timeframes and in the formats required by NSCC, the reports and information that all Members are required to submit regardless of type of Member and the reports and information required to be submitted for its respective type

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Sponsoring Member applicant’s financial responsibility and operational capability if NSCC has concerns about such Sponsoring Member or Sponsoring Member applicant’s overall financial health or credit rating.

of Member, all pursuant to Section 2 of Rule 2B (Ongoing Membership Requirements and Monitoring) and, if applicable, Addendum O (Admission of Non-US Entities as Direct NSCC Members).

Section 2(h) of proposed Rule 2C would provide that a Sponsoring Member's books and records, insofar as they relate to the Sponsored Member Transactions submitted to NSCC, shall be open to the inspection of the duly authorized representatives of NSCC to the same extent provided in Rule 2A (Initial Membership Requirements) for other Members.

Section 2(i) of proposed Rule 2C would provide that a Sponsoring Member shall promptly inform NSCC, both orally and in writing, if it is no longer in compliance with the relevant standards and qualifications for applying to become a Sponsoring Member set forth in the proposed Rule 2C. Notification must take place immediately and in no event later than 2 Business Days from the date on which the Sponsoring Member first learns of its non-compliance. As proposed, NSCC would assess a fine in accordance with the Fine Schedule in Addendum P against any Sponsoring Member that fails to so notify NSCC.<sup>55</sup> If the Sponsoring Member fails to remain in compliance with the relevant standards and qualifications, NSCC would, if necessary, undertake appropriate action to determine the status of the Sponsoring Member and its continued eligibility as such. In addition, NSCC may review the financial responsibility and operational capability of the Sponsoring Member, and otherwise require from the Sponsoring Member additional reports of its financial or operational condition at such intervals and in such detail as NSCC shall determine. In addition, if NSCC has reason to believe that a Sponsoring

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<sup>55</sup> See Addendum P (Fine Schedule), supra note 4.

Member may fail to comply with any of the Rules applicable to Sponsoring Members, it may require the Sponsoring Member to provide it, within such timeframe, and in such detail, and pursuant to such manner as NSCC shall determine, with assurances in writing of a credible nature that the Sponsoring Member shall not, in fact, violate any of the Rules.

Section 2(j) of proposed Rule 2C would provide that in the event that a Sponsoring Member fails to remain in compliance with the relevant requirements of the Rules, the Sponsoring Member Agreement or the Sponsoring Member Guaranty, NSCC shall have the right to cease to act for the Sponsoring Member in its capacity as a Sponsoring Member pursuant to Section 10 of proposed Rule 2C, unless the Sponsoring Member requests that such action not be taken and NSCC determines that, depending upon the specific circumstances and the record of the Sponsoring Member, it is appropriate instead to establish for such Sponsoring Member a time period, which shall be determined by NSCC and which shall be no longer than 30 calendar days unless otherwise determined by NSCC, during which the Sponsoring Member must resume compliance with such requirements. As proposed, in the event that the Sponsoring Member is unable to satisfy such requirements within the time period specified by NSCC, NSCC shall, pursuant to the Rules, cease to act for the Sponsoring Member in its capacity as a Sponsoring Member pursuant to Section 10 of the proposed Rule 2C.

Section 2(k) of proposed Rule 2C would provide that if the sum of the Volatility Charges applicable to a Sponsoring Member's Sponsored Member Sub-Accounts and its other accounts at NSCC exceeds its Net Member Capital (as defined below and in the proposed rule change), the Sponsoring Member shall not be permitted to submit activity

into its Sponsored Member Sub-Accounts, unless otherwise determined by NSCC in order to promote orderly settlement.<sup>56</sup> As proposed, “Volatility Charge” would mean, in respect to a Member, the amount of its Required Fund Deposit calculated by NSCC by applying Sections I.(A)(1)(a)(i)-(iii) of Procedure XV (Clearing Fund Formula and Other Matters); “Net Member Capital” would mean Net Capital (as defined below and in the proposed rule change), net assets or equity capital, as applicable to a Member, based on the type of regulation, and in particular the capital requirements, to which the Member is subject; and “Net Capital” would mean, as of a particular date, the amount equal to the net capital of a Registered Broker-Dealer as defined in Rule 15c3-1(c)(2) of the Act,<sup>57</sup> or any successor rule or regulation thereto.

Section 2(l) of proposed Rule 2C would provide that a Sponsoring Member may voluntarily elect to terminate its status as a Sponsoring Member, with respect to all Sponsored Members or with respect to one or more Sponsored Members from time to time, by providing NSCC with a written notice from a Sponsoring Member to NSCC that the Sponsoring Member is voluntarily electing to terminate its status as a Sponsoring Member with respect to all of its Sponsored Members or with respect to one or more of its Sponsored Members (“Sponsoring Member Voluntary Termination Notice”). The Sponsoring Member shall specify in the Sponsoring Member Voluntary Termination

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<sup>56</sup> NSCC selected the Volatility Charges and Net Member Capital as the criteria for purposes of establishing the activity limit for Sponsoring Members. This is because a Sponsoring Member’s total Volatility Charges being in excess of its Net Member Capital is an important indicator that the Sponsoring Member’s financial resources, as measured by its Net Capital, net assets or equity capital, may be insufficient to meet the largest component of its Required Fund Deposit (i.e., Volatility Charges).

<sup>57</sup> 17 CFR 240.15c3-1(c)(2).

Notice the Sponsored Member(s) in respect of which the Sponsoring Member is terminating its status (the “Former Sponsored Members”) and a desired date for such termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Sponsoring Member to NSCC with respect to the Former Sponsored Members as of the time such Sponsoring Member Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC.

Section 2(l) of proposed Rule 2C would also provide that such termination would not be effective until accepted by NSCC, which shall be no later than 10 Business Days after the receipt of the Sponsoring Member Voluntary Termination Notice from such Sponsoring Member. NSCC’s acceptance shall be evidenced by a notice to NSCC’s participants announcing the termination of the Sponsoring Member’s status as such with respect to the Former Sponsored Members and the date on which the termination of the Sponsoring Member’s status as a Sponsoring Member becomes effective (“Sponsoring Member Termination Date”). As proposed, after the close of business on the Sponsoring Member Termination Date, the Sponsoring Member shall no longer be eligible to submit Sponsored Member Transactions on behalf of the Former Sponsored Members, and each Former Sponsored Member shall cease to be a Sponsored Member unless it is the Sponsored Member of another Sponsoring Member. If any Sponsored Member Transactions is submitted to NSCC by the Sponsoring Member on behalf of a Former Sponsored Member that is scheduled to settle after the Sponsoring Member Termination Date, such Sponsoring Member’s Sponsoring Member Voluntary Termination Notice would be deemed void, and the Sponsoring Member would remain subject to the



proposed Rule 2C as if it had not given such Sponsoring Member Voluntary Termination Notice.

Section 2(m) of proposed Rule 2C would provide that a Sponsoring Member's voluntary termination of its status as such, in whole or in part, shall not affect its obligations to NSCC, or the rights of NSCC, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Transactions submitted to NSCC before the applicable Sponsoring Member Termination Date. Any such Sponsored Member Transactions that have been novated to NSCC shall continue to be processed by NSCC. The return of the Sponsoring Member's Clearing Fund deposit shall be governed by Section 7 of Rule 4 (Clearing Fund). If an Event Period were to occur after a Sponsoring Member has submitted the Sponsoring Member Voluntary Termination Notice but on or prior to the Sponsoring Member Termination Date, in order for the Sponsoring Member to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the Sponsoring Member would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Sponsoring Member Voluntary Termination Notice previously submitted by the Sponsoring Member.

Section 2(n) of proposed Rule 2C would provide that any non-public information furnished to NSCC pursuant to proposed Rule 2C shall be held in confidence as may be required under the laws, rules and regulations applicable to NSCC that relate to the confidentiality of records. Section 2(n) would also provide that each Sponsoring Member shall maintain DTCC Confidential Information in confidence to the same extent and using the same means it uses to protect its own confidential information, but no less than

a reasonable standard of care, and shall not use DTCC Confidential Information or disclose DTCC Confidential Information to any third party except as necessary to perform such Sponsoring Member's obligations under the Rules or as otherwise required by applicable law. Section 2(n) would further provide that each Sponsoring Member acknowledges that a breach of its confidentiality obligations under the Rules may result in serious and irreparable harm to NSCC and/or DTCC for which there is no adequate remedy at law. In addition, Section 2(n) would provide that in the event of such a breach by the Sponsoring Member, NSCC and/or DTCC shall be entitled to seek any temporary or permanent injunctive or other equitable relief in addition to any monetary damages thereunder.<sup>58</sup>

*Proposed Rule 2C, Section 3 (Qualifications of Sponsored Members, Approval Process and Continuance Standards)*

Section 3 of proposed Rule 2C would establish the eligibility requirements for Sponsored Members, the membership application process that would be required of each Sponsored Member, the on-going membership requirements that would apply to Sponsored Members, as well as the requirements regarding a Sponsored Member's election to voluntarily terminate its membership.

Section 3(a) of proposed Rule 2C would provide that a Person shall be eligible to apply to become a Sponsored Member if: (x) it is sponsored into membership by a Sponsoring Member, and (y) it (1) is a "qualified institutional buyer" as defined by Rule

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<sup>58</sup> Section 2(n) of proposed Rule 2C is designed to be consistent with provisions in the Rules relating to the confidentiality of information furnished by participants. See Rule 2A (Initial Membership Requirements), supra note 4.

144A<sup>59</sup> under the Securities Act,<sup>60</sup> or (2) is a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act, satisfies the financial requirements necessary to be a “qualified institutional buyer” as specified in that paragraph. NSCC would have the right to rely on the representation provided by the Sponsoring Member regarding satisfaction of (y).

Section 3(b) of proposed Rule 2C would provide that each time that a Sponsoring Member wishes to sponsor a Person into membership, it shall provide NSCC with the representation referred to in Section 3(a) of proposed Rule 2C, as well as any additional information in such form as may be prescribed by NSCC. NSCC shall approve or disapprove Persons as Sponsored Members. If NSCC denies the request of a Sponsoring Member to add a Person as a Sponsored Member, such denial shall be handled in the same manner as set forth in Section 1 of Rule 2A (Initial Membership Requirements) with respect to membership applications except that the written statement referred to therein shall be provided to both the Sponsoring Member and the Person seeking to become a Sponsored Member.

Section 3(c) of proposed Rule 2C would provide that each Person to become a Sponsored Member shall sign and deliver to NSCC an agreement whereby the Person shall agree to any terms and conditions deemed by NSCC to be necessary in order to protect itself and its participants (the “Sponsored Member Agreement”). Each Person to become a Sponsored Member that shall be an FFI Member must be FATCA Compliant.

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<sup>59</sup> 17 CFR 230.144A.

<sup>60</sup> 15 U.S.C. 77a et seq.

Section 3(d) of proposed Rule 2C would provide that a Sponsored Member shall immediately inform its Sponsoring Member, both orally and in writing, if the Sponsored Member is no longer in compliance with the requirements of Section 3(a) of proposed Rule 2C. A Sponsoring Member shall promptly inform NSCC, both orally and in writing, if a Sponsored Member is no longer in compliance with the requirements of Section 3(a) of proposed Rule 2C. Notification to NSCC by the Sponsoring Member must take place within one (1) Business Day from the date on which the Sponsoring Member first learns of the Sponsored Member's non-compliance. NSCC would assess a fine in accordance with the Fine Schedule in Addendum P against any Sponsoring Member that fails to so notify NSCC.<sup>61</sup>

Section 3(e) of proposed Rule 2C would provide that a Sponsored Member may voluntarily elect to terminate its membership by providing NSCC with a written notice from the Sponsored Member to NSCC that the Sponsored Member is voluntarily electing to terminate its membership ("Sponsored Member Voluntary Termination Notice"). The Sponsored Member shall specify in the Sponsored Member Voluntary Termination Notice a desired date for the termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Sponsored Member to NSCC as of the time such Sponsored Member Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC.

In addition, Section 3(e) of proposed Rule 2C would provide that such termination would not be effective until accepted by NSCC, which shall be no later than 10 Business Days after the receipt of the Sponsored Member Voluntary Termination

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<sup>61</sup> See Addendum P (Fine Schedule), supra note 4.

Notice from such Sponsored Member. NSCC's acceptance shall be evidenced by a notice to NSCC's participants announcing the termination of the Sponsored Member and the date on which the termination of the Sponsored Member becomes effective ("Sponsored Member Termination Date"). After the close of business on the Sponsored Member Termination Date, the relevant Sponsoring Member shall no longer be eligible to submit Sponsored Member Transactions on behalf of the Sponsored Member. If any Sponsored Member Transaction is submitted to NSCC by the relevant Sponsoring Member on behalf of the Sponsored Member that is scheduled to settle after the Sponsored Member Termination Date, such Sponsored Member's Sponsored Member Voluntary Termination Notice would be deemed void, and the Sponsored Member would remain subject to the proposed Rule 2C as if it had not given such Sponsored Member Voluntary Termination Notice.

Section 3(f) of proposed Rule 2C would provide that a Sponsored Member's voluntary termination shall not affect its obligations to NSCC, or the rights of NSCC, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Transactions submitted to NSCC before the Sponsored Member Termination Date, and the Sponsoring Member Guaranty shall remain in effect to cover all outstanding obligations of the Sponsored Member to NSCC that are within the scope of such Sponsoring Member Guaranty.

*Proposed Rule 2C, Section 4 (Compliance with Laws)*

Section 4 of proposed Rule 2C would provide that each Sponsoring Member and Sponsored Member shall comply in all material respects with all applicable laws,

including applicable laws relating to securities, taxation and money laundering, as well as global sanctions laws, in connection with the use of NSCC's services.

*Proposed Rule 2C, Section 5 (Sponsored Member Transactions)*

Section 5 of proposed Rule 2C would provide that a Sponsoring Member shall be permitted to submit to NSCC SFTs between itself and its Sponsored Members ("Sponsored Member Transactions") in accordance with proposed Rule 56, as described below. Section 5 of proposed Rule 2C would further provide that NSCC directs each Sponsored Member and Sponsoring Member to settle all Final Settlement, Rate Payment, Price Differential, and other securities delivery and payment obligations arising under a Sponsored Member Transaction that has been novated to NSCC by causing the relevant cash and securities to be transferred to the Transferor or Transferee, as applicable, on the books and records of the Sponsoring Member, and each Sponsored Member and Sponsoring Member agrees that any such transfer shall satisfy NSCC's corresponding obligation with respect to such Sponsored Member Transaction.

*Proposed Rule 2C, Section 6 (Sponsoring Member Agent Obligations)*

Section 6 of proposed Rule 2C would provide that a Sponsored Member shall appoint its Sponsoring Member to act as agent with respect to the Sponsored Member's satisfaction of its settlement obligations arising under Sponsored Member Transactions between the Sponsored Member and the Sponsoring Member and for performing all functions and receiving reports and information set forth in the Rules. NSCC's provision of such reports and information to the Sponsoring Member shall constitute satisfaction of any obligation of NSCC to provide such reports and information to the affected Sponsored Members. As proposed, notwithstanding the foregoing and any other

activities the Sponsoring Member may perform in its capacity as agent for Sponsored Members, each Sponsored Member shall be obligated as principal to NSCC with respect to all settlement obligations under the Rules, and the Sponsoring Member shall not be a principal under the Rules with respect to settlement obligations of its Sponsored Members.

*Proposed Rule 2C, Section 7 (Clearing Fund Obligations)*

Section 7 of proposed Rule 2C would set forth the Clearing Fund obligations.

Section 7(a) of proposed Rule 2C would provide that NSCC shall maintain a ledger maintained on the books and records of NSCC for a Sponsoring Member that reflects the outstanding SFTs that a Sponsoring Member enters into in respect of a Sponsored Member and that have been novated to NSCC, the SFT Positions or SFT Cash associated with those transactions and any debits or credits of cash associated with such transactions effected pursuant to Rule 12 (Settlement) (each a “Sponsored Member Sub-Account”). Each Sponsoring Member shall make and maintain so long as such Member is a Sponsoring Member a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in its Sponsored Member Sub-Accounts (the “Sponsoring Member Required Fund Deposit”).

Under Section 7(a), each Sponsoring Member, so long as such Member is a Sponsoring Member, shall also provide SLD to the Clearing Fund, as may be required pursuant to Rule 4A (Supplemental Liquidity Deposits); however, the Supplemental Liquidity Deposits shall be calculated without regard to Sponsored Member Transactions. This is because Sponsored Member Transactions do not independently create liquidity risk for NSCC as NSCC would not be required to complete settlement of any Sponsored

Member Transactions in the event that either the Sponsoring Member or Sponsored Member defaults. In the event that the Sponsoring Member defaults, Section 12(b) of proposed Rule 2C (as described below) would permit NSCC to closeout (rather than settle) the Sponsored Member Transactions of the defaulter's Sponsored Members. Likewise, if the Sponsored Member defaults, NSCC would also not be required to complete settlement. Rather, under Section 8 of proposed Rule 2C (as described below), NSCC may offset its settlement obligations to the Sponsoring Member against the Sponsoring Member's obligations under the Sponsoring Member Guaranty to perform on behalf of its defaulted Sponsored Member.

Section 7(a) would also propose that deposits to the Clearing Fund would be held by NSCC or its designated agents, to be applied as provided in the Rules.

Section 7(b) of proposed Rule 2C would provide that, in the ordinary course, for purposes of satisfying the Sponsoring Member's Clearing Fund requirements under the Rules for its Member activity, its Sponsoring Member activity, and, to the extent applicable, its Agent Clearing Member activity, the Sponsoring Member's proprietary accounts, its Sponsored Member Sub-Accounts, and its Agent Clearing Member Customer Omnibus Account(s), if any, shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time and without prior notice to the Sponsoring Member (but being obligated to give notice to the Sponsoring Member as soon as possible thereafter) and whether or not the Sponsoring Member or any of its Sponsored Members is in default of its obligations to NSCC, treat the Sponsoring Member's accounts as a single account for the purpose of applying Clearing Fund deposits; apply



Clearing Fund deposits made by the Sponsoring Member with respect to any account as necessary to ensure that the Sponsoring Member meets all of its obligations to NSCC under any other account(s); and otherwise exercise all rights to offset and net against the Clearing Fund deposits any net obligations among any or all of the accounts, whether or not any other Person is deemed to have any interest in such account.<sup>62</sup>

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<sup>62</sup> NSCC believes it unlikely that it would exercise this authority, as the Clearing Fund deposits associated with each Sponsored Member Sub-Account, Agent Clearing Member Customer Omnibus Account and proprietary account of a Sponsoring Member are designed to be sufficient to cover the obligations of such account or sub-account. However, if a Sponsoring Member defaults or fails to perform and the Clearing Fund deposits associated with a given account or sub-account of such Sponsoring Member are not sufficient to discharge the Sponsoring Member's obligations in relation to such account or sub-account, NSCC would look to the Clearing Fund deposits related to the Sponsoring Member's other accounts or sub-accounts. For example, if NSCC ceased to act for a Sponsoring Member and the close-out of the SFT Positions established in the Sponsoring Member's Sponsored Member Sub-Accounts resulted in a loss to NSCC in excess of the Clearing Fund previously posted by the Sponsoring Member in relation to such SFT Positions, NSCC may apply to the excess any other Clearing Fund deposits posted by the Sponsoring Member to NSCC, such as Clearing Fund posted in connection with the proprietary positions of the Sponsoring Member. Similarly, if a Sponsoring Member failed to perform under the Sponsoring Member Guaranty outside the context of a cease-to-act situation and the Clearing Fund previously posted by the Sponsoring Member in relation to the SFT Positions established in the Sponsoring Member's Sponsored Member Sub-Accounts was not sufficient to satisfy the obligations under the Sponsoring Member Guaranty, NSCC may apply to the remainder any other Clearing Fund deposits posted by the Sponsoring Member to NSCC.

NSCC believes this is appropriate because the Clearing Fund deposits of a Sponsoring Member are the proprietary assets of the Sponsoring Member, and NSCC generally has the right to apply the Clearing Fund deposits of a Member to any of the Member's obligations to NSCC, regardless of whether those were the obligations that generated the Clearing Fund deposit requirement. NSCC therefore believes that, consistent with the FICC Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members," a Sponsoring Member's Clearing Fund deposits should be available to satisfy any of the Sponsoring Member's guaranty or other obligations to NSCC.

Section 7(c) of proposed Rule 2C would provide that the Sponsoring Member Required Fund Deposit for each Sponsored Member Sub-Account shall be calculated separately based on the Sponsored Member Transactions in such Sponsored Member Sub-Account, and the Sponsoring Member shall, as principal, be required to satisfy the Sponsoring Member Required Fund Deposit for each of the Sponsoring Member's Sponsored Member Sub-Accounts.

Section 7(d) of proposed Rule 2C would provide that Sections 1, 2, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of Rule 4 (Clearing Fund) shall apply to the Sponsoring Member Required Fund Deposit with respect to obligations of a Sponsoring Member under the Rules, including its obligations arising under the Sponsored Member Sub-Accounts, and the obligations of a Sponsoring Member under its Sponsoring Member Guaranty to the same extent as such sections apply to any Required Fund Deposit and any other obligations of a Member. For purposes of Section 1 of Rule 4, obligations and liabilities of a Member to NSCC that shall be secured shall include, without limitation, a Member's obligations as a Sponsoring Member under the Rules, including, without limitation, any obligation of any such Sponsoring Member to provide the Sponsoring Member Required Fund Deposit, such Sponsoring Member's obligations arising under the Sponsored Member Sub-Accounts of such Sponsoring Member and such Sponsoring Member's obligations under its Sponsoring Member Guaranty.

Section 7(e) of proposed Rule 2C would provide that a Sponsoring Member shall be subject to such fines as may be imposed in accordance with the Rules for any late satisfaction of a Clearing Fund deficiency call.

Proposed Rule 2C, Section 8 (Right of Offset)

Section 8 of proposed Rule 2C would provide that in the ordinary course, with respect to satisfaction of any Sponsored Member's obligations under the Rules, the Sponsoring Member's Sponsored Member Sub-Accounts, the Sponsoring Member's proprietary accounts, and the Sponsoring Member's Agent Clearing Member Customer Omnibus Accounts, if any, at NSCC shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time any obligation of the Sponsoring Member arises under the Sponsoring Member Guaranty to pay or perform thereunder with respect to any Sponsored Member, exercise a right of offset and net any such obligation of the Sponsoring Member under its Sponsoring Member Guaranty against any obligations of NSCC to the Sponsoring Member in respect of such Sponsoring Member's proprietary accounts at NSCC.<sup>63</sup> NSCC would generally anticipate exercising this right if, upon a Sponsoring Member default, the Sponsoring Member owed an amount under the Sponsoring Member Guaranty and was owed an amount by NSCC in relation to the Sponsoring Member's proprietary or other obligations.

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<sup>63</sup> NSCC believes the most likely circumstance in which it would exercise this authority would be in the context of a Sponsoring Member default. If, in such circumstance, NSCC realizes a profit in closing out the positions associated with a proprietary account of the Sponsoring Member, but incurs a loss in closing out the positions associated with the Sponsored Member Sub-Accounts of the Sponsoring Member, it would offset its obligation to turn over to the Sponsoring Member the gains in relation to the Sponsoring Member's proprietary account against the obligations of the Sponsoring Member under the Sponsoring Member Guaranty.

Proposed Rule 2C, Section 9 (Loss Allocation Obligations)

Section 9 of proposed Rule 2C would establish loss allocation obligations under the sponsored membership model.

Section 9(a) of proposed Rule 2C would provide that Sponsored Members shall not be obligated for allocations, pursuant to Rule 4 (Clearing Fund), of loss or liability incurred by NSCC. To the extent that a loss or liability is determined by NSCC to arise in connection with Sponsored Member Transactions (i.e., in connection with the insolvency or default of a Sponsoring Member), the Sponsored Members shall not be responsible for or considered in the loss allocation calculation, but rather such loss shall be allocated to other Members in accordance with the principles set forth in Section 4 of Rule 4.

Section 9(b) of proposed Rule 2C would provide that, to the extent NSCC incurs a loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event and a loss allocation obligation arises, that would be the responsibility of a Sponsored Member Sub-Account as if the Sponsored Member Sub-Account were a Member, NSCC shall calculate such loss allocation obligation as if the affected Sponsored Member were subject to such allocations pursuant to Section 4 of Rule 4, but the Sponsoring Member shall be responsible for satisfying such obligations.

Section 9(c) of proposed Rule 2C would provide that the entire amount of the Required Fund Deposit associated with the Sponsoring Member's proprietary accounts at NSCC and the entire amount of the Sponsoring Member Required Fund Deposit may be used to satisfy any amount allocated against a Sponsoring Member, whether in its capacity as a Member, a Sponsoring Member, or otherwise. With respect to an obligation

to make payment due to any loss allocation amounts assessed on a Sponsoring Member pursuant to Section 9(b) of proposed Rule 2C, the Sponsoring Member may instead elect to terminate its membership in NSCC pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Sponsoring Member, its Required Fund Deposit shall be the sum of its Required Fund Deposits associated with its proprietary accounts at NSCC (including its proprietary SFT Account pursuant to proposed Rule 56), its Sponsoring Member Required Fund Deposit, and its Agent Clearing Member Required Fund Deposits, if any, for each of its Agent Clearing Member Customer Omnibus Accounts.

*Proposed Rule 2C, Section 10 (Restrictions on Access to Services by a Sponsoring Member)*

Section 10 of proposed Rule 2C would establish the rights of NSCC to restrict a Sponsoring Member's access to NSCC's services.

Section 10(a) of proposed Rule 2C would provide that the Board of Directors may at any time, upon NSCC providing notice to a Sponsoring Member pursuant to Section 5 of Rule 45 (Notices), suspend a Sponsoring Member in its capacity as a Sponsoring Member from any service provided by NSCC either with respect to a particular transaction or transactions or with respect to transactions generally or prohibit or limit such Sponsoring Member's access to services offered by NSCC in the event that one or more of the factors set forth in Section 1 of Rule 46 (Restrictions on Access to Services) is present with respect to the Sponsoring Member.

Section 10(b) of proposed Rule 2C would provide that Rule 46 shall apply with respect to a Sponsoring Member in the same way as it applies to Members, including the

Board of Directors' right to summarily suspend the Sponsoring Member and to cease to act for such Sponsoring Member. As under Rule 46, the Board of Directors would need to make the determination of whether to suspend, prohibit or limit a Sponsoring Member's access to services offered by NSCC on the basis of the factors set forth in that rule.

Section 10(c) of proposed Rule 2C would provide that if NSCC ceases to act for a Sponsoring Member in its capacity as a Sponsoring Member, Section 14 of proposed Rule 56 shall apply and NSCC shall decline to accept or process data from the Sponsoring Member on Sponsored Member Transactions and NSCC shall cease to act for all of the Sponsored Members of the affected Sponsoring Member (unless such Sponsored Members are also Sponsored Members of other Sponsoring Members). Section 10(c) would also provide that if NSCC suspends, prohibits or limits a Sponsoring Member in its capacity as a Sponsoring Member with respect to such Sponsoring Member's access to services offered by NSCC, NSCC shall decline to accept or process data from the Sponsoring Member on Sponsored Member Transactions and shall suspend the Sponsored Members of the affected Sponsoring Member (unless they are also Sponsored Members of other Sponsoring Members) for so long as NSCC is suspending, prohibiting or limiting the Sponsoring Member. Any Sponsored Member Transactions which have been novated to NSCC shall continue to be processed by NSCC. In addition, Section 10(c) would provide that NSCC, in its sole discretion, shall determine whether to close-out the affected Sponsored Member Transactions or permit the Sponsored Members to complete their settlement.

This is different from how NSCC would treat Agent Clearing Member Transactions of an Agent Clearing Member under Section 9 of proposed Rule 2D if NSCC ceased to act for the Agent Clearing Member. Specifically, for Agent Clearing Member Transactions, as proposed, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC; however, with respect to Sponsored Member Transactions, consistent with FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members," NSCC would have the option to either terminate or settle a Sponsored Member's novated positions after ceasing to act for the Sponsoring Member. NSCC would have the practical and legal capability to make such an election because each Sponsored Member would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customers' novated positions.

*Proposed Rule 2C, Section 11 (Restrictions on Access to Services by a Sponsored Member)*

Section 11 of proposed Rule 2C would establish the rights of NSCC to restrict a Sponsored Member's access to NSCC's services.

Section 11(a) of proposed Rule 2C would provide that the Board of Directors may at any time upon NSCC providing notice to a Sponsored Member and its Sponsoring Member pursuant to Section 5 of Rule 45 (Notices), suspend a Sponsored Member from any service provided by NSCC either with respect to a particular transaction or transactions or with respect to transactions generally, or prohibit or limit such Sponsored Member with respect to access to services offered by NSCC in the event that one or more of the factors set forth in Section 1 of Rule 46 (Restrictions on Access to Services) is present with respect to the Sponsored Member.

Section 11(b) of proposed Rule 2C would provide that Rule 46 shall apply with respect to a Sponsored Member in the same way as it applies to Members, including the Board of Directors' right to summarily suspend a Sponsored Member and to cease to act for such Sponsored Member. As under Rule 46, the Board of Directors would need to make the determination of whether to suspend, prohibit or limit a Sponsored Member's access to services offered by NSCC on the basis of the factors set forth in that rule.

Section 11(c) of proposed Rule 2C would provide that if NSCC ceases to act for a Sponsored Member, Section 14 of proposed Rule 56 shall apply.

Section 11(d) of proposed Rule 2C would provide that NSCC shall cease to act for a Sponsored Member that is no longer in compliance with the requirements of Section 3(a) of proposed Rule 2C.

*Proposed Rule 2C, Section 12 (Insolvency of a Sponsoring Member)*

Section 12(a) of proposed Rule 2C would provide that a Sponsoring Member shall be obligated to immediately notify NSCC that (a) it fails, or is unable, to perform its contracts or obligations or (b) it is insolvent, as required by Section 1 of Rule 20



(Insolvency) for other Members. A Sponsoring Member shall be treated by NSCC in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where NSCC treats a Sponsoring Member as insolvent.

Section 12(b) of proposed Rule 2C would provide that in the event that NSCC determines to treat a Sponsoring Member as insolvent pursuant to Rule 20 (Insolvency), NSCC shall have the right to cease to act for the insolvent Sponsoring Member pursuant to Section 10 of the proposed Rule 2C. If NSCC ceases to act for the insolvent Sponsoring Member, NSCC shall decline to accept or process data from the Sponsoring Member, including Sponsored Member Transactions, and NSCC shall terminate the membership of all of the insolvent Sponsoring Member's Sponsored Members unless they are the Sponsored Members of another Sponsoring Member. Any Sponsored Member Transactions which have been novated to NSCC shall continue to be processed by NSCC. NSCC, in its sole discretion, shall determine whether to close-out the affected Sponsored Member Transactions and/or permit the Sponsored Members to complete their settlement. This is different from how NSCC would treat Agent Clearing Member Transactions. As described above, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC. However, with respect to Sponsored Member Transactions, consistent with FICC's Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members," NSCC would have the option to either terminate or settle a Sponsored Member's novated positions after ceasing to act for the Sponsoring Member.

This is because NSCC would have the practical and legal capability to make such an election because each Sponsored Member would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customers' novated positions.

*Proposed Rule 2C, Section 13 (Insolvency of a Sponsored Member)*

Section 13 of proposed Rule 2C would establish NSCC's rights in the event of an insolvency of a Sponsored Member.

Section 13(a) of proposed Rule 2C would provide that a Sponsored Member and its Sponsoring Member (to the extent it has knowledge thereof) shall be obligated to immediately notify NSCC that the Sponsored Member is insolvent or that the Sponsored Member would be unable to perform any of its material contracts, obligations or agreements in the same manner as required by Section 1 of Rule 20 (Insolvency) for other Members. For purposes of Section 13 of proposed Rule 2C, a Sponsoring Member shall be deemed to have knowledge that a Sponsored Member is insolvent or would be unable to perform on any of its material contracts, obligations or agreements if one or more duly authorized representatives of the Sponsoring Member, in its capacity as such,

has knowledge of such matters. A Sponsored Member shall be treated by NSCC in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where NSCC treats a Sponsored Member as insolvent.

Section 13(b) of proposed Rule 2C would provide that in the event that NSCC determines to treat a Sponsored Member as insolvent pursuant to Rule 20 (Insolvency), NSCC shall have the right to cease to act for the insolvent Sponsored Member pursuant to Section 11 of the proposed Rule 2C. If NSCC ceases to act for the insolvent Sponsored Member, Section 14 of proposed Rule 56 shall apply with respect to the close-out of the insolvent Sponsored Member's Sponsored Member Transactions.

*Proposed Rule 2C, Section 14 (Liquidation of Sponsored Member and Related Sponsoring Member Positions)*

Section 14 of proposed Rule 2C would provide a mechanism by which a Sponsoring Member may cause the termination and liquidation of a Sponsored Member's positions arising from Sponsored Member Transactions between the Sponsoring Member and its Sponsored Member that have been novated to NSCC. Specifically, in the event (i) the Sponsoring Member triggers the termination of a Sponsored Member's positions or (ii) NSCC ceases to act for the Sponsored Member and the Sponsoring Member does not continue to perform the obligations of the Sponsored Member, both the Sponsored Member's positions and the Sponsoring Member's corresponding positions arising from the Sponsored Member Transactions between the Sponsoring Member and the Sponsored Member would be terminated. Thereupon, the Sponsoring Member would calculate a net liquidation value of such terminated positions, which liquidation value would be paid

either to or by the Sponsored Member by or to the Sponsoring Member. NSCC would not, as a practical matter, be involved in such settlement and would not need to take any market action because the termination of the Sponsored Member's positions and the corresponding Sponsoring Member's positions would leave NSCC flat. Additionally, the Sponsoring Member would indemnify NSCC for any claim by a Sponsored Member arising out of the Sponsoring Member's calculation of the net liquidation value.

Section 14(a) of proposed Rule 2C would specify the scope of positions to which Section 14 of proposed Rule 2C applies. It would state that Section 14 only applies with respect to the liquidation of positions resulting from Sponsored Member Transactions that have been novated to NSCC.

Section 14(a) of proposed Rule 2C would further state that such section would only apply if (i) a Sponsoring Member is a Defaulting Member and NSCC has not ceased to act for the Sponsoring Member and (ii) a Corporation Default has not occurred. This is because, as described above in Section 12(b) of proposed Rule 2C, NSCC would have discretion in the event it ceases to act for a Sponsoring Member to close-out the positions of Sponsored Members for which the defaulting Sponsoring Member was responsible or to allow them to settle. If NSCC does close-out such positions, it would do so in accordance with Section 14 of proposed Rule 56. If a Corporation Default has occurred with respect to NSCC, each Sponsored Member's positions would be closed out in accordance with Section 17 of proposed Rule 56.

Section 14(b) of proposed Rule 2C would set out the process by which a Sponsoring Member or NSCC may cause the termination of a Sponsored Member's positions. It would provide that on any Business Day, the Sponsoring Member or NSCC

may cause such termination by delivering a notice to NSCC or the Sponsoring Member, respectively. NSCC anticipates that each Sponsored Member and Sponsoring Member would agree in the bilateral documentation between them as to what circumstances or events give rise to the ability of the Sponsoring Member to deliver a notice to NSCC terminating the Sponsored Member's positions.<sup>64</sup>

The notice submitted by a Sponsoring Member to NSCC (or vice versa) would cause the termination of all of the SFT Positions of the Sponsored Member established in the Sponsored Member Sub-Account. The notice would also cause the immediate termination of the corresponding SFT Positions of the Sponsoring Member established in the Sponsoring Member's proprietary SFT Account. The effect of such terminations would be to leave NSCC flat.

Section 14(b) of proposed Rule 2C would also provide that the termination of the Sponsored Member's positions (and the Sponsoring Member's corresponding positions) would be effected by the Sponsoring Member's establishment of a final net settlement position for each eligible security with a distinct CUSIP number ("Final Net Settlement Position").

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<sup>64</sup> It bears noting in this regard that termination of the Sponsored Member's positions would not be the exclusive mechanism by which a Sponsoring Member may limit its credit risk. As described above, under Section 2(m) of proposed Rule 2C, a Sponsoring Member may voluntarily elect to terminate its status as a Sponsoring Member in respect of one or more Sponsored Members. Such a termination would not affect the settlement of the Sponsored Member's existing positions but would restrict the ability of the Sponsored Member to have its future trades accepted for novation by NSCC through such Sponsoring Member. The proposed rule change in Section 14(b) of proposed Rule 2C would not affect the functioning of the proposed rule change in Section 2(m) of proposed Rule 2C or the general ability of a Sponsoring Member and the Sponsored Member to agree on the circumstances of when the Sponsoring Member may terminate its status as Sponsoring Member for the Sponsored Member.

Section 14(c) of proposed Rule 2C would specify how the Final Net Settlement Positions established pursuant to Section 14(b) of proposed Rule 2C would be liquidated (i.e., how such positions would be converted into an amount payable). It would also provide how the amount payable arising from the liquidation of the Final Net Settlement Positions would be discharged.

Specifically, Section 14(c) of proposed Rule 2C would first provide that the Sponsoring Member would liquidate the Final Net Settlement Positions established pursuant to Section 14(b) of proposed Rule 2C by establishing (i) a single liquidation amount in respect of the Sponsored Member's Final Net Settlement Positions (a "Sponsored Member Liquidation Amount") and (ii) a single liquidation amount in respect of the Sponsoring Member's Final Net Settlement Positions (a "Sponsoring Member Liquidation Amount"). The Sponsored Member Liquidation Amount would be owed either by NSCC to the Sponsored Member or by the Sponsored Member to NSCC because it would relate to the Sponsored Member's Final Net Settlement Positions with NSCC, while the Sponsoring Member Liquidation Amount would be owed either by NSCC to the Sponsoring Member or by the Sponsoring Member to NSCC because it would relate to the Sponsoring Member's Final Net Settlement Positions with NSCC.

Because the Final Net Settlement Positions of the Sponsoring Member would be identical to, but in the opposite direction of, the Final Net Settlement Positions of the Sponsored Member, the Sponsored Member Liquidation Amount would equal the Sponsoring Member Liquidation Amount. Therefore, if NSCC were to owe the Sponsored Member Liquidation Amount to the Sponsored Member, the Sponsoring Member would owe the Sponsoring Member Liquidation Amount to NSCC. By the same

token, if the Sponsored Member were to owe the Sponsored Member Liquidation Amount to NSCC, NSCC would owe the Sponsoring Member the Sponsoring Member Liquidation Amount. In all instances, NSCC would owe and be owed the same amount of money.

Section 14(c) of proposed Rule 2C would also provide how the Sponsoring Member may calculate the Sponsoring Member Liquidation Amount. It would state that the Sponsoring Member may calculate the Sponsoring Member Liquidation Amount based on prevailing market prices of the relevant securities and/or the gains realized and losses incurred by the Sponsoring Member in hedging its risk associated with the liquidation of the Sponsoring Member's Final Net Settlement Positions. Section 14(c) of proposed Rule 2C would further clarify that such Sponsoring Member Liquidation Amount may also take into account any losses and expenses incurred by the Sponsoring Member in connection with the liquidation of the positions.

Section 14(c) of proposed Rule 2C would further provide that, if a Sponsored Member Liquidation Amount is due to NSCC, the Sponsoring Member would be obligated to pay such Sponsored Member Liquidation Amount to NSCC under the Sponsoring Member Guaranty and that this obligation would, automatically and without further action, be set off against the obligation of NSCC to pay the corresponding Sponsoring Member Liquidation Amount to the Sponsoring Member. By virtue of such setoff, the Sponsored Member's obligation to NSCC would be discharged, as would NSCC's obligation to the Sponsoring Member. The Sponsoring Member would, however, have a reimbursement claim against the Sponsored Member in an amount equal to the Sponsored Member Liquidation Amount. This reimbursement claim would arise

as a matter of law by virtue of the Sponsoring Member's performance under Sponsoring Member Guaranty, though Sponsoring Members and Sponsored Members may specify terms related to the reimbursement claim in their bilateral submission. NSCC would have no rights or obligations in respect of any such reimbursement claim.

If a Sponsored Member Liquidation Amount were owed by NSCC to the Sponsored Member, Section 14(c) of proposed Rule 2C would provide for the Sponsoring Member to satisfy that obligation by transferring the Sponsored Member Liquidation Amount to the Sponsoring Member's account at its Settling Bank ("Sponsoring Member Settling Bank Omnibus Account"). Section 14(c) of proposed Rule 2C would state that, to the extent the Sponsoring Member makes such a transfer, it would discharge NSCC's obligation to transfer the Sponsored Member Liquidation Amount to the Sponsored Member and the Sponsoring Member's corresponding obligation to transfer the Sponsoring Member Liquidation Amount to NSCC.

Section 14(d) of proposed Rule 2C would provide for the Sponsoring Member to indemnify NSCC and its employees, officers, directors, shareholders, agents, and Members (collectively, the "Sponsoring/Sponsored Membership Program Indemnified Parties" or "SMP Indemnified Parties") for any and all losses, liability, or expenses arising from any claim by an affected Sponsored Member disputing the Sponsoring Member's calculation of any Sponsored Member Liquidation Amount or Sponsoring Member Liquidation Amount.

Section 14(e) of proposed Rule 2C would provide that NSCC acknowledges that a Sponsoring Member may take a security interest in NSCC's obligations to a Sponsored Member in respect of its transactions that have been novated to NSCC by such



Sponsoring Member and established in the Sponsoring Member's Sponsored Member Sub-Account for the Sponsored Member. Such security interest would not impose new obligations on NSCC but could allow the Sponsoring Member to direct NSCC to submit payments due to the Sponsored Member to the Sponsoring Member, so that the Sponsoring Member can apply such amounts to the Sponsored Member's unsatisfied obligations to the Sponsoring Member.

**(B) Proposed Rule 2D – Agent Clearing Members**

NSCC is proposing to add Rule 2D, entitled "Agent Clearing Members." This new rule would govern the proposed agent clearing membership and would be comprised of 12 sections, each of which is described below.

*Proposed Rule 2D, Section 1 (General)*

Section 1 of proposed Rule 2D would be a general provision regarding the Rules applicable to Agent Clearing Members.

Section 1 of proposed Rule 2D would provide that NSCC will permit a Member that is approved to be an Agent Clearing Member to submit transactions to NSCC for novation on behalf of one or more of the Agent Clearing Member's Customers. Section 1 of proposed Rule 2D would further provide that the rights, liabilities and obligations of Agent Clearing Members shall be governed by proposed Rule 2D, and that references to the term "Member" in other Rules would not apply to Agent Clearing Members, in their respective capacities as such, unless specifically noted as such in proposed Rule 2D or in such other Rules.

Section 1 of proposed Rule 2D would also provide that an Agent Clearing Member shall continue to have all of the rights, liabilities and obligations as set forth in

the Rules and in any agreement between it and NSCC pertaining to its status as a Member, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as an Agent Clearing Member except as contemplated under Sections 6, 7 and 8 of proposed Rule 2D.

*Proposed Rule 2D, Section 2 (Qualifications of Agent Clearing Members, the Application Process and Continuance Standards)*

Section 2 of proposed Rule 2D would establish the eligibility requirements for Members that wish to become Agent Clearing Members, the membership application process that would be required of each Member to become an Agent Clearing Member, the on-going membership requirements that would apply to Agent Clearing Members, as well as the requirements regarding an Agent Clearing Member's election to voluntarily terminate its membership.

Under Section 2(a) of proposed Rule 2D, any Member would be eligible to apply to become an Agent Clearing Member; however, if a Member is a Registered Broker-Dealer, such Member would only be permitted to apply to become an Agent Clearing Member if it has (1) Net Worth of at least \$25 million and (2) excess net capital over the minimum net capital requirement imposed by the Commission (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million.<sup>65</sup> As proposed, NSCC may require that a Person be a Member for a certain time period before that Person may be considered to become an Agent Clearing Member.

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<sup>65</sup> NSCC is proposing these financial minimums for Registered Broker-Dealer Agent Clearing Member applicants to reflect the additional responsibility that the applicant would undertake as an Agent Clearing Member. These financial minimums are determined based on NSCC's assessment of the minimum capital that would be necessary for a broker-dealer to conduct meaningful level of NSCC-cleared activity while serving as a credit counterparty in respect of others' trades. In addition, NSCC is proposing these financial minimums for Registered

Section 2(b) of proposed Rule 2D would provide that each Member applicant to become an Agent Clearing Member would be required to provide an application and other information requested by NSCC. Agent Clearing Member applications shall first be reviewed by NSCC and would require the Board of Directors' approval, unless the Member applicant is already a Sponsoring Member under proposed Rule 2C or a sponsoring member of FICC. NSCC believes this approach to the Board of Directors' approval for Agent Clearing Members is appropriate in light of the fact that the critical components of the FICC sponsoring member applications as well as the NSCC Agent Clearing Member and Sponsoring Member applications and the criteria that the respective boards assess when determining whether to admit a Member in such respective capacities are substantially similar.

Under Section 2(c) of proposed Rule 2D, if the Agent Clearing Member application is denied, such denial would be handled in accordance with Section 1 of Rule 2A (Initial Membership Requirements).

As proposed in Section 2(d) of proposed Rule 2D, NSCC may impose additional financial requirements on an Agent Clearing Member applicant based upon the level of the anticipated positions and obligations of such applicant, the anticipated risk associated

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Broker-Dealer Agent Clearing Member applicants to be consistent with proposed requirements applicable to Registered Broker-Dealer Sponsoring Member applicants. NSCC believes this approach to financial minimums is appropriate because both Sponsoring Members and Agent Clearing Members would be viewed and surveilled as the credit counterparties to NSCC in respect of the transactions that they submit for clearing in respect of Sponsoring Member Sub-Accounts and Agent Clearing Member Customer Omnibus Accounts, respectively. Although the model of clearing would differ as between Sponsoring Members and Agent Clearing Members, both would be types of Members that would be standing behind the credit of their clients. Accordingly, NSCC believes it is appropriate to use consistent financial minimums.

with the volume and types of transaction such applicant proposes to process through NSCC as an Agent Clearing Member and the overall financial condition of such applicant. Under the proposal, with respect to an application of a Member to become an Agent Clearing Member that requires the Board of Directors' approval, the Board of Directors shall also approve any increased financial requirements imposed by NSCC in connection with the approval of the application, and NSCC would thereafter regularly review such Agent Clearing Member regarding its compliance with the increased financial requirements.<sup>66</sup>

In addition, under Section 2(e) of proposed Rule 2D, NSCC may require each Agent Clearing Member or any Agent Clearing Member applicant to furnish adequate assurances of such Agent Clearing Member or Agent Clearing Member applicant's financial responsibility and operational capability within the meaning of Rule 15 (Assurances of Financial Responsibility and Operational Capability), as NSCC may at any time or from time to time deem necessary or advisable in order to protect NSCC, its participants, creditors or investors, to safeguard securities and funds in the custody or

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<sup>66</sup> If the increased financial requirements are imposed in connection with an Agent Clearing Member application that does not require the Board of Directors' approval, the increased financial requirements would not be subject to the Board of Directors' approval. Nonetheless, once an Agent Clearing Member application is approved with increased financial requirements, NSCC would thereafter regularly review such Agent Clearing Member regarding its continued adherence to such increased financial requirements as well as determine whether such increased financial requirements are still appropriate. If the Agent Clearing Member is unable to adhere to the increased financial requirements, the Board of Directors may, pursuant to Section 9 of proposed Rule 2D, suspend, prohibit or limit the Agent Clearing Member's access to NSCC's services.

control of NSCC and for which NSCC is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions.<sup>67</sup>

Section 2(f) of proposed Rule 2D would provide that each Member whose Agent Clearing Member application is approved would sign and deliver to NSCC an agreement between NSCC and the Member and specifies the terms and conditions deemed by NSCC to be necessary in order to protect itself and its participants (“Agent Clearing Member Agreement”) and a related legal opinion in a form satisfactory to NSCC.

Section 2(g) of proposed Rule 2D would provide that each Agent Clearing Member shall submit to NSCC, within the timeframes and in the formats required by NSCC, the reports and information that all Members are required to submit regardless of type of Member and the reports and information required to be submitted for its respective type of Member, all pursuant to Section 2 of Rule 2B (Ongoing Membership Requirements and Monitoring) and, if applicable, Addendum O (Admission of Non-US Entities as Direct NSCC Members).

Section 2(h) of proposed Rule 2D would provide that an Agent Clearing Member’s books and records, insofar as they relate to the Agent Clearing Member Transactions submitted to NSCC, shall be open to the inspection of the duly authorized representatives of NSCC to the same extent provided in Rule 2A (Initial Membership Requirements) for other Members.

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<sup>67</sup> As an example, NSCC may require an Agent Clearing Member or an Agent Clearing Member applicant to furnish adequate assurances of such Agent Clearing Member or Agent Clearing Member applicant’s financial responsibility and operational capability if NSCC has concerns about such Agent Clearing Member or Agent Clearing Member applicant’s overall financial health or credit rating.

Section 2(i) of proposed Rule 2D would provide that an Agent Clearing Member shall promptly inform NSCC, both orally and in writing, if it is no longer in compliance with the relevant standards and qualifications for applying to become an Agent Clearing Member set forth in the proposed Rule 2D. Notification must take place immediately and in no event later than 2 Business Days from the date on which the Agent Clearing Member first learns of its non-compliance. As proposed, NSCC would assess a fine in accordance with the Fine Schedule in Addendum P against any Agent Clearing Member that fails to so notify NSCC.<sup>68</sup> If the Agent Clearing Member fails to remain in compliance with the relevant standards and qualifications, NSCC would, if necessary, undertake appropriate action to determine the status of the Agent Clearing Member and its continued eligibility as such. In addition, NSCC may review the financial responsibility and operational capability of the Agent Clearing Member, and otherwise require from the Agent Clearing Member additional reports of its financial or operational condition at such intervals and in such detail as NSCC shall determine. In addition, if NSCC has reason to believe that an Agent Clearing Member may fail to comply with any of the Rules applicable to Agent Clearing Members, it may require the Agent Clearing Member to provide it, within such timeframe, and in such detail, and pursuant to such manner as NSCC shall determine, with assurances in writing of a credible nature that the Agent Clearing Member shall not, in fact, violate any of the Rules.

Section 2(j) of proposed Rule 2D would provide that in the event that an Agent Clearing Member fails to remain in compliance with the relevant requirements of the Rules or the Agent Clearing Member Agreement, NSCC shall have the right to cease to

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<sup>68</sup> See Addendum P (Fine Schedule), supra note 4.

act for the Agent Clearing Member in its capacity as an Agent Clearing Member in accordance with Section 9 of proposed Rule 2D or as a Member more generally, unless the Agent Clearing Member requests that such action not be taken and NSCC determines that, depending upon the specific circumstances and the record of the Agent Clearing Member, it is appropriate instead to establish for such Agent Clearing Member a time period, which shall be determined by NSCC and which shall be no longer than 30 calendar days unless otherwise determined by NSCC, during which the Agent Clearing Member must resume compliance with such requirements. As proposed, in the event that the Agent Clearing Member is unable to satisfy such requirements within the time period specified by NSCC, NSCC shall, pursuant to the Rules, cease to act for the Agent Clearing Member in its capacity as an Agent Clearing Member pursuant to Section 9 of the proposed Rule 2D or as a Member more generally.

Section 2(k) of proposed Rule 2D would provide that if the sum of the Volatility Charges applicable to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account(s) and its other accounts at NSCC exceeds its Net Member Capital, the Agent Clearing Member shall not be permitted to submit activity into its Agent Clearing Member Customer Omnibus Account(s), unless otherwise determined by NSCC in order to promote orderly settlement.<sup>69</sup> As proposed, an "Agent Clearing Member Customer Omnibus Account" would mean a ledger maintained on the books and records of NSCC

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<sup>69</sup> NSCC selected the Volatility Charges and Net Member Capital as the criteria for purposes of establishing the activity limit for Agent Clearing Members. This is because an Agent Clearing Member's total Volatility Charges being in excess of its Net Member Capital is an important indicator that the Agent Clearing Member's financial resources, as measured by its Net Capital, net assets or equity capital, may be insufficient to meet the largest component of its Required Fund Deposit (i.e., Volatility Charges).

that reflects the outstanding Agent Clearing Member Transactions that an Agent Clearing Member enters into on behalf of Customers and that have been novated to NSCC, the SFT Positions or SFT Cash associated with those transactions, and any debits or credits of cash associated with such transactions effected pursuant to Rule 12 (Settlement).

Section 2(l) of proposed Rule 2D would provide that an Agent Clearing Member may voluntarily elect to terminate its status as an Agent Clearing Member by providing NSCC with a written notice from an Agent Clearing Member to NSCC that the Agent Clearing Member is voluntarily electing to terminate its status as an Agent Clearing Member (“Agent Clearing Member Voluntary Termination Notice”). The Agent Clearing Member shall specify in the Agent Clearing Member Voluntary Termination Notice a desired date for such termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Agent Clearing Member to NSCC as of the time such Agent Clearing Member Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC.

Section 2(l) of proposed Rule 2D would also provide that such termination would not be effective until accepted by NSCC, which shall be no later than 10 Business Days after the receipt of the Agent Clearing Member Voluntary Termination Notice from such Agent Clearing Member. NSCC’s acceptance shall be evidenced by a notice to NSCC’s participants announcing the termination of the Agent Clearing Member’s status as such and the date on which the termination of the Agent Clearing Member’s status as an Agent Clearing Member becomes effective (“Agent Clearing Member Termination Date”). As proposed, after the close of business on the Agent Clearing Member Termination Date, the Agent Clearing Member shall no longer be eligible to submit Agent Clearing Member



Transactions. If any Agent Clearing Member Transaction is submitted to NSCC by the Agent Clearing Member that is scheduled to settle after the Agent Clearing Member Termination Date, such Agent Clearing Member's Agent Clearing Member Voluntary Termination Notice would be deemed void, and the Agent Clearing Member would remain subject to the proposed Rule 2D as if it had not given such Agent Clearing Member Voluntary Termination Notice.

Section 2(m) of proposed Rule 2D would provide that an Agent Clearing Member's voluntary termination of its status as such shall not affect its obligations to NSCC, or the rights of NSCC, with respect to Agent Clearing Member Transactions submitted to NSCC before the applicable Agent Clearing Member Termination Date. Any such Agent Clearing Member Transactions that have been novated to NSCC shall continue to be processed by NSCC. The return of the Agent Clearing Member's Clearing Fund deposit shall be governed by Section 7 of Rule 4 (Clearing Fund). If an Event Period were to occur after an Agent Clearing Member has submitted the Agent Clearing Member Voluntary Termination Notice but on or prior to the Agent Clearing Member Termination Date, in order for the Agent Clearing Member to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the Agent Clearing Member would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Agent Clearing Member Voluntary Termination Notice previously submitted by the Agent Clearing Member.

Section 2(n) of proposed Rule 2D would provide that any non-public information furnished to NSCC pursuant to proposed Rule 2D shall be held in confidence as may be

required under the laws, rules and regulations applicable to NSCC that relate to the confidentiality of records. Section 2(n) would also provide that each Agent Clearing Member shall maintain DTCC Confidential Information in confidence to the same extent and using the same means it uses to protect its own confidential information, but no less than a reasonable standard of care, and shall not use DTCC Confidential Information or disclose DTCC Confidential Information to any third party except as necessary to perform such Agent Clearing Member's obligations under the Rules or as otherwise required by applicable law. Section 2(n) would further provide that each Agent Clearing Member acknowledges that a breach of its confidentiality obligations under the Rules may result in serious and irreparable harm to NSCC and/or DTCC for which there is no adequate remedy at law. In addition, Section 2(n) would provide that in the event of such a breach by the Agent Clearing Member, NSCC and/or DTCC shall be entitled to seek any temporary or permanent injunctive or other equitable relief in addition to any monetary damages thereunder.<sup>70</sup>

*Proposed Rule 2D, Section 3 (Compliance with Laws)*

Section 3 of proposed Rule 2D would provide that each Agent Clearing Member shall comply in all material respects with all applicable laws, including applicable laws relating to securities, taxation and money laundering, as well as global sanctions laws, in connection with the use of NSCC's services.

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<sup>70</sup> Section 2(n) of proposed Rule 2D is designed to be consistent with provisions in the Rules relating to the confidentiality of information furnished by participants. See Rule 2A (Initial Membership Requirements), supra note 4.

Proposed Rule 2D, Section 4 (Agent Clearing Member Transactions)

Section 4 of proposed Rule 2D would provide that an Agent Clearing Member shall be permitted to submit to NSCC on behalf of one or more Customers' Securities Financing Transactions ("Agent Clearing Member Transactions") in accordance with proposed Rule 56, as described below.

Proposed Rule 2D, Section 5 (Agent Clearing Member Agent Obligations)

Section 5 of proposed Rule 2D would establish rules-based obligations for Agent Clearing Members and the establishment of Agent Clearing Member Customer Omnibus Accounts.

Section 5(a) of proposed Rule 2D would provide that an Agent Clearing Member shall be permitted to submit to NSCC for novation Agent Clearing Member Transactions entered into by the Agent Clearing Member as agent on behalf of one or more Customers. Any such submission shall be in accordance with proposed Rule 2D. As proposed, subject to the provisions of the Rules, an Agent Clearing Member's clearing of Agent Clearing Member Transactions for Customers ("Customer Clearing Service") may be provided by an Agent Clearing Member to its Customers on any terms and conditions mutually agreed to by the Agent Clearing Member and its Customers; provided, that each Agent Clearing Member shall, before providing Customer Clearing Service to any Customer, enter into an agreement with that Customer that binds the Customer to the provisions of the Rules applicable to Agent Clearing Member Transactions and Customers.

Section 5(b) of proposed Rule 2D would provide that, with respect to an Agent Clearing Member that submits Agent Clearing Member Transactions to NSCC for

novation on behalf of its Customers, NSCC shall maintain one or more Agent Clearing Member Customer Omnibus Accounts in the name of the Agent Clearing Member for the benefit of its Customers. Each Agent Clearing Member Customer Omnibus Account would be permitted to contain only (i) SFTs entered into by the Agent Clearing Member, on behalf of a Customer, as Transferor or (ii) SFTs entered into by the Agent Clearing Member, on behalf of a Customer, as a Transferee. An Agent Clearing Member would not be permitted to combine SFTs entered into as Transferee and Transferor in the same Agent Clearing Member Customer Omnibus Account. This is designed to ensure that NSCC's volatility-based Clearing Fund deposit requirements represent the sum of each individual Customer's activity (i.e., that the positions are margined on a gross basis).<sup>71</sup>

Section 5(c) of proposed Rule 2D would provide that an Agent Clearing Member shall act solely as agent of its Customers in connection with the clearing of Agent Clearing Member Transactions; provided that the Agent Clearing Member shall remain fully liable for the performance of all obligations to NSCC arising in connection with Agent Clearing Member Transactions; and provided further, that the liabilities and obligations of NSCC with respect to Agent Clearing Member Transactions entered into by the Agent Clearing Member shall extend only to the Agent Clearing Member. Section 5(c) of proposed Rule 2D would further provide that, without limiting the generality of the foregoing, NSCC shall not have any liability or obligation arising out of or with

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<sup>71</sup> If an Agent Clearing Member were permitted to maintain SFTs entered into as both Transferee and Transferor in the same Agent Clearing Member Customer Omnibus Account, the Required Fund Deposit obligations of the Agent Clearing Member could potentially be reduced by offsetting SFT Positions of different Customers in the same SFT Security.

respect to any Agent Clearing Member Transaction to any Customer on behalf of whom an Agent Clearing Member entered into the Agent Clearing Member Transaction.

Section 5(d) of proposed Rule 2D would provide that nothing in the Rules shall prohibit an Agent Clearing Member from seeking reimbursement from a Customer for payments made by the Agent Clearing Member (whether out of Clearing Fund deposits or otherwise) under the Rules, or as otherwise may be agreed between the Agent Clearing Member and the Customer.

*Proposed Rule 2D, Section 6 (Clearing Fund Obligations)*

Section 6 of proposed Rule 2D would set forth the Clearing Fund obligations.

Section 6(a) of proposed Rule 2D would provide that NSCC shall maintain one or more Agent Clearing Member Customer Omnibus Accounts for an Agent Clearing Member. Each Agent Clearing Member shall make and maintain so long as such Member is an Agent Clearing Member a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in its Agent Clearing Member Customer Omnibus Account(s) (the “Agent Clearing Member Required Fund Deposit”). Each Agent Clearing Member, so long as such Member is an Agent Clearing Member, shall also provide SLD to the Clearing Fund, as may be required pursuant to Rule 4A (Supplemental Liquidity Deposits), to support the activity in its Agent Clearing Member Customer Omnibus Account(s). Deposits to the Clearing Fund would be held by NSCC or its designated agents, to be applied as provided in the Rules.

Section 6(b) of proposed Rule 2D would provide that, in the ordinary course, for purposes of satisfying the Agent Clearing Member’s Clearing Fund requirements under the Rules for its Member activity, its Agent Clearing Member activity, and, to the extent

applicable, its Sponsoring Member activity, the Agent Clearing Member's proprietary accounts, its Agent Clearing Member Customer Omnibus Account(s), and its Sponsored Member Sub-Accounts, if any, shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time and without prior notice to the Agent Clearing Member (but being obligated to give notice to the Agent Clearing Member as soon as possible thereafter) and whether or not the Agent Clearing Member is in default of its obligations to NSCC, treat the Agent Clearing Member's accounts as a single account for the purpose of applying Clearing Fund deposits; apply Clearing Fund deposits made by the Agent Clearing Member with respect to any account as necessary to ensure that the Agent Clearing Member meets all of its obligations to NSCC under any other account(s); and otherwise exercise all rights to offset and net against the Clearing Fund deposits any net obligations among any or all of the accounts, whether or not any other Person is deemed to have any interest in such account.<sup>72</sup>

Section 6(c) of proposed Rule 2D would provide that the Agent Clearing Member Required Fund Deposit for each Agent Clearing Member Customer Omnibus Account shall be calculated separately based on the Agent Clearing Member Transactions in such

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<sup>72</sup> NSCC believes this is appropriate because the Clearing Fund deposits of an Agent Clearing Member are the proprietary assets of the Agent Clearing Member and NSCC generally has the right to apply the Clearing Fund deposits of a Member to any of the Member's obligations to NSCC, regardless of whether those were the obligations that generated the Clearing Fund deposit requirement. NSCC therefore believes that, consistent with the FICC Sponsoring Member/Sponsored Member Program for the reasons described above in Item II(B)(iii) "Sponsoring Members and Sponsored Members," an Agent Clearing Member's Clearing Fund deposits should be available to satisfy any of the Agent Clearing Member's obligations to NSCC.

Agent Clearing Member Customer Omnibus Account, and the Agent Clearing Member shall, as principal, be required to satisfy the Agent Clearing Member Required Fund Deposit for each of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts.

Section 6(d) of proposed Rule 2D would provide that Sections 1, 2, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of Rule 4 (Clearing Fund) shall apply to the Agent Clearing Member Required Fund Deposit with respect to obligations of an Agent Clearing Member under the Rules, including its obligations arising under the Agent Clearing Member Customer Omnibus Account(s), to the same extent as such sections apply to any Required Fund Deposit and any other obligations of a Member. For purposes of Section 1 of Rule 4, obligations and liabilities of a Member to NSCC that shall be secured shall include, without limitation, a Member's obligations as an Agent Clearing Member under the Rules, including, without limitation, any obligation of any such Agent Clearing Member to provide the Agent Clearing Member Required Fund Deposit and such Agent Clearing Member's obligations arising under SFTs established in the Agent Clearing Member Customer Omnibus Accounts of such Agent Clearing Member.

Section 6(e) of proposed Rule 2D would provide that an Agent Clearing Member shall be subject to such fines as may be imposed in accordance with the Rules for any late satisfaction of a Clearing Fund deficiency call.

*Proposed Rule 2D, Section 7 (Right of Offset)*

Section 7 of proposed Rule 2D would provide that in the ordinary course, with respect to satisfaction of any Agent Clearing Member's obligations under the Rules, the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts, the

Agent Clearing Member's proprietary accounts, and the Agent Clearing Member's Sponsored Member Sub-Accounts, if any, at NSCC shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, NSCC may, in its sole discretion, at any time any obligation of the Agent Clearing Member arises in respect of any Agent Clearing Member Customer Omnibus Account, exercise a right of offset and net any such obligation against any obligations of NSCC to the Agent Clearing Member in respect of such Agent Clearing Member's proprietary accounts at NSCC.

*Proposed Rule 2D, Section 8 (Loss Allocation Obligations)*

Section 8 of proposed Rule 2D would establish loss allocation obligations for Agent Clearing Members.

Section 8(a) of proposed Rule 2D would provide that, to the extent NSCC incurs a loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event and a loss allocation obligation arises, that would be the responsibility of the Agent Clearing Member Customer Omnibus Account as if the Agent Clearing Member Customer Omnibus Account were a Member, NSCC shall calculate such loss allocation obligation and the Agent Clearing Member shall be, as principal, responsible for satisfying such obligations.

Section 8(b) of proposed Rule 2D would provide that the entire amount of the Required Fund Deposit associated with the Agent Clearing Member's proprietary accounts at NSCC and the entire amount of the Agent Clearing Member Required Fund Deposit may be used to satisfy any amount allocated against an Agent Clearing Member, whether in its capacity as a Member, an Agent Clearing Member, or otherwise. With



respect to an obligation to make payment due to any loss allocation amounts assessed on an Agent Clearing Member pursuant to Section 8(a) of proposed Rule 2D, the Agent Clearing Member may instead elect to terminate its membership in NSCC pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Agent Clearing Member, its Required Fund Deposit shall be the sum of its Required Fund Deposits associated with its proprietary accounts at NSCC (including its proprietary SFT Account pursuant to proposed Rule 56), its Agent Clearing Member Required Fund Deposit for each of its Agent Clearing Member Customer Omnibus Accounts, and its Sponsoring Member Required Fund Deposit, if any.

*Proposed Rule 2D, Section 9 (Restrictions on Access to Services by an Agent Clearing Member)*

Section 9 of proposed Rule 2D would establish the rights of NSCC to restrict an Agent Clearing Member's access to NSCC's services.

Section 9(a) of proposed Rule 2D would provide that the Board of Directors may at any time upon NSCC providing notice to an Agent Clearing Member pursuant to Section 5 of Rule 45 (Notices), suspend an Agent Clearing Member in its capacity as an Agent Clearing Member from any service provided by NSCC either with respect to a particular transaction or transactions or with respect to transactions generally, or prohibit or limit such Agent Clearing Member's access to services offered by NSCC in the event that one or more of the factors set forth in Section 1 of Rule 46 (Restrictions on Access to Services) is present with respect to the Agent Clearing Member.

Section 9(b) of proposed Rule 2D would provide that Rule 46 shall apply with respect to an Agent Clearing Member in the same way as it applies to Members,

including the Board of Directors' right to summarily suspend the Agent Clearing Member and to cease to act for such Agent Clearing Member. As under Rule 46, the Board of Directors would need to make the determination of whether to suspend, prohibit or limit an Agent Clearing Member's access to services offered by NSCC on the basis of the factors set forth in that rule.

Section 9(c) of proposed Rule 2D would provide that if NSCC ceases to act for an Agent Clearing Member in its capacity as an Agent Clearing Member, Section 14 of proposed Rule 56 shall apply and NSCC shall decline to accept or process data from the Agent Clearing Member on Agent Clearing Member Transactions and close-out any Agent Clearing Member Transactions that have been novated to NSCC. Section 9(c) would also provide that if NSCC suspends, prohibits or limits an Agent Clearing Member in its capacity as an Agent Clearing Member with respect to such Agent Clearing Member's access to services offered by NSCC, NSCC shall decline to accept or process data from the Agent Clearing Member on Agent Clearing Member Transactions for so long as NSCC is suspending, prohibiting or limiting the Agent Clearing Member. Furthermore, Section 9(c) would state that, in addition, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC.

This is different from how NSCC would treat Sponsored Member Transactions of a Sponsoring Member under Section 10 of proposed Rule 2C if NSCC ceases to act for the Sponsoring Member. With respect to such transactions, NSCC would have the option to either terminate or settle a Sponsored Member's positions after ceasing to act for the Sponsoring Member. The reason for this difference is that NSCC would have the practical and legal capability to make such an election because each Sponsored Member

would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customer's novated positions.

*Proposed Rule 2D, Section 10 (Insolvency of an Agent Clearing Member)*

Section 10(a) of proposed Rule 2D would provide that an Agent Clearing Member shall be obligated to immediately notify NSCC that (a) it fails, or is unable, to perform its contracts or obligations or (b) it is insolvent as required by Section 1 of Rule 20 (Insolvency) for other Members. An Agent Clearing Member shall be treated by NSCC in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where NSCC treats an Agent Clearing Member as insolvent.

Section 10(b) of proposed Rule 2D would provide that in the event that NSCC determines to treat an Agent Clearing Member as insolvent pursuant to Rule 20 (Insolvency), NSCC shall have the right to cease to act for the insolvent Agent Clearing Member pursuant to Section 9 of proposed Rule 2D. If NSCC ceases to act for the insolvent Agent Clearing Member, NSCC shall decline to accept or process data from the

Agent Clearing Member, including Agent Clearing Member Transactions. As proposed, NSCC would close-out any Agent Clearing Member Transactions which have been novated to NSCC.

This is different from how NSCC would treat Sponsored Member Transactions. As described above, NSCC would have the option to either terminate or settle a Sponsored Member's novated positions after ceasing to act for the Sponsoring Member. However, with respect to Agent Clearing Member Transactions, NSCC would close-out any such transactions which have been novated to NSCC. This is because NSCC would have the practical and legal capability to make such an election with respect to Sponsored Member Transactions because each Sponsored Member would be a limited-purpose member of NSCC. Accordingly, NSCC would have the requisite information about each of the Sponsored Member's novated positions (by virtue of each Sponsored Member's novated portfolio represented as a different sub-account of the Sponsoring Member (i.e., Sponsored Member Sub-Account) on the books and records of NSCC) to make such an election. By contrast, an Agent Clearing Member's Customers would not be limited-purpose members of NSCC nor would NSCC know which transactions within an Agent Clearing Member Customer Omnibus Account belong to which Customers. As such, NSCC would not be able to separately terminate or complete settlement with respect to Customers' novated positions.

*Proposed Rule 2D, Section 11 (Transfer of Agent Clearing Member Transactions in Agent Clearing Member Customer Omnibus Accounts)*

Section 11 of proposed Rule 2D would (i) permit an Agent Clearing Member, upon a default of a Customer and consent of NSCC, to transfer Agent Clearing Member Transactions of the Customer established in one or more of the Agent Clearing Member's

Agent Clearing Member Customer Omnibus Accounts from such Agent Clearing Member Customer Omnibus Accounts to the Agent Clearing Member's proprietary account at NSCC as a Member and (ii) govern how the transfer would be effectuated.

Section 11(a) of proposed Rule 2D would clarify the scope to which Section 11 of proposed Rule 2D applies. It would state that Section 11 would not apply if either (i) the relevant Agent Clearing Member is a Defaulting Member or (ii) a Corporation Default has occurred. This is because, as described above with respect to Section 10(b) of proposed Rule 2D, NSCC would close-out all Agent Clearing Member Transactions for which the defaulting Agent Clearing Member was responsible. If a Corporation Default has occurred with respect to NSCC, each Agent Clearing Member's positions would be closed out in accordance with Section 17 of proposed Rule 56.

Section 11(b) of proposed Rule 2D would set out the process by which an Agent Clearing Member may transfer the Agent Clearing Member Transactions of a defaulting Customer in one or more of Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts. It would provide that, to the extent permitted under applicable laws and regulations, an Agent Clearing Member may, upon a default of a Customer and the consent of NSCC, transfer the Agent Clearing Member Transactions of the Customer established in one or more of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts from such Agent Clearing Member Customer Omnibus Accounts to the Agent Clearing Member's proprietary account at NSCC as a Member. As proposed, any such transfer shall occur by novation, such that the obligations between NSCC and the relevant Customer in respect of the Agent Clearing Member Transactions shall be terminated and replaced with identical obligations between NSCC and the Agent

Clearing Member, acting as principal. Section 11(b) would also provide the Agent Clearing Member shall indemnify NSCC, and its employees, officers, directors, shareholders, agents, and Members, for any and all losses, liability, or expenses incurred by them arising from, or in relation to, any such transfer.

*Proposed Rule 2D, Section 12 (Customer Acknowledgments)*

Section 12 of proposed Rule 2D would provide that each Agent Clearing Member on behalf of each of its Customers agrees that such Customer, by participating in and entering into Agent Clearing Member Transactions through the Agent Clearing Member, understands, acknowledges, and agrees that: (a) the service provided by NSCC with regard to the Customer Clearing Service would be subject to and governed by the Rules; (b) the Rules shall govern the novation of Agent Clearing Member Transactions and all transactions between the Customer and its Agent Clearing Member resulting in the novation of such transactions, and at the time of novation of an Agent Clearing Member Transaction, the Customer on whose behalf it was submitted would be bound by the Agent Clearing Member Transaction automatically and without any further action by the Customer or by its Agent Clearing Member, and the Customer agrees to be bound by the applicable provisions of the Rules in all respects; (c) NSCC shall be under no obligation to deal directly with the Customer, and NSCC may deal exclusively with the Customer's Agent Clearing Member; (d) NSCC shall have no obligations to the Customer with respect to any Agent Clearing Member Transactions submitted by an Agent Clearing Member on behalf of the Customer, including with respect to any payment or delivery obligations; and (e) the Customer shall have no right to receive from NSCC, or any right to assert a claim against NSCC with respect to, nor shall NSCC be liable to the Customer

for, any payment or delivery obligation in connection with any Agent Clearing Member Transactions submitted by an Agent Clearing Member on behalf of the Customer, and NSCC shall make any such payments or redeliveries solely to the relevant Agent Clearing Member.

**(C) Proposed Rule 56 – Securities Financing Transaction Clearing Service**

NSCC is proposing to add Rule 56, entitled “Securities Financing Transaction Clearing Service.” This new rule would govern the proposed SFT Clearing Service and would be comprised of 18 sections, each of which is described below.

In connection with the proposed SFT Clearing Service, NSCC is proposing to add the following terms and definitions, as described below.

The term “Aggregate Net SFT Close-out Value” would mean, with respect to an SFT Member, the sum of the SFT Close-out Value (as defined below and in the proposed rule change) for each SFT Position to which the SFT Member is a party.

The term “Approved SFT Submitter” would mean a provider of transaction data on an SFT that the parties to the SFT have selected and NSCC has approved, subject to such terms and conditions as to which the Approved SFT Submitter and NSCC may agree.

The term “Bilaterally Initiated SFT” would mean an SFT, the Initial Settlement of which occurred prior to the submission of such SFT to NSCC.

The term “Buy-In Amount” would mean a net amount equal to (x) the Buy-In Costs or Deemed Buy-In Costs (as defined below and in the proposed rule change) of the SFT Securities (as defined below and in the proposed rule change) in respect of which a Transferor has effected a Buy-In, less (y) the amount of the SFT Cash for the relevant

SFT (unless the Transferor effected a Buy-In in respect of some, but not all, of the SFT Securities that are the subject of the SFT, in which case (y) shall be the amount of the Corresponding SFT Cash (as defined below and in the proposed rule change)).

The term “Contract Price” would mean, with respect to SFT Securities subject to an SFT, the price of such securities at the time the SFT is submitted to NSCC for novation, which price shall be determined by the SFT Member parties to the relevant SFT and provided by an Approved SFT Submitter to NSCC in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose; provided that if no such price is provided by the time required by NSCC, the “Contract Price” shall be the Current Market Price of the SFT Securities.

The term “Corresponding SFT Cash” would mean (a) in respect of a Recalled SFT (as defined below and in the proposed rule change) for which a Transferor has effected a Buy-In in respect of some, but not all, of the SFT Securities that are the subject of the SFT, the portion of the SFT Cash for such SFT equal to the product of (i) the percentage of the SFT Securities in respect of which the Transferor effected a Buy-In and (ii) the SFT Cash of the SFT; and (b) in respect of a Settling SFT which has a greater quantity of SFT Securities as its subject than the corresponding Linked SFT, the portion of the SFT Cash of the Settling SFT equal to the product of (i) the percentage of the SFT Securities of the Settling SFT that the Linked SFT has as its subject and (ii) the SFT Cash of the Settling SFT.

The term “Deemed Buy-In Costs” would mean the product of the number of SFT Securities subject to the relevant Buy-In and the per-share price therefor on the date of



the Buy-In obtained from a generally recognized source or the last bid quotation from such a source at the most recent close of trading for the SFT Security.

The term “Defaulting SFT Member” would mean an SFT Member for which NSCC has ceased to act in accordance with Section 14 of proposed Rule 56, as described below.

The term “Distribution” would mean, with respect to any SFT Security at any time, any cash payment of amounts equivalent to dividends and other distributions on the SFT Security.

The term “Distribution Amount” would mean, in respect of an SFT, an amount of cash equal to the product of: (a) the amount per security in respect of (x) a cash dividend on the SFT Securities that are the subject of the SFT or (y) an exchange of the SFT Securities that are the subject of the SFT for cash; and (b) the number of the relevant SFT Securities subject to the SFT.

The term “Distribution Payment” would mean an amount payable by one party to an SFT to the other party to the SFT during the term of the SFT in respect of a Distribution on the SFT Securities subject to the SFT.

The term “Existing Master Agreement” would mean, in respect of an SFT, a written agreement that (i) exists at the time transaction data for the SFT is submitted to NSCC by an Approved SFT Submitter, (ii) provides for, among other things, terms governing the payment and delivery obligations of the parties and (iii) the parties have established (by written agreement, oral agreement, course of conduct or otherwise) would govern such SFT.

The term “Final Settlement” would mean the exchange of SFT Securities for SFT Cash described in clause (b) of the proposed definition of Securities Financing Transaction.

The term “Final Settlement Date” would mean the Business Day on which the final settlement of a transaction is scheduled to occur. If the transaction is an SFT, the Final Settlement Date means the Business Day on which the Final Settlement of the SFT is scheduled to occur in accordance with proposed Rule 56 or, if the SFT is accelerated in accordance with proposed Rule 56, the date to which the Final Settlement obligations have been accelerated.

The term “Incremental Additional Independent Amount SFT Cash” would mean, (a) in respect of a Linked SFT, the excess, if any, of the Independent Amount SFT Cash of the Linked SFT over the Independent Amount SFT Cash of the Settling SFT; (b) in respect of a Non-Returned SFT, the portion of the Price Differential payable by the Transferee, if any, that is attributable to the Independent Amount SFT Cash of the SFT (which shall be calculated by multiplying such Priced Differential by the excess, if any, of the Independent Amount Percentage (as defined below and in the proposed rule change) over 100%); and (c) in respect of any other SFT, the Independent Amount SFT Cash of such SFT.

The term “Independent Amount Percentage” would mean, in respect of an SFT, a percentage obtained by dividing the SFT Cash of such SFT by the Market Value SFT Cash (as defined below and in the proposed rule change) of such SFT.

The term “Independent Amount SFT Cash” would mean the portion, if any, of the SFT Cash for an SFT equal to the amount by which the SFT Cash for such SFT at the

time of the Initial Settlement exceeds the Contract Price of the SFT Securities that are the subject of such SFT.

The term “Ineligibility Date” would mean, with respect to an SFT, the date on which the SFT Security that is the subject of the SFT becomes an Ineligible SFT Security (as defined below and in the proposed rule change).

The term “Ineligible SFT” would mean an SFT that has, as its subject, SFT Securities that have become Ineligible SFT Securities.

The term “Ineligible SFT Security” would mean an SFT Security that is not eligible to be the subject of a novated SFT.

The term “Initial Settlement” would mean the exchange of SFT Securities for SFT Cash described in clause (a) of the proposed definition of Securities Financing Transaction.

The term “Linked SFT” would mean an SFT entered into by the pre-novation SFT Member parties to a Settling SFT that has the same Transferor, Transferee and subject SFT Securities (including CUSIP) as the Settling SFT. As proposed, a Linked SFT would include an SFT that has as its subject fewer SFT Securities than the corresponding Settling SFT but would not include an SFT that has as its subject more SFT Securities than the corresponding Settling SFT.

The term “Market Value SFT Cash” would mean the portion of the SFT Cash for an SFT equal to the amount of the SFT Cash for such SFT minus the Independent Amount SFT Cash of such SFT.

The term “Price Differential” would mean (a) for purposes of the discharge of offsetting Final Settlement and Initial Settlement obligations, (i) the SFT Cash for the

Settling SFT (or if the Settling SFT has a greater quantity of SFT Securities as its subject than the corresponding Linked SFT, the Corresponding SFT Cash) minus (ii) the SFT Cash for the Linked SFT; and (b) for all other purposes, (i) the SFT Cash for the SFT minus (ii) the product of the Independent Amount Percentage, if any, and the Current Market Price of the SFT Securities.

The term “Rate Payment” would mean an amount payable from one party to an SFT to the other party to the SFT at the Final Settlement expressed as a percentage of the amount of SFT Cash for the SFT. As an example, if the Rate Payment is specified as 0.02%, the amount payable would be the product 0.02% and the SFT Cash for the SFT.

The term “Recall Date” would mean, in respect of a Recall Notice, the second Business Day following NSCC’s receipt of such Recall Notice.

The term “Recall Notice” would mean a notice that triggers the provisions of Section 9(b) of proposed Rule 56, relating to a Buy-In in respect of an SFT and that is submitted by an Approved SFT Submitter on behalf of a Transferor in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose.

The term “Recalled SFT” would mean an SFT that has been novated to NSCC in respect of which a Recall Notice has been submitted.

The term “Securities Financing Transaction” or “SFT” would mean a transaction between two SFT Members pursuant to which (a) one SFT Member agrees to transfer specified SFT Securities to another SFT Member versus the SFT Cash; and (b) the Transferee agrees to retransfer such specified SFT Securities or equivalent SFT Securities

(including quantity and CUSIP) to the Transferor versus the SFT Cash on the following Business Day.

The term “Settling SFT” would mean, as of any Business Day, an SFT that has been novated to NSCC, the Final Settlement of which is scheduled to occur on that Business Day.

The term “SFT Account” would mean a ledger maintained on the books and records of NSCC that reflects the outstanding SFTs that an SFT Member enters into and that have been novated to NSCC, the SFT Positions or SFT Cash associated with those transactions and any debits or credits of cash associated with such transactions effected pursuant to Rule 12 (Settlement). As proposed, the term “SFT Account” would include any Agent Clearing Member Customer Omnibus Account and any Sponsored Member Sub-Account.

The term “SFT Cash” would mean the specified amount of U.S. dollars that the Transferee agrees to transfer to the Transferor at the Initial Settlement of an SFT, (i) plus any Price Differential paid by NSCC to the SFT Member as Transferor or by the SFT Member as Transferee to NSCC during the term of the SFT and (ii) less any Price Differential paid by NSCC to the SFT Member as Transferee or by the SFT Member as Transferor to NSCC during the term of the SFT.

The term “SFT Close-out Value” would mean, with respect to an SFT Position of an SFT Member, an amount equal to: (i) if the SFT Member is the Transferor of the SFT Securities that are the subject of such SFT, (a) the CNS Market Value of the SFT Securities that are the subject of such SFT minus (b) the SFT Cash for such SFT; and (ii) if the SFT Member is a Transferee of the SFT Securities that are the subject of such SFT,

(a) the SFT Cash for such SFT minus (b) the CNS Market Value of the SFT Securities that are the subject of such SFT.

The term “SFT Long Position” would mean the number of units of an SFT Security which an SFT Member is entitled to receive from NSCC at Final Settlement of an SFT against payment of the SFT Cash.

The term “SFT Member” would mean any Member, Sponsored Member acting in its principal capacity, Sponsoring Member acting in its principal capacity or Agent Clearing Member acting on behalf of a Customer, in each case that is a party to an SFT, permitted to participate in NSCC’s SFT Clearing Service.

The term “SFT Position” would mean an SFT Member’s SFT Long Position or SFT Short Position (as defined below and in the proposed rule change) in an SFT Security that is the subject of an SFT that has been novated to NSCC.

The term “SFT Security” would mean a security that is eligible to be the subject of an SFT novated to NSCC and is included in the list for which provision is made in proposed Section 1(g) of Rule 3 (Lists to be Maintained), as described below. As proposed, if any new or different security is exchanged for any SFT Security in connection with a recapitalization, merger, consolidation or other corporate action, such new or different security shall, effective upon such exchange, become an SFT Security in substitution for the former SFT Security for which such exchange is made.

The term “SFT Short Position” would mean the number of units of an SFT Security that an SFT Member is obligated to deliver to NSCC at Final Settlement of an SFT against payment of the SFT Cash.

The term “Transferee” would mean the SFT Member party to an SFT that agrees to receive SFT Securities from the other SFT Member party to the SFT in exchange for SFT Cash in connection with the Initial Settlement of the SFT.

The term “Transferor” would mean the SFT Member party to an SFT that agrees to transfer SFT Securities to the other SFT Member party to the SFT in exchange for SFT Cash in connection with the Initial Settlement of the SFT.

Proposed Rule 56, Section 1 (General)

Section 1 of proposed Rule 56 would be a general provision regarding the SFT Clearing Service applicable to Members, Sponsoring Members and Agent Clearing Members that participate in the proposed SFT Clearing Service.

Section 1(a) of proposed Rule 56 would establish that NSCC may accept for novation SFTs entered into between (i) a Member and another Member, (ii) a Sponsoring Member and its Sponsored Member, or (iii) an Agent Clearing Member acting on behalf of a Customer and either (x) a Member or (y) the same or another Agent Clearing Member acting on behalf of a Customer.

Section 1(b) of proposed Rule 56 would provide that any SFT that is submitted to NSCC for novation, and any Member and Sponsored Member that enters into an SFT (and any Customer on behalf of whom an Agent Clearing Member enters into an SFT) shall be subject to the provisions of proposed Rule 56; provided that Sections 15 and 16 of proposed Rule 56 shall only apply to Sponsoring Members, Agent Clearing Members, Sponsored Members and Customers, as applicable.

Section 1(c) of proposed Rule 56 would further provide that any amount of cash described in proposed Rule 56 may be rounded up to the nearest one cent, five cents, 10

cents, 25 cents or dollar according to the rounding convention requested by the SFT Member parties to the relevant SFT as conveyed to NSCC in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose.

*Proposed Rule 56, Section 2 (Eligibility for SFT Clearing Service: SFT Member)*

Section 2 of proposed Rule 56 would establish the eligibility requirements for using the proposed SFT Clearing Service.

Under Section 2 of proposed Rule 56, NSCC may permit any Member acting in its principal capacity, Sponsored Member acting in its principal capacity, or Agent Clearing Member acting on behalf of a Customer to be an SFT Member and participate in the proposed SFT Clearing Service.

Section 2 of proposed Rule 56 would provide that the rights, liabilities and obligations of SFT Members in their capacity as such shall be governed by the proposed Rule 56. References to a Member would not apply to an SFT Member in its capacity as such, unless specifically noted in the proposed Rule 56 or in such other Rules as applicable to an SFT Member.

Section 2 of proposed Rule 56 would also provide that an SFT Member that participates in NSCC in another capacity pursuant to another Rule, or which has entered into an agreement with NSCC independent from proposed Rule 56, shall continue to have all the rights, liabilities and obligations set forth in such other Rule or pursuant to such agreement, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as an SFT Member, except as contemplated under Sections 15 and 16 of proposed Rule 56, as described below.



Proposed Rule 56, Section 3 (Membership Documents)

Section 3 of proposed Rule 56 would govern the documents that SFT Member applicants would be required to complete and deliver to NSCC. Specifically, Section 3 of proposed Rule 56 would provide that to become an SFT Member, each applicant shall complete and deliver to NSCC documents in such forms as may be prescribed by NSCC from time to time and any other information requested by NSCC.

Proposed Rule 56, Section 4 (Securities Financing Transaction Data Submission)

Section 4 of proposed Rule 56 would govern the submission of transaction data for SFTs into NSCC for novation by Approved SFT Submitters on behalf of Transferors (e.g., lenders) and Transferees (e.g., borrowers).

Section 4(a) of proposed Rule 56 would provide that in order for an SFT to be submitted to NSCC, the transaction data for the SFT must be submitted to NSCC by an Approved SFT Submitter in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Any such transaction data shall be submitted to NSCC on a locked-in basis. In determining whether to accept transaction data from an Approved SFT Submitter, NSCC may require the Approved SFT Submitter to provide a Cybersecurity Confirmation. This is consistent with the existing requirement in Section 6 of Rule 7 (Comparison and Trade Recording Operation (Including Special Representative/Index Receipt Agent)) for organizations reporting trade data to NSCC.<sup>73</sup>

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<sup>73</sup> Section 6 of Rule 7 (Comparison and Trade Recording Operation (Including Special Representative/Index Receipt Agent)) provides that NSCC may require organizations that deliver trade data to NSCC as described in that Rule to provide a Cybersecurity Confirmation before agreeing to accept such trade data. Supra note 4.

Section 4(b) of proposed Rule 56 would provide that NSCC would not act upon any instruction received from an Approved SFT Submitter in respect of an SFT unless each SFT Member (other than an SFT Member that is a Sponsored Member) designated by the Approved SFT Submitter as a party to such SFT has consented, in a writing delivered to NSCC, to the Approved SFT Submitter acting on behalf of the SFT Member in respect of SFTs.

Section 4(c) of proposed Rule 56 would provide that the obligations reflected in the transaction data on an SFT shall be deemed to have been confirmed and acknowledged by each SFT Member designated by the Approved SFT Submitter as a party thereto and to have been adopted by such SFT Member and, for the purposes of determining the rights and obligations between NSCC and such SFT Member under the proposed Rule 56 and such other Rules applicable to SFTs, shall be valid and binding upon such SFT Member. In addition, Section 4(c) would provide that an SFT Member which has been so designated by an Approved SFT Submitter shall resolve any differences or claims regarding the rights and obligations reflected in the transaction data submitted by the Approved SFT Submitter with the Approved SFT Submitter, and NSCC shall have no responsibility in respect thereof or to adjust its records or the accounts of the SFT Member in any way, other than pursuant to the instructions of the Approved SFT Submitter. Section 4(c) would also provide that any such adjustment shall be in the sole discretion of NSCC.

Section 4(d) of proposed Rule 56 would provide that NSCC makes no representation, whether expressed or implied, as to the complete and timely performance of an Approved SFT Submitter's duties and obligations. Section 4(d) would also provide

that NSCC assumes no liability to any SFT Member for any act or failure to act by an Approved SFT Submitter in connection with any information received by NSCC or given to the SFT Member by NSCC via the Approved SFT Submitter, as the case may be.

Section 4(e) of proposed Rule 56 would provide that the submission of each SFT to NSCC and the performance of any obligation under such SFT shall constitute a representation to NSCC and covenant by the Transferor and the Transferee, any Sponsoring Member that is acting on behalf of the Transferor or Transferee and any Agent Clearing Member that is acting on behalf of a Customer in connection with such SFT that its participation in such SFT is in compliance, and would continue to comply, with all applicable laws and regulations, including without limitation Rule 15c3-3 and all other applicable rules and regulations of the Commission, any applicable provisions of Regulation T, Regulation U and Regulation X of the Board of Governors of the Federal Reserve System, and the rules of FINRA and any other regulatory or self-regulatory organization to which the Transferor, the Transferee, any Sponsoring Member that is acting on behalf of the Transferor or Transferee or any Agent Clearing Member that is acting on behalf of a Customer is subject.

Section 4(f) of proposed Rule 56 would provide that the submission of each SFT to NSCC shall constitute an authorization to NSCC by the Transferor, the Transferee and any Agent Clearing Member that is acting on behalf of a Customer for NSCC to give instructions regarding the SFT to DTC in respect of the relevant accounts of the Transferor, Transferee and Agent Clearing Member at DTC.

Proposed Rule 56, Section 5 (Novation of Securities Financing Transactions)

Section 5 of proposed Rule 56 would govern the nature and timing of the novation to NSCC of obligations related to an SFT.

Section 5(a) of proposed Rule 56 would provide that NSCC to only novate an SFT if, at the time of novation, the Final Settlement of such transaction is scheduled to occur one Business Day following the Initial Settlement and the SFT Cash is no less than 100% of the Contract Price of the SFT.

Section 5(b) of proposed Rule 56 would provide that each SFT that is a Bilaterally Initiated SFT, including any Sponsored Member Transaction, and validated pursuant to the Rules shall be novated to NSCC as of the time NSCC provides the Approved SFT Submitter for such SFT a report confirming such novation in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Section 5(b) would also provide that each SFT that is neither a Bilaterally Initiated SFT nor a Sponsored Member Transaction and that is validated pursuant to the Rules shall be novated to NSCC as of the time (x) the Initial Settlement of such SFT has completed by (i) the Transferor instructing DTC to deliver from the relevant DTC account of the Transferor to NSCC's account at DTC the subject SFT Securities versus payment of the amount of the SFT Cash, (ii) NSCC instructing DTC to deliver from NSCC's account at DTC to the relevant DTC account of the Transferee the subject SFT Securities versus payment of the amount of SFT Cash and (iii) DTC processes the deliveries in accordance with the rules and procedures of DTC, or (y) the Initial Settlement obligations of such SFT have been discharged in accordance with Section 8 of proposed Rule 56, as described below. In addition, Section 5(b) would provide that if the

Initial Settlement obligations of an SFT that is neither a Bilaterally Initiated SFT nor a Sponsored Member Transaction are not discharged in accordance with clause (x) or (y), then such SFT shall be deemed void *ab initio*.

Section 5(c) of proposed Rule 56 would provide that, subject to Sections 5(d) and 5(e) of proposed Rule 56 as described below, the novation of SFTs shall consist of the termination of the Final Settlement, Rate Payment and Distribution Payment obligations and entitlements between the parties to the SFT with respect to such SFT and their replacement with obligations and entitlements to and from NSCC to perform, in accordance with the Rules, the Final Settlement, Rate Payment, and Distribution Payment obligations and entitlements under the SFT.

Section 5(d) of proposed Rule 56 would govern the novation of SFTs having Incremental Additional Independent Amount SFT Cash and provides when the obligation to return Independent Amount SFT Cash for which an associated Clearing Fund deposit has not been made will be novated away from a Transferor to NSCC. Specifically, Section 5(d)(i) of proposed Rule 56 would provide that if an SFT has Incremental Additional Independent Amount SFT Cash, then, unless the SFT is a Sponsored Member Transaction and the Sponsoring Member is the Transferee,<sup>74</sup> the obligation of the Transferor to return the Incremental Additional Independent Amount SFT Cash to the Transferee shall not be terminated and novated to NSCC (nor shall NSCC otherwise be

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<sup>74</sup> Where the Transferor is a Sponsored Member receiving Independent Amount SFT Cash, NSCC would not be requiring Independent Amount SFT Cash Deposit Requirement. This is because in the case of the Sponsored Member's default, the party giving the Independent Amount SFT Cash, i.e., Sponsoring Member, is the guarantor of the settlement obligation of the Sponsored Member Independent Amount SFT Cash back to NSCC.

required to return such Incremental Additional Independent Amount SFT Cash), except to the extent that the Transferor, Sponsoring Member or Agent Clearing Member, as applicable, has satisfied the associated Independent Amount SFT Cash Deposit Requirement. As proposed, to the extent the associated Clearing Fund deposit has not been made in respect of Independent Amount SFT Cash at the time of the Initial Settlement, the obligation to return the Independent Amount SFT Cash would not be novated to NSCC.

Section 5(d)(ii) of proposed Rule 56 would provide that to the extent the Transferor, Sponsoring Member or Agent Clearing Member has not satisfied the associated Independent Amount SFT Cash Deposit Requirement, the Transferor's (or in the case of a Non-Returned SFT, NSCC's) obligation to return the Incremental Additional Independent Amount SFT Cash shall: (1) if the SFT is an Agent Clearing Member Transaction for which the Agent Clearing Member, acting on behalf of the Customer, is the Transferor, be terminated and replaced with an obligation of the Agent Clearing Member, in its capacity as principal, to return the Incremental Additional Independent Amount SFT Cash to the Transferee; or (2) otherwise, remain (or in the context of a Non-Returned SFT, be terminated and replaced with) a bilateral obligation of the Transferor to the Transferee. As proposed, if the associated Clearing Fund deposit has not been made in respect of Independent Amount SFT Cash, the Independent Amount SFT Cash would be owed by the Transferor to the Transferee as a bilateral principal-to-principal obligation, unless the Transferor is a Customer of an Agent Clearing Member, in which case the obligation to return the Independent Amount SFT Cash in respect of which the Clearing Fund has not been made would be novated from the Customer to the

Agent Clearing Member, and the Agent Clearing Member would owe the Independent Amount SFT Cash back to the Transferee as principal.<sup>75</sup>

Section 5(d)(iii) of proposed Rule 56 would provide that each SFT Member agrees that any obligation to return Incremental Additional Independent Amount SFT Cash that is novated to an Agent Clearing Member or that remains (or becomes) a bilateral obligation of the Transferor to the Transferee in accordance with Section 5(d)(ii) of proposed Rule 56, is a binding and enforceable obligation of the Agent Clearing Member or Transferor, as applicable, regardless of whether the Transferee has entered into an Existing Master Agreement with the Agent Clearing Member or Transferor. In addition, Section 5(d)(iii) would provide that each SFT Member further agrees that any such obligation shall only be due and payable to the Transferee upon the final discharge of NSCC's Final Settlement obligations to the Transferor under the portion of the SFT that has been novated to NSCC in accordance with Section 5(b) of proposed Rule 56, as described above.

Section 5(d)(iv) of proposed Rule 56 would provide that, until the Transferor, Sponsoring Member or Agent Clearing Member has satisfied in full its Independent Amount SFT Cash Deposit Requirement, the SFT Cash of the SFT shall, for purposes of determining the obligations owing to and from NSCC under such SFT, equal the SFT Cash of the SFT less the Incremental Additional Independent Amount SFT Cash.

Section 5(d)(v) of proposed Rule 56 would provide that once the Transferor, Sponsoring Member or Agent Clearing Member, as applicable, has satisfied in full its

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<sup>75</sup> This interim novation is designed to avoid any credit concerns that would manifest if the Customer and the Transferee had to have a principal bilateral obligation to each other for the Independent Amount SFT Cash.

Independent Amount SFT Cash Deposit Requirement, the obligation of the Transferor to return the Incremental Additional Independent Amount SFT Cash to the Transferee (or, in the case of an SFT that is an Agent Clearing Member Transaction, any obligation of the Agent Clearing Member to return the Incremental Additional Independent Amount SFT Cash to the Transferee) shall be novated to NSCC, and the SFT Cash of the SFT shall, for purposes of determining the obligations owing to and from NSCC under the SFT, include the full amount of the SFT Cash of such SFT.

Section 5(e) of proposed Rule 56 would govern novation in respect of certain corporate actions and provide that NSCC would (i) have an obligation to pay the cash distribution to the Transferor and the Transferee would have an obligation to pay the cash distribution to NSCC, and (ii) not novate any obligations related to unsupported corporate actions and distributions. Specifically, Section 5(e)(i) of proposed Rule 56 would provide that regardless of anything to the contrary in any Existing Master Agreement (including a provision addressing when an issuer pays different amounts to different security holders due to withholding tax or other reasons), the Distribution Payment obligations and entitlements between NSCC and each party to an SFT that has been novated to NSCC shall be the obligation of NSCC to pay to the Transferor and the obligation of the Transferee to pay to NSCC the Distribution Amount in respect of each Distribution and the corresponding entitlements of the Transferor and NSCC, in each case, in accordance with the Rules.

Section 5(e)(ii) of proposed Rule 56 would provide that NSCC shall maintain a list of corporate actions and distributions that NSCC does not support with respect to SFTs. Section 5(e)(ii) would further provide that no Final Settlement, Rate Payment,



Distribution Payment or other obligation resulting from a corporate action or distribution that is not supported by NSCC shall be novated to NSCC. In addition, Section 5(e)(ii) would provide that none of such unsupported corporate action shall modify the Final Settlement, Rate Payment, Distribution Payment or other obligations of NSCC, Transferor and Transferee under an SFT that has been novated to NSCC. Section 5(e)(ii) would also provide that each SFT Member agrees that any obligation under an SFT resulting from a corporate action or distribution not supported by NSCC shall remain a binding and enforceable bilateral obligation between the Transferor and the Transferee, regardless of whether the Transferor and Transferee have entered into an Existing Master Agreement.

Section 5(f) of proposed Rule 56 would provide that the novation of SFTs shall not affect the fundamental substance of the SFT as a transfer of securities by one party in exchange for a transfer of cash by the other party and an agreement by each party to return the property it received and shall not affect the economic obligations or entitlements of the parties under the SFT except that following novation, the Final Settlement, Rate Payment and Distribution Payment obligations and entitlements shall be owed to and by NSCC rather than the original counterparty under the SFT.

Section 5(g) of proposed Rule 56 would provide that the representations and warranties made by each of the parties to an SFT that has been novated to NSCC under the parties' Existing Master Agreement, if any, shall (x) to the extent that they are inconsistent with the Rules, be eliminated and replaced with the Rules and (y) to the extent that they are not inconsistent with the Rules, remain in effect as between the parties to the original SFT, but shall not impose any additional obligations on NSCC.

Proposed Rule 56, Section 6 (Rate and Distributions)

Section 6 of proposed Rule 56 would govern the settlement of Rate Payments and supported Distributions by NSCC for novated SFTs. Section 6(a) of proposed Rule 56 would provide that NSCC shall debit and credit the Rate Payment from and to the SFT Accounts of the SFT Member parties to an SFT that has been novated to NSCC as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service) on the scheduled Final Settlement Date for the SFT, irrespective of whether Final Settlement of such SFT occurs on such date.

Section 6(b) of proposed Rule 56 would provide that if (x) a cash dividend is made on or in respect of an SFT Security that is the subject of an SFT that has been novated to NSCC or (y) cash is exchanged, in whole or in part, for such an SFT Security in a merger, consolidation or similar transaction, and the Transferor under the SFT would have been entitled to a cash payment related to the event described in clause (x) or (y) had it not transferred the SFT Securities that are the subject of the SFT to the Transferee in the Initial Settlement, then NSCC shall, within the time period determined by NSCC from time to time, credit the Distribution Amount to the Transferor's SFT Account and debit the Distribution Amount from the Transferee's SFT Account as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII. Section 6(b) would further provide that if cash is exchanged in whole for such an SFT Security, then the completion of the actions described in the preceding sentence shall discharge NSCC's Final Settlement obligations to the relevant Transferor and the Transferee's Final Settlement obligations to NSCC.

*Proposed Rule 56, Section 7 (Final Settlement of Securities Financing Transactions)*

Section 7 of proposed Rule 56 would govern the mechanics of Final Settlement of SFTs by providing that, subject to Section 11 of proposed Rule 56, as described below, the Final Settlement of an SFT that has been novated to NSCC shall be scheduled to occur on the Business Day immediately following the date the SFT was novated to NSCC. Section 7 would further provide that unless the Final Settlement obligations under such an SFT are discharged in accordance with Section 8 of proposed Rule 56, as described below, Final Settlement of the SFT shall occur by (x) NSCC instructing DTC to (i) deliver from the relevant DTC account of the Transferee to NSCC's account at DTC the subject SFT Securities versus payment of the amount of SFT Cash and (ii) deliver from NSCC's account at DTC to the relevant DTC account of the Transferor the subject SFT Securities versus payment of the amount of SFT Cash, and (y) the processing of such deliveries by DTC in accordance to the rules and procedures of DTC; provided that if such transfers do not occur and a Buy-In does not occur in respect of the SFT, then the Final Settlement Date shall be rescheduled for the following Business Day as described in Section 9 of proposed Rule 56, as described below. The obligation of a Transferor (or a Sponsoring Member that guarantees to NSCC the obligation of a Transferor or an Agent Clearing Member that is responsible for the performance of the obligation under an SFT that is an Agent Clearing Member Transaction to return SFT Cash to NSCC) in respect of the Final Settlement of an SFT that has been novated to NSCC shall be to pay the SFT Cash and, if applicable, the Rate Payment to NSCC against the transfer of the relevant SFT Securities by NSCC. The obligation of a Transferee (or a Sponsoring Member that guarantees to NSCC the obligation of a

Transferee or an Agent Clearing Member that is responsible for the performance of the obligation under an SFT that is an Agent Clearing Member Transaction to return SFT Securities to NSCC) in respect of the Final Settlement of an SFT that has been novated to NSCC shall be to transfer the SFT Securities and, if applicable, the Rate Payment to NSCC against the transfer of SFT Cash by NSCC.

Section 7 of proposed Rule 56 would also provide that an SFT, or a portion thereof, shall be deemed complete and final upon Final Settlement of the SFT, or such portion, whether pursuant to Sections 7, 8, 9(d) or 13(c) of proposed Rule 56. Section 7 would also provide that from and after the Final Settlement of an SFT, or a portion thereof, pursuant to any Sections 7, 8, 9(d) or 13(c) of proposed Rule 56, NSCC shall be discharged from its obligations to the Transferor and the Transferee, and NSCC shall have no further obligation in respect of the SFT or such portion. This is to make it clear to SFT Members the point at which settlement of an SFT is deemed to be complete and final.<sup>76</sup>

*Proposed Rule 56, Section 8 (Discharge of Offsetting Final Settlement and Initial Settlement Obligations)*

Section 8 of proposed Rule 56 would govern the “roll” (i.e., pair off or offset) process whereby the Final Settlement obligations on one SFT (i.e., the Settling SFT) between two parties can be offset with the Initial Settlement obligations on another SFT

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<sup>76</sup> With respect to an SFT between a Sponsoring Member and its Sponsored Member, the SFT would settle on the books of the Sponsoring Member because the Sponsored Member are not participants at DTC and thus would not have accounts at DTC. Accordingly, the finality of the settlement of such SFT would occur when the Sponsoring Member credits the securities and cash on its or the relevant custodian’s books and records.

between the same parties (i.e., the Linked SFT) through the debiting and crediting of the difference in cash collateral between the two offsetting SFTs (i.e., the Price Differential).

Section 8(a) of proposed Rule 56 would provide that, subject to the provisions of Section 13(c) of proposed Rule 56, as described below, if, on any Business Day, the prenovation SFT Member parties to a Settling SFT enter into a Linked SFT and the Approved SFT Submitter provides an appropriate instruction to NSCC in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose, the Final Settlement obligations of the parties to the Settling SFT and the Initial Settlement obligations of the parties to the Linked SFT shall be discharged once NSCC has instructed DTC to debit and credit the relevant DTC accounts, of the SFT Member parties, as described below in Section 8(b) of proposed Rule 56, and DTC processes such debits and credits in accordance with the rules and procedures of DTC. To the extent the Price Differential is not processed by DTC in accordance with the rules and procedures of DTC, NSCC shall debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service). If the Price Differential is positive, NSCC shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account. If the Price Differential is negative, NSCC shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account. However, if the Linked SFT has as its subject fewer SFT Securities than the Settling SFT,

then only the following Final Settlement obligations under the Settling SFT shall be discharged in accordance with Section 8 of proposed Rule 56: (i) the Transferee's and NSCC's Final Settlement obligations in respect of a quantity of SFT Securities equal to the quantity of SFT Securities that are the subject of the Linked SFT and (ii) the Transferor's and NSCC's Final Settlement obligations in respect of the Corresponding SFT Cash.

Section 8(b) of proposed Rule 56 would provide that if the Price Differential is positive, NSCC shall (x) instruct DTC to debit an amount equal to the Price Differential from NSCC's account at DTC and credit such amount to the relevant DTC account of the Transferee and (y) instruct DTC to debit an amount equal to the Price Differential from the relevant DTC account of the Transferor and credit such amount to NSCC's account at DTC. If the Price Differential is negative, NSCC shall (x) instruct DTC to debit an amount equal to the absolute value of the Price Differential from NSCC's account at DTC and credit such amount to the relevant DTC account of the Transferor and (y) instruct DTC to debit an amount equal to the absolute value of the Price Differential from the relevant DTC account of the Transferee and credit such amount to NSCC's account at DTC.

*Proposed Rule 56, Section 9 (Non-Returned Securities Financing Transactions and Recalls)*

Section 9 of proposed Rule 56 would govern the processing of a novated SFT for which the Final Settlement obligations have not been discharged either through Final Settlement in accordance with Section 7 of proposed Rule 56 (as described above) or a pair off in accordance with Section 8 of proposed Rule 56 (as described above), and the recall and buy-in process for such an SFT.

Specifically, Section 9(a) of proposed Rule 56 would provide that if (x) the Transferee does not satisfy its Final Settlement obligations in respect of an SFT that has been novated to NSCC on the Final Settlement Date, (y) such Final Settlement obligations have not been discharged in accordance with the provisions of Section 8 of proposed Rule 56, as described above, and (z) a Buy-In has not occurred in respect of such SFT or a portion thereof (such SFT, a “Non-Returned SFT”), the Final Settlement Date of the Non-Returned SFT shall be rescheduled for the following Business Day, and NSCC shall instruct DTC to debit and credit the relevant DTC accounts of the SFT Member parties, as described in subsection (b) of Section 8 above. To the extent the Price Differential is not processed by DTC in accordance with the rules and procedures of DTC, NSCC shall debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the Non-Returned SFT as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service). Section 9(a) would further provide that if the Price Differential is positive, NSCC shall (x) credit an amount equal to the Price Differential to the Transferee’s SFT Account and (y) debit an amount equal to the Price Differential from the Transferor’s SFT Account; if the Price Differential is negative, NSCC shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor’s SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee’s SFT Account. This process would continue until Final Settlement, a pair off in accordance with Section 8 of proposed Rule 56 (as discussed above), or a Buy-In.

Section 9(b) of proposed Rule 56 would provide that if NSCC receives a Recall Notice in respect of an SFT that has been novated to NSCC and the Transferee does not satisfy its Final Settlement obligations by the Recall Date for the Recall Notice, the Transferor may, in a commercially reasonable manner,<sup>77</sup> purchase some or all of the SFT Securities that are the subject of the SFT<sup>78</sup> or elect to be deemed to have purchased the SFT Securities, in each case in accordance with such timeframes and deadlines as established by NSCC for such purpose (a “Buy-In”); provided that in the case of a Default-Related SFT (as defined below and in the proposed rule change), the commercial reasonableness of a Buy-In shall be determined by NSCC based on whether, in the opinion of NSCC, such Buy-In would create a disorderly market in the relevant SFT Security. Following such purchase or deemed purchase, the Transferor shall (x) give written notice to NSCC of the Transferor’s costs to purchase the relevant SFT Securities (including the price paid by the Transferor and any broker’s fees and commissions and reasonable out-of-pocket transaction costs, fees or interest expenses incurred in connection with such purchase) (such costs, the “Buy-In Costs”) or, if the Transferor elects to be deemed to have purchased the SFT Securities, the Deemed Buy-In Costs, and (y) indemnify NSCC, and its employees, officers, directors, shareholders, agents and

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<sup>77</sup> The requirement that a party exercising buy-in rights do so in a “commercially reasonable manner” is market standard. See, e.g., Section 13.1 of the Master Securities Loan Agreement published by Securities Industry and Financial Markets Association (“SIFMA”). NSCC has proposed to include this language in order to align the standards applicable to an exercise of remedies in relation to SFTs with those applicable in the bilateral uncleared space. NSCC believes that such alignment will increase certainty for SFT Members and allow them to follow standards with which they are familiar.

<sup>78</sup> The Transferor would purchase these securities from one or more third parties.



Members (collectively the “Buy-In Indemnified Parties”), for any and all losses, liability or expenses of a Buy-In Indemnified Party arising from any claim disputing the calculation of the Buy-In Costs, the Deemed Buy-In Costs or the method or manner of effecting the Buy-In. Section 9(b) would further provide that each SFT Member acknowledges and agrees that each SFT Security is of a type traded in a recognized market and that, in the absence of a generally recognized source for prices or bid or offer quotations for any SFT Security, the Transferor may, for purposes of a Buy-In, establish the source therefor in its commercially reasonable discretion. In addition, Section 9(b) would provide that each SFT Member further acknowledges and agrees that NSCC would not calculate any Buy-In Costs or Deemed Buy-In Costs and shall have no liability for any such calculation. Section 9(b) would also provide that NSCC would assign to any Transferee whose SFT is subject to a Buy-In any rights it may have against the Transferor to dispute the Transferor’s calculation of the Buy-In Costs or Deemed Buy-In Costs.

Section 9(c) of proposed Rule 56 would provide that on the Business Day following NSCC’s receipt of written notice of the Transferor’s Buy-In Costs, NSCC shall debit and credit the Buy-In Amount from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service). Section 9(c) would provide that if the Buy-In Amount is positive, NSCC would (x) credit the value of the Buy-In Amount to the Transferor’s SFT Account and (y) debit the value of the Buy-In Amount from the Transferee’s SFT Account. Section 9(c) would further provide that if the Buy-In Amount is negative, NSCC would (x) credit the value of the Buy-In Amount

to the Transferee's SFT Account and (y) debit the value of the Buy-In Amount from the Transferor's SFT Account.

Section 9(d) of proposed Rule 56 would provide that following the application of such Buy-In Amount, the Final Settlement obligations under the SFT shall be discharged; provided that if the Transferor effected a Buy-In in respect of some but not all of the SFT Securities that are the subject of an SFT, then only the following obligations shall be discharged: (i) the Transferee's and NSCC's Final Settlement obligations in respect of the SFT Securities for which the Transferor effected the Buy-In and (ii) the Transferor's and NSCC's Final Settlement obligations in respect of the Corresponding SFT Cash.

Section 9(e) of proposed Rule 56 would provide that a Recalled SFT shall be treated as a Non-Returned SFT by NSCC until the earlier of the time that the SFT settles or a Buy-In is processed by NSCC in accordance with Section 9 of proposed Rule 56, except that the additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of proposed Rule 56, as described below, shall not apply. Section 9(e) would further provide that if the Transferor effects the Buy-In in respect of some, but not all, of the SFT Securities that are the subject of a Recalled SFT, the Final Settlement obligations of the Recalled SFT that are not discharged in accordance with Section 9(d) of proposed Rule 56 shall be treated as a Non-Returned SFT until the SFT settles or a Buy-In is processed by NSCC in accordance with Section 9 of proposed Rule 56, and the additional SFT Deposit required under Section 12(c) of proposed Rule 56, as described below, for Non-Returned SFTs shall apply.

Proposed Rule 56, Section 10 (Cancellation, Modification and Termination of Securities Financing Transactions)

Section 10 of proposed Rule 56 would govern the process for cancellations, modifications and terminations of SFTs in NSCC's systems.

Section 10(a) of proposed Rule 56 would provide that transaction data on an SFT that has not been novated to NSCC may be cancelled upon receipt by NSCC of appropriate instructions from the Approved SFT Submitter with respect to such SFT on behalf of both SFT Member parties thereto, submitted in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Section 10(a) would further provide that an SFT that is so cancelled by NSCC would be deemed to be void *ab initio*.

Section 10(b) of proposed Rule 56 would provide the Rate Payment on an SFT that has been novated to NSCC may be modified upon receipt by NSCC of appropriate instructions from the Approved SFT Submitter with respect to such SFT, submitted in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Section 10(b) would further provide that any instructions submitted by an Approved SFT Submitter to modify the Rate Payment of an SFT must be submitted on behalf of both SFT Member parties to the SFT.

Section 10(c) of proposed Rule 56 would provide an SFT that has been novated to NSCC in accordance with Section 5 of proposed Rule 56, as described above, may be terminated upon receipt by NSCC of appropriate instructions from the Approved SFT Submitter with respect to such SFT on behalf of both SFT Member parties thereto, submitted in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purposes. Section 10(c) would further provide

that following any such termination, no amounts or further obligations shall be owing in respect of the SFT between NSCC and Transferor or NSCC and the Transferee.

*Proposed Rule 56, Section 11 (Accelerated Final Settlement)*

Section 11 of proposed Rule 56 would allow a Transferee (i.e., the borrower) to do a same day return of borrowed securities, if necessary, to satisfy its regulatory purpose requirements by accelerating the Final Settlement of an SFT that has been novated to NSCC. Specifically, Section 11 would provide that the Transferee may accelerate the scheduled Final Settlement of an SFT that has been novated to NSCC upon receipt by NSCC of appropriate instruction from the Approved SFT Submitter with respect to such SFT, submitted in accordance with the communication links, formats, timeframes and deadlines established by NSCC for such purpose. Section 11 would further provide that such accelerated Final Settlement shall be effected by NSCC in accordance with the provisions of Section 7 of proposed Rule 56, as described above.

*Proposed Rule 56, Section 12 (Clearing Fund Obligations)*

Section 12 of proposed Rule 56 would set out the Clearing Fund obligations for SFT Members with respect to their SFT activity.

Section 12(a) of proposed Rule 56 would provide each SFT Member, other than an SFT Member that is a Sponsored Member, shall make and maintain on an ongoing basis a deposit to the Clearing Fund with respect to its SFT Positions (the “SFT Deposit”). Section 12(a) would provide that, for the avoidance of doubt, the SFT Positions for an SFT Member that is a Sponsoring Member shall include all SFT Positions held in its Sponsored Member Sub-Account(s) in addition to its proprietary account(s).

Section 12(b) of proposed Rule 56 would provide that the SFT Deposit shall be held by NSCC or its designated agents as part of the Clearing Fund, to be applied as provided in Sections 1 through 12 of Rule 4 (Clearing Fund).

Section 12(c) of proposed Rule 56 would provide that NSCC shall calculate the amount of each such SFT Member's required deposit for SFT Positions, subject to a \$250,000<sup>79</sup> minimum (excluding the minimum contribution to the Clearing Fund as required by Procedure XV (Clearing Fund Formula and Other Matters), Section II.(A)), by applying the Clearing Fund formula for CNS Transactions in Sections I.(A)(1)(a), (b), (c), (e) (f), (g) of Procedure XV as well as the additional Clearing Fund formula in Section I.(B)(5) (Intraday Mark-to-Market Charge) of Procedure XV, except as noted otherwise, in the same manner as such sections apply to CNS Transactions submitted to NSCC for regular way settlement, plus, with respect to any Non-Returned SFT, an additional charge that is calculated by (x) multiplying the Current Market Price of the SFT Securities that are the subject of such Non-Returned SFTs by the number of such SFT Securities that are the subject of the SFT and (y) multiplying such product by (i) 5% for SFT Members rated 1 through 4 on the Credit Risk Rating Matrix, (ii) 10% for SFT Members rated 5 or 6 on the Credit Risk Rating Matrix, or (iii) 20% for SFT Members rated 7 on the Credit Risk Rating Matrix shall be applied to each SFT Member that is a party thereto<sup>80</sup> (collectively and includes any and all Independent Amount SFT Cash

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<sup>79</sup> Supra note 32.

<sup>80</sup> The Required SFT Deposit multipliers proposed for Non-Returned SFTs are identical to the Required Fund Deposit multipliers applied to CNS Fails Positions. See Procedure XV (Clearing Fund Formula and Other Matters), Section I.(A)(1)(d)), supra note 4. While the concept of a "fail" does not exist in the securities lending market in the same manner as it does in the cash market, to the extent that the Final Settlement of an SFT is scheduled on a particular date but

Deposit Requirements, the “Required SFT Deposit”); provided, however, notwithstanding anything to the contrary, (A) a minimum of 40% of an SFT Member’s Required SFT Deposit shall be made in the form of cash and/or Eligible Clearing Fund Treasury Securities and (y) the lesser of \$5,000,000 or 10% of an SFT Member’s Required SFT Deposit, with a minimum of \$250,000, must be made and maintained in cash;<sup>81</sup> provided, further, the additional Clearing Fund formula in Sections I.(B)(1) (Additional Deposits for Members on the Watch List); (2) (Excess Capital Premium); (3) (Backtesting Charge); (4) (Bank Holiday Charge); Minimum Clearing Fund and Additional Deposit Requirements in Sections II.(A)1(a) – (b), II.(B), II.(C), and II.(D); as well as Section III (Collateral Value of Eligible Clearing Fund Securities) of Procedure XV shall apply to SFT Members in the same manner as such sections apply to Members. As noted in the proposed rule text, for the purpose of applying Section I.(A)(1)(a)(i) of

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does not occur, whether directly or through a pair off as described in Section 8 of proposed Rule 56 (as discussed above), that could potentially be a result of a “squeeze” or other market dislocation whereby NSCC may face increased market risk in the event of the default of either the Transferor or the Transferee. As a result, NSCC believes it is prudent to apply the same Required Fund Deposit multiplier to a Non-Returned SFT as it does to CNS Fails Positions.

The Credit Risk Rating Matrix is a financial model utilized by NSCC in its ongoing monitoring of Members based on various risk criteria. Each Member is rated by the Credit Risk Rating Matrix on a 7-point rating system, with “1” being the strongest credit rating and “7” being the weakest credit rating. As described above, to the extent that the Final Settlement of an SFT is scheduled on a particular date but does not occur, NSCC, as a central counterparty, is exposed to market risks. Such exposures generally increase when the SFT Member’s risk of default increases, as reflected by the SFT Member’s Credit Risk Rating Matrix credit rating. As such, the Required SFT Deposit multipliers proposed for Non-Returned SFTs vary based on the SFT Member’s credit rating to reflect the potential increase in market risk from SFT Members with higher risk of default.

<sup>81</sup> Supra note 34.

Procedure XV (Value-at-Risk (VaR) charge), the volatility of an SFT Member's SFT Positions shall be the sum of (a) the highest resultant value between Section I.(A)(1)(a)(i)I. (Core Parametric Estimation) and Section I.(A)(1)(a)(i)III. (Margin Floor) and (b) the resultant value of Section I.(A)(1)(a)(i)II. (Gap Risk Measure). Also, as noted in the proposed rule text, for the purpose of applying Section I.(A)(1)(g) of Procedure XV (Margin Liquidity Adjustment (MLA) charge), SFT Positions shall be aggregated with Net Unsettled Positions, as defined in Rule 1,<sup>82</sup> in the same asset group or subgroup; provided, however, in the event such aggregation results in a reduction of the aggregate positions in the relevant asset group or subgroup, NSCC shall apply the greater of (a) the sum of MLA charges separately calculated for SFT Positions and Net Unsettled Positions in the asset group or subgroup and (b) the MLA charge calculated from aggregating the SFT Positions and the Net Unsettled Positions in the asset group or subgroup.

Section 12(d) of proposed Rule 56 would provide that NSCC shall have the discretion to require an SFT Member to post its Required SFT Deposit in proportion of cash higher than as required under subsection (c) of proposed Section 12, as determined by NSCC from time to time in view of market conditions and other financial and operational capabilities of the SFT Member. Section 12(d) would further provide that NSCC shall make any such determination based on such factors as NSCC determines to be appropriate from time to time.

Section 12(e) of proposed Rule 56 would provide that if an SFT has Incremental Additional Independent Amount SFT Cash, the Transferor shall make an additional deposit to the Clearing Fund that equals the amount of the Incremental Additional

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<sup>82</sup> Supra note 33.

Independent Amount SFT Cash for such SFT (“Independent Amount SFT Cash Deposit, and such requirement the “Independent Amount SFT Cash Deposit Requirement”).

Section 12(e) would also provide that the Independent Amount SFT Cash Deposit Requirement must be satisfied in cash and may, at the discretion of NSCC, be satisfied using Independent Amount SFT Cash Deposits that have previously been made by the Transferor in respect of SFTs with the same Transferee that have since settled.<sup>83</sup> Section 12(e) would further provide that the Transferor shall satisfy any Independent Amount SFT Cash Deposit Requirement in respect of an SFT on the date that the SFT is novated to NSCC pursuant to the timeframes and deadlines established by NSCC for such purpose. In addition, Section 12(e) would provide that if, on a given day, the Transferor satisfies its Independent Amount SFT Cash Deposit Requirement for some, but not all, SFTs novated to NSCC on that day, NSCC will consider the Transferor to have satisfied its Independent Amount SFT Cash Deposit Requirement for none of the SFTs that were novated to NSCC on that day.

Section 12(f) of proposed Rule 56 would provide that each SFT Member, other than an SFT Member that is a Sponsored Member, so long as such Member is an SFT Member, shall also provide Supplemental Liquidity Deposits to the Clearing Fund, as may be required pursuant to Rule 4A. In addition, Section 12(f) would also provide that references to Clearing Fund in the other Rules shall include and apply to SFT Deposit,

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<sup>83</sup> This could occur in a situation in which an existing SFT settles and then the Transferor enters into a new SFT with the same Transferee (e.g., in a pair off as described in Section 8 of proposed Rule 56, discussed above). In that situation, if the Transferee (or Sponsoring Member or Agent Clearing Member) has not yet called back the Independent Amount SFT Cash Deposit it posted in respect of the Settling SFT, then NSCC may apply the deposit to the Independent Amount SFT Cash Deposit obligation associated with the new SFT.



and references to Required Fund Deposit shall include and apply to Required SFT Deposit, unless specifically noted otherwise in proposed Rule 56 or in such other Rules.

*Proposed Rule 56, Section 13 (Ineligible SFT Securities and Supported Corporate Actions)*

Section 13 of proposed Rule 56 would govern the processing of SFTs where the underlying securities become ineligible SFT Securities and the processing of SFTs in the context of supported corporate actions.

Specifically, Section 13(a) of proposed Rule 56 would provide that NSCC would remove an Ineligible SFT Security from the list maintained by NSCC as set forth in Rule 3 (Lists to be Maintained); provided that NSCC may not be able to identify that an SFT Security is an Ineligible SFT Security and remove such SFT Security from the list maintained by NSCC if the reason for the ineligibility is that the SFT Security is undergoing a corporate action or distribution not supported by NSCC and NSCC is not in receipt of reasonably advanced notice of such corporate action or distribution.

Section 13(b) of proposed Rule 56 would provide that notwithstanding Section 12 of proposed Rule 56, as described above, if an SFT Security becomes an Ineligible SFT Security because the Current Market Price of the SFT Security falls below the threshold established by NSCC from time to time, the Required SFT Deposit of each SFT Member party to an SFT which has such Ineligible SFT Security as its subject shall include an additional amount equal to the product of 100% of the Current Market Price of such Ineligible SFT Security and the number of such Ineligible SFT Securities that the SFT

has as its subject.<sup>84</sup> The threshold that would be established by NSCC is currently \$5.00, which could be modified by NSCC<sup>85</sup> at a later date after NSCC gains more experience with the nature of the SFT portfolios submitted for clearing, as discussed above.

Section 13(c) of proposed Rule 56 would provide that if NSCC declares that an SFT Security has or would become an Ineligible SFT Security because the security is or would become ineligible for processing or is or would be undergoing a corporate action or distribution that is not supported by NSCC, the Final Settlement of all SFTs that have been novated to NSCC and have such SFT Security as their subject must occur before the Ineligibility Date.<sup>86</sup> In addition, Section 13(c) would provide that if following such declaration the Transferee does not satisfy its Final Settlement obligations in respect of any such SFT as provided in Section 7 of proposed Rule 56, as described above, by the Ineligibility Date, NSCC shall, unless NSCC has previously debited and credited the

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<sup>84</sup> If the Current Market Price of the SFT Security falls below the threshold established by NSCC from time to time, NSCC would assess the additional amount as part of the Required SFT Deposit.

<sup>85</sup> Supra note 23.

<sup>86</sup> The duration between the declaration and Ineligibility Date would vary. If the ineligibility is because the SFT Security will become ineligible for processing (i.e., no longer CNS eligible), the duration would depend on the timing of the CNS ineligibility triggering event (e.g., compliance with regulatory orders, risk concerns, trading suspension, etc.).

If the ineligibility is because the SFT Security will be undergoing an unsupported corporate action or distribution, then it would depend on when the issuer of the relevant SFT Security announces the particular corporate action or distribution event and the record date for such corporate action or distribution. Specifically, when announcements from the issuers are received by DTC, DTC would announce the corporate action or distribution event. NSCC would notify Members of such event when it is announced by DTC and would generally tie the Ineligibility Date to shortly before or on the record date for the corporate action or distribution.

Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT in accordance with Section 8 of proposed Rule 56, as described above, on Ineligibility Date, debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement process in accordance with Rule 12 (Settlement) and Procedure VIII (Money Settlement Service).<sup>87</sup> Section 13(c) would further provide that if the Price Differential is positive, NSCC shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account. Section 13(c) would also provide that if the Price Differential is negative, NSCC shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account. Furthermore, Section 13(c) would provide that following the application of Price Differential to an Ineligible SFT on or after the relevant Ineligibility Date, all rights and obligations as between NSCC and the SFT Member parties thereto with respect to such SFT shall be discharged.

Section 13(d) of proposed Rule 56 would provide that if a corporate action supported by NSCC in respect of the SFT Securities that are the subject of an SFT is scheduled to occur, NSCC may cease to permit the discharge of the SFT's Final Settlement obligations, whether pursuant to Section 8 of proposed Rule 56, as described above, or otherwise, and treat the SFT as a Non-Returned SFT for such period of time

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<sup>87</sup> NSCC is proposing this simplified process for applying Price Differentials to Ineligible SFTs because NSCC anticipates such instances would occur on a much less frequent basis than those in connection with Linked SFTs pursuant to Section 8(a) of proposed Rule 56 and Non-Returned SFTs pursuant to Section 9(a) of proposed Rule 56.

determined by NSCC as necessary to process the corporate action, except that the additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of proposed Rule 56, as described above, shall not apply. Section 13(d) would further provide that notwithstanding the foregoing, NSCC shall not limit the ability of a Member to accelerate the Final Settlement of an SFT in accordance with Section 11 of proposed Rule 56, as described above, provided that any Price Differential for the SFT has settled in accordance with Section 9(a) of proposed Rule 56, as described above, and that such accelerated Final Settlement is permitted in accordance with the rules and procedures of DTC.

*Proposed Rule 56, Section 14 (Cease to Act Procedures for SFT Members with Open Securities Financing Transactions)*

Section 14 of proposed Rule 56 would establish NSCC's procedures for when it ceases to act for an SFT Member with open SFTs, including recalling a non-defaulting SFT Member that is a Transferee and liquidating the Defaulting SFT Member's SFT Positions by deeming NSCC to have bought in or sold out some or all the SFT Securities that are the subject of such SFTs at prevailing market price or by crossing.

Section 14(a) of proposed Rule 56 would provide that the provisions of Rule 18 (Procedures for When the Corporation Ceases to Act) shall not apply to the SFTs except for Sections 1 and 8 of Rule 18.

Section 14(b) of proposed Rule 56 would provide that if NSCC has ceased to act for an SFT Member and subject to Section 14 of proposed Rule 2C, as described above:

(i) Except as otherwise may be determined by the Board of Directors, any SFT entered into by the SFT Member that, at the time NSCC ceased to act for such SFT

Member, has not been novated to NSCC pursuant to proposed Rule 56, shall be excluded from all operations of NSCC applicable to such SFT.

(ii) NSCC may decline to act upon any instructions, transaction data or notices submitted by such SFT Member or an Approved SFT Submitter on behalf of such SFT Member.

(iii) NSCC shall close-out such SFT Member's proprietary SFT Positions as well as any SFT Positions established in the SFT Member's Agent Clearing Member Customer Omnibus Account by (x) buying in or selling out, as applicable, some or all of the SFT Securities that are the subject of each SFT of the SFT Member that has been novated to NSCC but for which the Final Settlement has not occurred, (y) deeming NSCC to have bought in or sold out some or all such SFT Securities at the bid or ask price therefor, respectively, from a generally recognized source or at such price or prices as NSCC is able to purchase or sell, respectively, some such SFT Securities, or (z) otherwise liquidating such SFT Member's SFT Positions.

(iv) Any Sponsored Member Transactions for which a Defaulting SFT Member is the Sponsoring Member and which have been novated to NSCC shall continue to be processed by NSCC. NSCC, in its sole discretion, would determine whether to close-out the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts (if any), which close out shall be effected in accordance with the provisions of Section 14(b)(iii), as described above, or instead permit the relevant Sponsored Members to complete settlement of the relevant Sponsored Member Transactions.

(v) If, in the aggregate, the close-out of a Defaulting SFT Member's proprietary SFT Positions results in a profit to NSCC, such profit shall be applied to any loss to

NSCC arising from the closing out of such Defaulting SFT Member (including losses arising from closing out the SFT Positions established in any of the Defaulting SFT Member's Agent Clearing Member Customer Omnibus Accounts or Sponsored Member Sub-Accounts or losses arising from closing out any Net Close Out Positions of the Defaulting SFT Member). If, in the aggregate, the close-out of a Defaulting SFT Member's proprietary SFT Positions results in a loss to NSCC, such loss shall be netted against, or otherwise applied to, any amounts owed by NSCC to such SFT Member in its proprietary capacity and thereafter debited from such Defaulting SFT Member's Clearing Fund deposit at NSCC.

(vi) If, in the aggregate, the close-out of the SFT Positions established in the Agent Clearing Member Customer Omnibus Accounts of a Defaulting SFT Member results in a profit to NSCC, such profit shall be credited to the Agent Clearing Member Customer Omnibus Accounts. If, in the aggregate, the close-out of the SFT Positions established in the Agent Clearing Member Customer Omnibus Accounts of a Defaulting SFT Member results in a loss to NSCC, such loss shall be netted against, or otherwise applied to, any amounts owed by the NSCC to such SFT Member in its proprietary capacity, and thereafter debited from the Defaulting SFT Member's Clearing Fund deposit at NSCC.

(vii) If, in the aggregate, the close-out of the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts results in a profit to NSCC, such profit shall be credited to the Sponsored Member Sub-Accounts. If, in the aggregate, the closing out of the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts results in a loss to NSCC, such loss shall be netted

against, or otherwise applied to, any amounts owed by NSCC to such SFT Member in its proprietary capacity and thereafter debited from such Defaulting SFT Member's Clearing Fund deposit at NSCC.

(viii) The Final Settlement Date of each SFT that has been novated to NSCC and that, prior to novation, was with a Defaulting SFT Member (each, a "Default-Related SFT") shall be the Business Day following the day on which NSCC ceased to act for the Defaulting SFT Member.

(ix) Until Final Settlement, each Default-Related SFT shall be treated as a Non-Returned SFT, and NSCC would pay and collect the Price Differential amounts described in Section 9(a) of proposed Rule 56, as described above. NSCC shall have all of the rights of a Transferor in relation to any Default-Related SFT in respect of which the Defaulting SFT Member was the Transferor, including the ability to deliver a Recall Notice in relation to such Default-Related SFT and to effect a Buy-In, and all of the rights of a Transferee in relation to any Default-Related SFT in respect of which the Defaulting SFT Member was the Transferee, including the ability to accelerate the scheduled Final Settlement Date of the Default-Related SFT. However, no additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of proposed Rule 56, as described above, shall apply to any Default-Related SFT, and no Rate Payments shall accrue on Default-Related SFTs after the date on which NSCC ceases to act for the Defaulting SFT Member.

*Proposed Rule 56, Section 15 (Sponsored Member SFT Clearing)*

Section 15 of proposed Rule 56 would govern the requirements for Sponsored Member participation in the proposed SFT Clearing Service.

Section 15(a) of proposed Rule 56 would provide that a Sponsoring Member shall be permitted to submit, either directly as an Approved SFT Submitter or via another Approved SFT Submitter, to NSCC Sponsored Member Transactions between itself and its Sponsored Member in accordance with the provisions of proposed Rule 56 and proposed Rule 2C.

Section 15(b) of proposed Rule 56 would provide that NSCC shall maintain for the Sponsoring Member one or more Sponsored Member Sub-Accounts. Section 15(b) would further provide that the SFT Deposits for each Sponsored Member Sub-Account shall be calculated separately based on the SFT Positions in such Sponsored Member Sub-Account, and the Sponsoring Member, as principal, shall be required to satisfy the SFT Deposits for each of the Sponsoring Member's Sponsored Member Sub-Accounts.

Section 15(c) of proposed Rule 56 would provide that settlement of the Final Settlement, Rate Payment, Price Differential, Distribution Payment and other obligations of a Sponsored Member Transaction that have been novated to NSCC shall be effected by the Sponsoring Member, as settlement agent for the relevant Sponsored Member, crediting and debiting the account the Sponsoring Member maintains for the Sponsored Member on the Sponsoring Member's books and records.

*Proposed Rule 56, Section 16 (Customer SFT Clearing)*

Section 16 of proposed Rule 56 would govern the requirements for participation by Agent Clearing Members and their Customers in the proposed SFT Clearing Service.

Section 16(a) of proposed Rule 56 would provide that an Agent Clearing Member shall be permitted to submit, either directly as an Approved SFT Submitter or via another Approved SFT Submitter, to NSCC for novation SFTs that are Agent Clearing Member



Transactions. Section 16(a) would further provide that any such submission shall be in accordance with proposed Rule 56 and proposed Rule 2D.

Section 16(b) of proposed Rule 56 would provide that with respect to an Agent Clearing Member that submits SFTs to NSCC for novation on behalf of its Customers, NSCC shall maintain one or more Agent Clearing Member Customer Omnibus Accounts in the name of the Agent Clearing Member for the benefit of its Customers in which all SFT Positions and SFT Cash carried by the Agent Clearing Member on behalf of its Customers are reflected; provided, that each Agent Clearing Member Customer Omnibus Account may only contain activity where the Agent Clearing Member is acting as Transferor on behalf of its Customers, or as Transferee on behalf of its Customers, but not both.

Section 16(c) of proposed Rule 56 would provide that with respect to SFTs entered into on behalf of its Customers and maintained in the Agent Clearing Member Customer Omnibus Account, the Agent Clearing Member shall act solely as agent of its Customers in connection with the clearing of such SFTs; provided, that the Agent Clearing Member shall remain fully liable for the performance of all obligations to NSCC arising in connection with such SFTs; and provided further, that the liabilities and obligations of NSCC with respect to such SFTs entered into by the Agent Clearing Member on behalf of its Customers shall extend only to the Agent Clearing Member. Without limiting the generality of the foregoing, NSCC shall not have any liability or obligation arising out of or with respect to any SFT to any Customer of an Agent Clearing Member.

Section 16(d) of proposed Rule 56 would provide the SFT Deposits for each Agent Clearing Member Customer Omnibus Account shall be calculated separately based on the SFT Positions in such Agent Clearing Member Customer Omnibus Account, and the Agent Clearing Member shall, as principal, be required to satisfy the SFT Deposit for each of Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts.

Proposed Rule 56, Section 17 (Corporation Default)

Section 17 of proposed Rule 56 would govern the close-out netting process that would apply with respect to SFTs that have been novated to NSCC in the event of a default of NSCC.

Section 17(a) of proposed Rule 56 would provide that if a "Corporation Default" occurs pursuant to Section 2 of Rule 41 (Corporation Default), all SFTs that have been novated to NSCC but not yet settled, and all obligations and rights arising thereunder which have been assumed by NSCC pursuant to proposed Rule 56, shall be immediately terminated, and the Board of Directors shall determine the Aggregate Net SFT Close-out Value owed by or to each SFT Member with respect to each of its SFT Positions.

Section 17(b) of proposed Rule 56 would provide that for purposes of Section 17 of proposed Rule 56, a Member shall be considered a different SFT Member in respect of each of (i) its proprietary SFT Positions; (ii) the SFT Positions established in its Agent Clearing Member Customer Omnibus Accounts (if any); and (iii) the SFT Positions established in its Sponsored Member Sub-Accounts (if any).

Section 17(c) of proposed Rule 56 would provide that each SFT Member's Aggregate Net SFT Close-out Value shall be netted and offset as described in Section

14(b)(v) through Section 14(b)(vii) of proposed Rule 56, as though NSCC had ceased to act for each SFT Member.

Section 17(d) of proposed Rule 56 would provide that the Board of Directors shall notify each SFT Member of the Aggregate SFT Close-out Value, taking into account the netting and offsetting provided for above. SFT Members that have been notified that they owe an amount to NSCC shall pay that amount on or prior to the date specified by the Board of Directors, subject to any applicable setoff rights. SFT Members who have a net claim against NSCC shall be entitled to payment thereof along with other Members' and any other creditors' claims pursuant to the underlying contracts with respect thereto, the Rules and applicable law. Section 17(d) would further provide that nothing therein shall limit the rights of NSCC upon an SFT Member default (including following a Corporation Default), including any rights under any Clearing Agency Cross-Guaranty Agreement or otherwise.

*Proposed Rule 56, Section 18 (Other Applicable Rules, Procedures, and Addendums)*

Section 18 of proposed Rule 56 would establish certain other Rules as being applicable to SFTs and SFT Members, unless expressly stated otherwise.

Specifically, Section 18 of proposed Rule 56 would provide that Rule 1 (Definitions and Descriptions), Rule 2 (Members, Limited Members and Sponsored Members), Rule 5 (General Provisions), Rule 12 (Settlement), Rule 13 (Exception Processing), Rule 17 (Fine Payments), Rule 19 (Miscellaneous Rights of the Corporation), Rule 21 (Honest Broker), Rule 22 (Suspension of Rules), Rule 23 (Action by the Corporation), Rule 24 (Charges for Services Rendered), Rule 26 (Bills Rendered), Rule 27 (Admission to Premises of the Corporation - Powers of Attorney, Etc.), Rule 28

(Forms), Rule 29 (Qualified Securities Depositories), Rule 32 (Signatures), Rule 33 (Procedures), Rule 34 (Insurance), Rule 35 (Financial Reports), Rule 36 (Rule Changes), Rule 37 (Hearing Procedures), Rule 38 (Governing Law and Captions), Rule 39 (Reliance on Instructions), Rule 40 (Wind-Down of a Member, Fund Member or Insurance Carrier/Retirement Services Member), Rule 41 (Corporation Default), Rule 42 (Wind-down of the Corporation), Rule 45 (Notice), Rule 47 (Interpretation of Rules), Rule 48 (Disciplinary Proceedings), Rule 49 (Release of Clearing Data and Clearing Fund Data), Rule 55 (Settling Banks and AIP Settling Banks), Rule 58 (Limitations on Liability), Rule 60 (Market Disruption and Force Majeure), Rule 60A (Systems Disconnect: Threat of Significant Impact to the Corporation's Systems), Rule 63 (SRO Regulatory Reporting), Procedure I (Introduction), Procedure VIII (Money Settlement Service), Procedure XII (Time Schedule), Procedure XIII (Definitions), Procedure XIV (Forms, Media and Technical Specifications), Procedure XV (Clearing Fund Formula and Other Matters), Addendum B (Qualifications and Standards of Financial Responsibility, Operational Capability and Business History), Addendum H (Interpretation of the Board of Directors Release of Clearing Data), Addendum L (Statement of Policy Pertaining to Information Sharing), and Addendum P (Fine Schedule) shall apply to SFTs and SFT Members, unless the context otherwise requires.

**(D) Other Rule Changes**

In connection with proposed Rules 2C, 2D and 56, NSCC is also proposing to make conforming and technical changes to the following Rules to accommodate the proposed introduction of the new membership categories and the proposed SFT Clearing Service.

Rule 1 (Definitions and Descriptions)

In connection with proposed Rules 2C, 2D and 56, NSCC is proposing to add the following defined terms to Rule 1, in alphabetical order: Agent Clearing Member, Agent Clearing Member Agreement, Agent Clearing Member Customer Omnibus Account, Agent Clearing Member Required Fund Deposit, Agent Clearing Member Termination Date, Agent Clearing Member Transaction, Agent Clearing Member Voluntary Termination Notice, Aggregate Net SFT Close-out Value, Approved SFT Submitter, Bilaterally Initiated SFT, Buy-In, Buy-In Amount, Buy-In Costs, Buy-In Indemnified Parties, Contract Price, Corresponding SFT Cash, Customer, Customer Clearing Service, Deemed Buy-In Costs, Defaulting SFT Member, Default-Related SFT, Distribution, Distribution Amount, Distribution Payment, Existing Master Agreement, Final Net Settlement Position, Final Settlement, Final Settlement Date, Former Sponsored Member, Incremental Additional Independent Amount SFT Cash, Independent Amount Percentage, Independent Amount SFT Cash, Independent Amount SFT Cash Deposit, Independent Amount SFT Cash Deposit Requirement, Ineligibility Date, Ineligible SFT, Ineligible SFT Security, Initial Settlement, Linked SFT, Market Value SFT Cash, Net Capital, Net Member Capital, Net Worth, Non-Returned SFT, Price Differential, Rate Payment, Recall Date, Recall Notice, Recalled SFT, Required SFT Deposit, Securities Financing Transaction or SFT, Securities Financing Transaction Clearing Service or SFT Clearing Service, Settling SFT, SFT Account, SFT Cash, SFT Close-out Value, SFT Deposit, SFT Long Position, SFT Member, SFT Position, SFT Security, SFT Short Position, Sponsored Member, Sponsored Member Agreement, Sponsored Member Liquidation Amount, Sponsored Member Sub-Account, Sponsored Member Termination

Date, Sponsored Member Transaction, Sponsored Member Voluntary Termination Notice, Sponsoring Member, Sponsoring Member Agreement, Sponsoring Member Guaranty, Sponsoring Member Liquidation Amount, Sponsoring Member Required Fund Deposit, Sponsoring Member Settling Bank Omnibus Account, Sponsoring Member Termination Date, Sponsoring Member Voluntary Termination Notice, Sponsoring/Sponsored Membership Program Indemnified Parties or SMP Indemnified Parties, Transferee, Transferor and Volatility Charge.

In addition, NSCC is proposing to add three defined terms: “CNS Market Value”, which is already defined in Rule 41 (Corporation Default), “CNS Transaction”, which is already defined in Rule 11 (CNS System), and “Corporation Default”, which is already defined in Rule 41 (Corporation Default).

NSCC is also proposing to add the defined term “FICC” to mean Fixed Income Clearing Corporation. The term “FICC” is already used in Addendum P (Fine Schedule) but has not been defined.

Furthermore, NSCC is proposing to reorder the defined term Index Receipt Agent so it would be in alphabetical order.

In connection with proposed Rules 2C, 2D and 56, NSCC is also proposing to modify the definitions for the following defined terms in Rule 1, in alphabetical order: Clearing Fund, FFI Member, Qualified Securities Depository, and Required Fund Deposit. Specifically, NSCC is proposing to expand the definition of Clearing Fund to include SFT Deposit, unless noted otherwise in the Rules. NSCC is also proposing to

revise the definition of FFI Member and the definition of Tax Certification<sup>88</sup> to add references to Sponsored Members. Furthermore, NSCC is proposing to revise the definition of Qualified Securities Depository to include a reference to transfer of securities in respect of the proposed SFT Clearing Service. Lastly, NSCC is proposing to expand the definition of Required Fund Deposit to include Sponsoring Member Required Fund Deposit, the Agent Clearing Member Required Fund Deposit, and the Required SFT Deposit, unless noted otherwise in the Rules.

*Rule 2 (Members and Limited Members)*

NSCC is proposing to revise the title of Rule 2 to include a reference to Sponsored Members. As proposed, Rule 2 would be retitled as “Members, Limited Members and Sponsored Members”.

NSCC is also proposing to revise Section 2 of Rule 2. Specifically, NSCC is proposing to clarify in Section 2(i) that a Member shall include a Member in its capacity as a Sponsoring Member to the extent specified in proposed Rule 2C and an Agent Clearing Member to the extent specified in proposed Rule 2D. In addition, NSCC is proposing to add a new subsection (iii) to Section 2 that would describe Sponsored Members as any Person that has been approved by NSCC to become a Sponsored Member and only participates in NSCC’s SFT Clearing Service as provided for in proposed Rule 56. In addition, NSCC is proposing to add references to Sponsored Members in the last paragraph of Section 2, Sections 4(i) and 4(ii).

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<sup>88</sup> NSCC recently added Tax Certification as a defined term in Rule 1 (Definitions and Descriptions). See Securities Exchange Act Release No. 92682 (August 17, 2021), 86 FR 47172 (August 23, 2021) (SR-NSCC-2021-009).

Rule 2B (Ongoing Membership Requirements and Monitoring)

NSCC is proposing to add references to Sponsored Member in Section 5<sup>89</sup> of Rule 2B.

Rule 3 (Lists to be Maintained)

NSCC is proposing to add subsection (g) to Section 1 of Rule 3 to provide that NSCC shall maintain a list of the securities that may be the subject of a novated SFT and may from time to time add securities to such list or remove securities therefrom.

NSCC is also proposing to modify Sections 3(b) and 4 of Rule 3 to include references to Sponsored Members.

Rule 4 (Clearing Fund)

NSCC is proposing to modify Section 1 of Rule 4 in order to make it clear that the minimum Required Fund Deposit amount provided therein shall not include Required SFT Deposit, which is subject to a separate minimum \$250,000 deposit requirement pursuant to Section 12(c) of proposed Rule 56, as described above.

Rule 5 (General Provisions)

NSCC is proposing to modify Section 1 of Rule 5 in order to provide that delivery of SFT Securities and SFT Cash to NSCC shall be made through the facilities of a Qualified Securities Depository. In addition, NSCC is also proposing changes in Section 1 of Rule 5 to provide that delivery and payment with respect to SFT Securities and SFT Cash shall be effected as prescribed in the Rules and regulations as NSCC may from time to time adopt.

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<sup>89</sup> NSCC recently added Section 5 to Rule 2B (Ongoing Membership Requirements and Monitoring). See Securities Exchange Act Release No. 93278 (October 8, 2021), 86 FR 57229 (October 14, 2021) (SR-NSCC-2021-007).



Rule 24 (Charges for Services Rendered)

NSCC is proposing to modify Section 1 of Rule 24 to include a reference to Sponsored Members. In addition, NSCC is proposing to add an additional paragraph in Section 1 to clarify that Members shall be responsible for all fees pertaining to their respective Sponsoring Member activity or Agent Clearing Member activity, if applicable, as set forth in NSCC's Fee Structure.<sup>90</sup>

Rule 26 (Bills Rendered)

NSCC is proposing to modify the first paragraph of Rule 26 to include a reference to Sponsored Members. In addition, NSCC is proposing to add a sentence in that paragraph to clarify that Members shall receive bills for their respective aggregate Sponsoring Member activity and Agent Clearing Member activity, if applicable, as set forth in NSCC's Fee Structure.<sup>91</sup>

Rule 32 (Signatures)

NSCC is proposing to modify Rule 32 to include a reference to Sponsored Member. Specifically, NSCC is proposing to modify Rule 32 to provide that the use of an electronic signature shall have the same validity and effect as the use of a signature affixed by hand with respect to any and all agreements and other documents entered into between a Sponsored Member and NSCC.

Rule 38 (Governing Law and Captions)

NSCC is proposing to modify Section 1 of Rule 38 to include a reference to Sponsored Member. Specifically, NSCC is proposing to modify Section 1 of Rule 38 to

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<sup>90</sup> See Addendum A (Fee Structure), supra note 4.

<sup>91</sup> Id.

provide that Rules and all agreements and other documents entered into between a Sponsored Member and NSCC or otherwise delivered to or by NSCC pursuant to the Rules, and the rights and obligations under the Rules thereunder, shall be governed by, and construed in accordance with, the laws of the State of New York applicable to contracts executed and performed therein, unless otherwise provided.

Rule 39 (Reliance on Instructions)

NSCC is proposing to modify Rule 39 to include references to Sponsored Member and Approved SFT Submitter, where applicable. Specifically, NSCC is proposing to modify the first paragraph of Rule 39 to provide that NSCC may accept or rely upon instructions given to NSCC by a Sponsored Member or Approved SFT Submitter, in addition to the various participant types currently provided in Rule 39. Similarly, NSCC is proposing to add references to Approved SFT Submitter in the second and last paragraphs of Rule 39 so that those paragraphs would also apply to instructions submitted by an Approved SFT Submitter.

Rule 42 (Wind-Down of the Corporation)

NSCC is proposing to modify Rule 42 to include references to Sponsored Members. Specifically, for purposes of Rule 42, NSCC is proposing to revise the defined term “Limited Member” to include Sponsored Members.

Rule 49 (Release of Clearing Data and Clearing Fund Data)

NSCC is proposing to modify Rule 49 to clarify that NSCC would release Clearing Data of a Sponsored Member to its Sponsoring Member upon the Sponsoring Member’s written request. Specifically, as proposed, Section (a) of Rule 49 would provide that if the participant is a Sponsored Member, NSCC would also release Clearing

Data relating to transactions of such participant to such participant's Sponsoring Member upon the Sponsoring Member's written request.

Rule 58 (Limitations on Liability)

NSCC is proposing to modify Rule 58 to clarify that NSCC would not be responsible for the completeness or accuracy of the transaction data received from the Approved SFT Submitters, nor shall NSCC, absent gross negligence on NSCC's part, be responsible for any errors, omissions or delays that may occur in the transmission of transaction data from an Approved SFT Submitter.

Rule 64 (DTCC Shareholders Agreement)

The proposed changes to Section 4 of Rule 64 and footnote 4 thereto would provide that Rule 64 would not be applicable to a Sponsored Member. However, if the Sponsored Member is also a member or participant of another clearing agency subsidiary of DTCC, the Sponsored Member may be a Mandatory Purchaser Participant or a Voluntary Purchaser Participant pursuant to the terms of the Shareholders Agreement and the rules and procedures of such other subsidiary.

Procedure XV (Clearing Fund Formula and Other Matters)

NSCC is proposing to modify subsection A of Section II (Minimum Clearing Fund and Additional Deposit Requirements) in Procedure XV in order to make it clear that the minimum contribution amount provided therein shall not include Required SFT Deposit, which is subject to a separate minimum \$250,000 deposit requirement pursuant to Section 12(c) of proposed Rule 56, as described above. In addition, NSCC is proposing to modify Section II.A of Procedure XV to make it clear that calculation of a Member's Required Fund Deposit amount that must be in cash shall exclude the

Required SFT Deposit, which is subject to a separate \$250,000 minimum cash requirement pursuant to Section 12(c) of proposed Rule 56, as described above.

*Addendum B (Qualifications and Standards of Financial Responsibility, Operational Capability and Business History)*

NSCC is proposing an additional section for the Sponsored Members. Specifically, NSCC is proposing to add Section 12 to Addendum B that would describe the qualification and operational capability that NSCC would require from Sponsored Members.

In addition, NSCC is proposing a conforming change to replace “net worth” in Section 3.B.4. with “Net Worth” to reflect the proposed defined term in Rule 1 (Definitions).

*Addendum P (Fine Schedule)*

NSCC is proposing to modify paragraph (2) of Addendum P to reflect the proposed notification obligations of Sponsoring Members, Sponsored Members and Agent Clearing Members as proposed under Sections 2(i) and 3(d) of proposed Rule 2C and Section 2(i) of proposed Rule 2D.

**(vii) Impact of the Proposed SFT Clearing Service on Various Persons**

The proposed SFT Clearing Service would be voluntary. Institutional firm clients that wish to become Sponsored Members, and Members that wish to participate in the proposed SFT Clearing Service would have an opportunity to review the proposed rule change and determine if they would like to participate. Choosing to participate would make these entities subject to all of the rule changes that would be applicable to the proposed SFT Clearing Service and membership type, as described below.

The proposed SFT Clearing Service would affect institutional firm clients that choose to become Sponsored Members because it would impose various requirements on them. These requirements include, but are not limited to, proposed Rule 56 and the following sections of proposed Rule 2C: (1) eligibility, approval process and on-going membership requirements as specified in Sections 3 and 4, (2) requirements related to restriction on access to NSCC services in Section 11, (3) requirements related to insolvency of a Sponsored Member in Section 13, and (4) requirements related to liquidation of positions resulting from Sponsored Member Transactions in Section 14. Specific details on the requirements and the manner in which the proposed SFT Clearing Service would affect institutional firm clients that choose to become Sponsored Members can be found above in Item II(B)(vi)(A) – Proposed Rule Changes – Proposed Rule 2C – Sponsoring Members and Sponsored Members.

The proposed SFT Clearing Service would affect Members that choose to participate in the service because it would impose various requirements on them, depending on whether they are participating in the service as a Sponsoring Member, an Agent Clearing Member and/or as a Member. These requirements include, but are not limited to, the requirements specified in proposed Rule 2C for Members participating in the service as a Sponsoring Member; the requirements specified in proposed Rule 2D for Members participating in the service as an Agent Clearing Member; and for all Members participating in the service, the requirements specified in proposed Rule 56. Specific details on these requirements and the manner in which the proposed SFT Clearing Service would affect Members that choose to participate in the proposed SFT Clearing Service are described above in Sections 10(vi)(A) – Proposed Rule Changes – Proposed

Rule 2C – Sponsoring Members and Sponsored Members, (vi)(B) – Proposed Rule Changes – Proposed Rule 2D – Agent Clearing Members, and (vi)(C) – Proposed Rule Changes – Proposed Rule 56 – Securities Financing Transaction Clearing Service.

The proposed SFT Clearing Service would not materially affect existing Members that do not choose to participate in it. First, the proposed SFT Clearing Service would not materially affect the operation of CNS or any other services offered by NSCC. In addition, SFT Members would be subject to the same or higher credit standards and market risk management requirements as those applicable to Members that choose not to participate in the proposed SFT Clearing Service, as described above. Moreover, although Members who choose not to participate in the proposed SFT Clearing Service would be subject to potential loss allocation in the event of an SFT Member default (just as SFT Members would be subject to potential loss allocation in the event of the default of a Member that chooses not to participate in the proposed SFT Clearing Service), the underlying securities that would be subject of any such default-related liquidation of an SFT Member are a subset of the same CNS-eligible securities with respect to which NSCC today guarantees settlement in the cash equity market, thus not materially affecting the nature of the loss allocation risk applicable to Members.

*Expected Effect on, and Management of, Risks to the Clearing Agency, Its Participants and the Market*

NSCC expects certain market, liquidity, credit and operational risks may be presented by the establishment of the proposed SFT Clearing Service and the additional membership categories proposed in connection therewith. Accordingly, NSCC proposes to address and manage each of these risks as detailed below.

Market Risk

The proposal is structured in a manner that allows NSCC to protect itself from associated market risk. Specifically, as described above, except with respect to the VaR charge, SFT activity would be risk managed by NSCC in a manner consistent with Members' CNS positions. Moreover, except with respect to the MLA charge, all SFT Positions would be margined independently of the Member's other positions, i.e., Required SFT Deposit. The Required SFT Deposit would generally be calculated using the same procedure applicable to CNS positions, but with a separate \$250,000 minimum.<sup>92</sup>

As described above, consistent with the manner in which clearing fund requirements are satisfied by members of FICC for their cleared securities financing transactions, NSCC would require that (i) a minimum of 40% of an SFT Member's Required SFT Deposit consist of a combination of cash and Eligible Clearing Fund Treasury Securities and (ii) the lesser of \$5,000,000 or 10% of an SFT Member's Required SFT Deposit (but not less than \$250,000) consist of cash.<sup>93,94</sup> NSCC would also have the discretion to require a Member to post its Required SFT Deposit in proportion of cash higher than would otherwise be required.<sup>95</sup> NSCC's determination to impose any such requirement would be made in view of market conditions and other financial and operational capabilities of the relevant SFT Member.

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<sup>92</sup> Supra note 32.

<sup>93</sup> Supra note 34.

<sup>94</sup> Supra note 35.

<sup>95</sup> See Section 12(d) of proposed Rule 56.

Furthermore, NSCC would require additional Clearing Fund deposits to address two situations that may present unique risk. First, if the share price of underlying securities of an SFT that has already been novated to NSCC falls below the threshold established by NSCC from time to time, NSCC would require both pre-novation counterparties to the SFT to post Clearing Fund equal to 100% of the market value of such underlying securities until such time as the per share price of the underlying securities equals or exceeds such threshold.<sup>96</sup> Second, in the event an SFT is subject to a collateral haircut (i.e., the SFT Cash exceeds the market value of the securities), NSCC would require the Transferor (or in the case of an Agent Clearing Member Transaction, the Agent Clearing Member) to post Clearing Fund equal to such excess.<sup>97</sup>

Additionally, the Sponsoring Member Required Fund Deposits and Agent Clearing Member Required Fund Deposits would each be calculated on a gross basis, and no offsets for netting of positions as between different Sponsored Members or different Customers, as applicable, would be permitted. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above).

NSCC is also proposing to limit the SFTs eligible for clearing to overnight transactions on securities that are CNS-eligible equity securities with a share price that equals or exceeds the threshold established by NSCC from time to time and that are fully collateralized by cash. NSCC believes these limitations, in addition to the Clearing Fund requirements, would limit the potential market risk associated with SFTs.

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<sup>96</sup> See Section 13(b) of proposed Rule 56.

<sup>97</sup> See Section 12(e) of proposed Rule 56.



Liquidity Risk

The proposal is also structured in a manner that allows NSCC to protect itself from associated liquidity risk. Specifically, the proposal would provide that the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>98</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member, on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT

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<sup>98</sup> Supra note 27.

Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>99</sup> NSCC would take into account such Price Differential payment obligations, as well as any Final Settlement obligations to non-defaulting SFT Members, when calculating the amount of liquidity resources that NSCC may require in the event of the default of the participant family that would generate the largest aggregate payment obligation for NSCC in extreme but plausible market conditions.<sup>100,101</sup> By continuing to process these Price Differential payments until Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact are generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT Deposit and any SLD that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>102</sup>

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<sup>99</sup> See proposed Rule 56, Section 14(b)(ix)

<sup>100</sup> Id.

<sup>101</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>102</sup> Supra note 39.

Credit Risk

The proposal is also structured in a manner that allows NSCC to protect itself from associated credit risk. In addition to the Clearing Fund requirements discussed above, any Member that elects to participate in the proposed SFT Clearing Service would be subject to the same initial membership requirements and ongoing membership requirements and monitoring as any other Member. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above) in addition to an approval process that is separate from its original Member applications, as well as ongoing credit surveillance in its capacity as a Sponsoring Member or Agent Clearing Member, as applicable.

Operational Risk

The proposal is also structured in a manner that allows NSCC to protect itself from associated operational risk. NSCC proposes to utilize to a significant extent the same processes and infrastructure as it has used for many years to clear and settle cash market transactions for purposes of clearing and settling SFTs. NSCC staff is well versed in such processes and infrastructure and has been actively involved in the development of the proposed SFT Clearing Service, thereby allowing for ready integration of support for the proposed SFT Clearing Service into NSCC staff's current workflows.

Accordingly, NSCC believes that, taken as a whole, the proposal would not have any risks to NSCC, its Members and the market overall that cannot be prudently managed or mitigated.

*Consistency with the Clearing Supervision Act*

The proposed rule change would be consistent with Section 805(b) of the Clearing Supervision Act.<sup>103</sup> The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.<sup>104</sup>

NSCC believes that the proposal would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.

*Promoting Robust Risk Management and Promoting Safety and Soundness.*

NSCC believes that the proposal is consistent with promoting robust risk management and promoting safety and soundness, particularly management of market risks, liquidity risks, credit risks and operational risks presented to NSCC.

The proposal is structured in a manner that allows NSCC to protect itself from associated market risk. SFT activity would, except as otherwise noted above, be risk managed by NSCC in a manner consistent with Members' CNS positions. Moreover, except with respect to the MLA charge, all SFT Positions would be margined independently of the Member's other positions, i.e., Required SFT Deposit. The Required SFT Deposit would generally be calculated using the same procedure applicable to CNS positions, but with a separate \$250,000 minimum.<sup>105</sup>

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<sup>103</sup> 12 U.S.C. 5464(b).

<sup>104</sup> Id.

<sup>105</sup> See Section 12(c) of proposed Rule 56.

As described above, consistent with the manner in which clearing fund requirements are satisfied by members of FICC for their cleared securities financing transactions, NSCC would require that (i) a minimum of 40% of an SFT Member's Required SFT Deposit consist of a combination of cash and Eligible Clearing Fund Treasury Securities and (ii) the lesser of \$5,000,000 or 10% of an SFT Member's Required SFT Deposit (but not less than \$250,000) consist of cash.<sup>106, 107</sup> NSCC would also have the discretion to require a Member to post its Required SFT Deposit in proportion of cash higher than would otherwise be required.<sup>108</sup> NSCC's determination to impose any such requirement would be made in view of market conditions and other financial and operational capabilities of the relevant SFT Member.

Furthermore, NSCC would require additional Clearing Fund deposits to address two situations that may present unique risk. First, if the share price of underlying securities of an SFT that has already been novated to NSCC falls below the threshold established by NSCC from time to time, NSCC would require both pre-novation counterparties to the SFT to post Clearing Fund equal to 100% of the market value of such underlying securities until such time as the per share price of the underlying securities equals or exceeds such threshold.<sup>109</sup> Second, in the event an SFT is subject to a collateral haircut (i.e., the SFT Cash exceeds the market value of the securities), NSCC

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<sup>106</sup> Supra note 34.

<sup>107</sup> Supra note 35.

<sup>108</sup> See Section 12(d) of proposed Rule 56.

<sup>109</sup> See Section 13(b) of proposed Rule 56.

would require the Transferor (or in the case of an Agent Clearing Member Transaction, the Agent Clearing Member) to post Clearing Fund equal to such excess.<sup>110</sup>

Additionally, the Sponsoring Member Required Fund Deposits and Agent Clearing Member Required Fund Deposits would each be calculated on a gross basis, and no offsets for netting of positions as between different Sponsored Members or different Customers, as applicable, would be permitted. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above).

NSCC is also proposing to limit the SFTs eligible for clearing to overnight transactions on securities that are CNS-eligible equity securities with a share price that equals or exceeds the threshold established by NSCC from time to time and that are fully collateralized by cash. NSCC believes these limitations, in addition to the Clearing Fund requirements, would limit the potential market risk associated with SFTs.

The proposal is also structured in a manner that allows NSCC to protect itself from associated liquidity risk. Specifically, the proposed rule change would provide that the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>111</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

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<sup>110</sup> See Section 12(e) of proposed Rule 56.

<sup>111</sup> Supra note 27.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member, on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>112</sup> NSCC would take into account such Price Differential payment obligations, as well as any Final Settlement obligations to non-defaulting SFT Members, when calculating the amount of liquidity resources that NSCC may require in the event of the default of the participant family that would generate the largest aggregate payment obligation for NSCC in extreme but plausible market conditions.<sup>113,114</sup> By continuing to process these Price Differential payments until

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<sup>112</sup> See proposed Rule 56, Section 14(b)(ix).

<sup>113</sup> Id.

<sup>114</sup> 17 CFR 240.17Ad-22(e)(7).

Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact are generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT Deposit and any SLD that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>115</sup>

The proposal is also structured in a manner that allows NSCC to protect itself from associated credit risk. In addition to the Clearing Fund requirements discussed above, any Member that elects to participate in the proposed SFT Clearing Service would be subject to the same initial membership requirements and ongoing membership requirements and monitoring as any other Member. Moreover, any Member that opts to apply to become a Sponsoring Member or an Agent Clearing Member would be subject to an activity limit (as described above) in addition to an approval process that is separate from its original Member applications, as well as ongoing credit surveillance in its capacity as a Sponsoring Member or Agent Clearing Member, as applicable.

The proposal is also structured in a manner that allows NSCC to protect itself from associated operational risk. NSCC proposes to utilize to a significant extent the

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<sup>115</sup> Supra note 39.



same processes and infrastructure as it has used for many years to clear and settle cash market transactions for purposes of clearing and settling SFTs. NSCC staff is well versed in such processes and infrastructure and has been actively involved in the development of the proposed SFT Clearing Service, thereby allowing for ready integration of support for the proposed SFT Clearing Service into NSCC staff's current workflows.

For these reasons NSCC believes the proposal would help promote robust risk management at NSCC, consistent with the objective and principles of Section 805(b) of the Clearing Supervision Act.

*Reducing Systemic Risks and Supporting the Stability of the Broader Financial System.*

NSCC also believes that the proposal is consistent with reducing systemic risks and supporting the stability of the broader financial system. As described above, the proposal would lower the risk of liquidity drain in the U.S. equity securities financing market by lessening counterparties' likely inclination to unwind transactions in a stressed market scenario. NSCC would use its risk management resources to provide confidence to market participants that they will receive back their cash or securities, as applicable, which should limit the propensity for market participants to seek to unwind their transactions in a stressed market scenario.

In addition, the proposal would protect against fire sale risk. As described above, in the event of a default, NSCC would conduct a centralized, orderly liquidation of the defaulter's SFT Positions. Such an organized liquidation should result in substantially less price depreciation and market disruption than multiple independent non-defaulting parties racing against one another to liquidate the positions. In addition, NSCC would only need to liquidate the defaulter's net positions. Limiting the positions that need to be liquidated to the defaulter's net positions should reduce the volume of required sales

activity, which in turn should limit the price and market impact of the close-out of the defaulter's positions. NSCC would also use its risk management resources to provide confidence to market participants that they will receive back their cash or securities, as applicable, which should limit the propensity for market participants to seek to unwind their transactions in a stressed market scenario. By lowering the risk of liquidity drain in the U.S. equity securities financing market and protecting against fire sale risk, NSCC believes the proposal would help reduce systemic risks, which in turn helps support the stability of the broader financial system, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.

NSCC also believes that the proposed rule change is consistent with Rules 17Ad-22(e)(7), 17Ad-22(e)(8), and 17Ad-22(e)(18), promulgated under the Act,<sup>116</sup> for the reasons stated below.

Rule 17Ad-22(e)(7) under the Act requires NSCC to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency.<sup>117</sup> NSCC believes that the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(7) because, as described above, the proposal is structured in a manner that allows NSCC to protect itself from associated liquidity risk. Specifically, the proposal would provide that the Final Settlement obligations and Price Differential of each SFT, other than a Sponsored Member

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<sup>116</sup> 17 CFR 240.17Ad-22(e)(7), (e)(8), and (e)(18).

<sup>117</sup> 17 CFR 240.17Ad-22(e)(7).

Transaction, that is novated to NSCC would settle RVP/DVP at DTC.<sup>118</sup> SFT deliver orders would be processed in accordance with DTC's rules and procedures, including provisions relating to risk controls. Therefore each DTC participant's Final Settlement obligation would complete at DTC on a fully collateralized basis, and the associated debits (if any) would be subject to DTC's risk controls.

To the extent the Price Differential is not processed by DTC, for example if a receiver does not satisfy DTC's risk controls, NSCC would debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement.

In the event NSCC ceases to act for a Defaulting SFT Member, on the Business Day that NSCC ceased to act, NSCC's daily liquidity need calculation would include all Price Differential debits owed by the Defaulting SFT Member not processed at DTC. On subsequent days of the liquidation of the Defaulting SFT Member's SFT Positions, NSCC's total liquidity need calculations would include all novated SFT activity that has not reached Final Settlement on the Business Day NSCC ceased to act, netted together with all other outstanding settlement activity of the Defaulting SFT Member at NSCC.

Until NSCC has satisfied the Final Settlement obligations owing to non-defaulting SFT Members, NSCC would continue paying to and receiving from non-defaulting SFT Members the applicable Price Differential (i.e., the change in market value of the relevant securities) with respect to their novated SFTs.<sup>119</sup> NSCC would take into account such Price Differential payment obligations, as well as any Final Settlement obligations to

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<sup>118</sup> Supra note 27.

<sup>119</sup> See proposed Rule 56, Section 14(b)(ix).

non-defaulting SFT Members, when calculating the amount of liquidity resources that NSCC may require in the event of the default of the participant family that would generate the largest aggregate payment obligation for NSCC in extreme but plausible market conditions.<sup>120,121</sup> By continuing to process these Price Differential payments until Final Settlement occurs, NSCC would ensure that non-defaulting SFT Members are kept in largely the same position as if the Defaulting SFT Member had not defaulted and the pre-novation counterparties had instead agreed to roll the SFTs. This is because even though the non-payment of the Rate Payment in an SFT Member default context may have an impact on non-defaulting SFT Members, such impact is generally de minimis. To the extent NSCC is required to pay a Price Differential, as well as any Final Settlement obligations, to a non-defaulting SFT Member, NSCC would rely on NSCC's liquidity resources, including the Required SFT Deposit and any SLD that may be collected, when applicable, in order to cover the liquidity need associated with any such Price Differential and Final Settlement obligations, consistent with the Clearing Agency Liquidity Risk Management Framework.<sup>122</sup> Therefore, NSCC believes that the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(7) under the Act.<sup>123</sup>

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<sup>120</sup> Id.

<sup>121</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>122</sup> Supra note 39.

<sup>123</sup> 17 CFR 240.17Ad-22(e)(7).

Rule 17Ad-22(e)(8) under the Act<sup>124</sup> requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to define the point at which settlement is final to be no later than the end of the day on which the payment or obligation is due. NSCC believes that the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(8)<sup>125</sup> because, as described above, the proposal would make it clear to SFT Members the point at which settlement is final with respect to SFTs cleared through NSCC. Specifically, Section 7 in the proposed Rule 56 (Securities Financing Transaction Clearing Service) provides that an SFT, or a portion thereof, shall be deemed complete and final upon Final Settlement of the SFT, or such portion. Having clear provisions in this regard would enable SFT Members to better identify the point at which settlement is final with respect to their SFTs. As such, NSCC believes the proposed changes to establish the SFT Clearing Service are consistent with Rule 17Ad-22(e)(8) under the Act.<sup>126</sup>

Rule 17Ad-22(e)(18) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation.<sup>127</sup> NSCC believes the proposed changes to establish new membership categories and requirements for Sponsoring Members and Sponsored Members would establish objective, risk-based, and publicly disclosed criteria for participation in NSCC as Sponsoring Members and

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<sup>124</sup> 17 CFR 240.17Ad-22(e)(8).

<sup>125</sup> Id.

<sup>126</sup> Id.

<sup>127</sup> 17 CFR 240.17Ad-22(e)(18).

Sponsored Members. Specifically, as proposed, in order for an applicant to become a Sponsoring Member, the applicant would be required to satisfy a number of objective and risk-based eligibility criteria. First, the applicant must be a Member. In addition, if the applicant is a Registered-Broker-Dealer, then it would be required to have (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the applicant's designated examining authority) of at least \$10 million. Likewise, in order for an applicant to become a Sponsored Member, the applicant would be required to meet certain objective, risk-based eligibility criteria. Specifically, an applicant would be eligible to apply to become a Sponsored Member if it is either a "qualified institutional buyer" as defined by Rule 144A<sup>128</sup> under the Securities Act,<sup>129</sup> or a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act, satisfies the financial requirements necessary to be a "qualified institutional buyer" as specified in that paragraph. If approved, the requirements for proposed new Sponsoring Member and Sponsored Member membership categories would become part of the Rules, which are publicly available on DTCC's website ([www.dtcc.com](http://www.dtcc.com)), and market participants would be able to review them in connection with their evaluation of potential participation in NSCC as Sponsoring Members and Sponsored Members. Therefore, NSCC believes that the proposed changes

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<sup>128</sup> 17 CFR 230.144A.

<sup>129</sup> 15 U.S.C. 77a et seq.

to establish new membership categories and requirements for Sponsoring Members and Sponsored Members are consistent with Rule 17Ad-22(e)(18) under the Act.<sup>130</sup>

Similarly, NSCC believes the proposed changes to establish new a membership category and requirements for Agent Clearing Members would establish objective, risk-based, and publicly disclosed criteria for participation in NSCC as Agent Clearing Members. Specifically, as proposed, in order for an applicant to become an Agent Clearing Member, the applicant would be required to satisfy a number of objective and risk-based eligibility criteria. First, the applicant must be a Member. In addition, if the applicant is a Registered-Broker-Dealer, then it would be required to have (i) Net Worth of at least \$25 million and (ii) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the applicant's designated examining authority) of at least \$10 million. If approved, the requirements for proposed new Agent Clearing Member membership category would become part of the Rules, which are publicly available on DTCC's website ([www.dtcc.com](http://www.dtcc.com)), and market participants would be able to review them in connection with their evaluation of potential participation in NSCC as Agent Clearing Members. Therefore, NSCC believes that the proposed changes to establish a new membership category and requirements for Agent Clearing Members are consistent with Rule 17Ad-22(e)(18) under the Act.<sup>131</sup>

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<sup>130</sup> 17 CFR 240.17Ad-22(e)(18).

<sup>131</sup> Id.

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](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2022-801 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-2022-801. 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-2022-801 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary

**EXHIBIT 3a**

Below is the response of National Securities Clearing Corporation (“NSCC”) to a Request for Additional Information issued on August 30, 2021 by the Commission pursuant to Section 806(e)(1)(D) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled the Payment, Clearing, and Settlement Supervision Act of 2010, with respect to advance notice SR-NSCC-2021-803, an earlier version of the proposal that has now been withdrawn. Accordingly, certain parts of the response may no longer be applicable.

**NSCC’s response is redacted in its entirety and filed separately with the Commission. Confidential treatment of the redacted pages is being requested pursuant to 17 CFR 240.24b-2.**

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**EXHIBIT 3b**

Below is the response of National Securities Clearing Corporation (“NSCC”) to a Second Request for Additional Information issued on February 28, 2022 by the Commission pursuant to Section 806(e)(1)(D) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled the Payment, Clearing, and Settlement Supervision Act of 2010, with respect to advance notice SR-NSCC-2021-803, an earlier version of the proposal that has now been withdrawn. Accordingly, certain parts of the response may no longer be applicable.

**NSCC’s response is redacted in its entirety and filed separately with the Commission. Confidential treatment of the redacted pages is being requested pursuant to 17 CFR 240.24b-2.**

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NATIONAL  
SECURITIES  
CLEARING  
CORPORATION

RULES & PROCEDURES

TEXT OF PROPOSED RULE CHANGE

**Bold and underlined text** indicates proposed added language.

**~~Bold and strikethrough text~~** indicates proposed deleted language.

**Bold, underlined and shaded text** indicates proposed language added in connection with a separate proposal that has not yet been approved (SR-NSCC-2021-016).

**~~Bold, strikethrough and shaded text~~** indicates proposed language deleted in connection with a separate proposal that has not yet been approved (SR-NSCC-2021-016).

## RULE 1. DEFINITIONS AND DESCRIPTIONS\*

Unless the context requires otherwise, the terms defined in this Rule shall, for all purposes of these Rules and Procedures, have the meanings herein specified.

\*\*\*\*

### **Agent Clearing Member**

**The term “Agent Clearing Member” means a Member that enters into transactions on behalf of Customers in accordance with the provisions of Rule 2D.**

### **Agent Clearing Member Agreement**

**The term “Agent Clearing Member Agreement” means an agreement between the Corporation and a Member who is approved to become an Agent Clearing Member and specifies the terms and conditions deemed by the Corporation to be necessary in order to protect itself and its participants.**

### **Agent Clearing Member Customer Omnibus Account**

**The term “Agent Clearing Member Customer Omnibus Account” means a ledger maintained on the books and records of the Corporation that reflects the outstanding Agent Clearing Member Transactions that an Agent Clearing Member enters into on behalf of Customers and that have been novated to the Corporation, the SFT Positions or SFT Cash associated with those transactions, and any debits or credits of cash associated with such transactions effected pursuant to Rule 12.**

### **Agent Clearing Member Required Fund Deposit**

**The term “Agent Clearing Member Required Fund Deposit” shall have the meaning given to such term in Rule 2D.**

### **Agent Clearing Member Termination Date**

**The term “Agent Clearing Member Termination Date” means the date on which the termination of an Agent Clearing Member’s status as an Agent Clearing Member becomes effective.**

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\* All products and services provided by the Corporation referenced in these Rules are either registered trademarks or servicemarks of, or trademarks or servicemarks of, The Depository Trust & Clearing Corporation or its affiliates. Other names of companies, products or services appearing in these Rules are the trademarks or servicemarks of their respective owners.

**Agent Clearing Member Transaction**

**The term “Agent Clearing Member Transaction” shall have the meaning given to such term in Rule 2D.**

**Agent Clearing Member Voluntary Termination Notice**

**The term “Agent Clearing Member Voluntary Termination Notice” means a written notice from an Agent Clearing Member to the Corporation that the Agent Clearing Member is voluntarily electing to terminate its status as an Agent Clearing Member.**

**Aggregate Net SFT Close-out Value**

**The term “Aggregate Net SFT Close-out Value” means, with respect to an SFT Member, the sum of the SFT Close-out Value for each SFT Position to which the SFT Member is a party.**

\*\*\*\*

**Approved SFT Submitter**

**The term “Approved SFT Submitter” means a provider of transaction data on an SFT that the parties to the SFT have selected and the Corporation has approved, subject to such terms and conditions as to which the Approved SFT Submitter and the Corporation may agree.**

\*\*\*\*

**Bilaterally Initiated SFT**

**The term “Bilaterally Initiated SFT” means an SFT, the Initial Settlement of which occurred prior to the submission of such SFT to the Corporation.**

\*\*\*\*

**Buy-In**

**The term “Buy-In” shall have the meaning given to such term in Rule 56.**

**Buy-In Amount**

**The term “Buy-In Amount” means a net amount equal to (x) the Buy-In Costs or Deemed Buy-In Costs of the SFT Securities in respect of which a Transferor has effected a Buy-In, less (y) the amount of the SFT Cash for the relevant SFT (unless the Transferor effected a Buy-In in respect of some, but not all, of the SFT Securities that are the subject of the SFT, in which case (y) shall be the amount of the Corresponding SFT Cash).**



**Buy-In Costs**

**The term “Buy-In Costs” shall have the meaning given to such term in Rule 56.**

**Buy-In Indemnified Parties**

**The term “Buy-In Indemnified Parties” shall have the meaning given to such term in Rule 56.**

\*\*\*\*

**Clearing Fund**

The term “Clearing Fund” means the fund created pursuant to Rule 4. **Clearing Fund shall include the SFT Deposit, if any, unless otherwise noted in these Rules.**

\*\*\*\*

**CNS Market Value**

**The term “CNS Market Value” has the meaning specified in Rule 41.**

\*\*\*\*

**CNS Transaction**

**The term “CNS Transaction” has the meaning specified in Rule 11.**

\*\*\*\*

**Contract Price**

**The term “Contract Price” means, with respect to SFT Securities subject to an SFT, the price of such securities at the time the SFT is submitted to the Corporation for novation, which price shall be determined by the SFT Member parties to the relevant SFT and provided by an Approved SFT Submitter to the Corporation in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose; provided that if no such price is provided by the time required by the Corporation, the “Contract Price” shall be the Current Market Price of the SFT Securities.**

\*\*\*\*

**Corporation Default**

**The term “Corporation Default” shall have the meaning given to such term in Rule 41.**

**Corresponding SFT Cash**

**The term “Corresponding SFT Cash” means:**

**(a) in respect of a Recalled SFT for which a Transferor has effected a Buy-In in respect of some, but not all, of the SFT Securities that are the subject of the SFT, the portion of the SFT Cash for such SFT equal to the product of (i) the percentage of the SFT Securities in respect of which the Transferor effected a Buy-In and (ii) the SFT Cash of the SFT; and**

**(b) in respect of a Settling SFT which has a greater quantity of SFT Securities as its subject than the corresponding Linked SFT, the portion of the SFT Cash of the Settling SFT equal to the product of (i) the percentage of the SFT Securities of the Settling SFT that the Linked SFT has as its subject and (ii) the SFT Cash of the Settling SFT.**

\*\*\*\*

**Customer**

**The term “Customer” shall have the meaning given to such term in Rule 2D.**

**Customer Clearing Service**

**The term “Customer Clearing Service” means an Agent Clearing Member’s clearing of Agent Clearing Member Transactions for Customers.**

\*\*\*\*

**Deemed Buy-In Costs**

**The term “Deemed Buy-In Costs” means the product of the number of SFT Securities subject to the relevant Buy-In and the per-share price therefor on the date of the Buy-In obtained from a generally recognized source or the last bid quotation from such a source at the most recent close of trading for the SFT Security.**

\*\*\*\*

**Defaulting SFT Member**

**The term “Defaulting SFT Member” means an SFT Member for which the Corporation has ceased to act in accordance with Section 14 of Rule 56.**

**Default-Related SFT**

**The term “Default-Related SFT” shall have the meaning given to such term in Rule 56.**

**Distribution**

**The term “Distribution” means, with respect to any SFT Security at any time, any cash payment of amounts equivalent to dividends and other distributions on the SFT Security.**

**Distribution Amount**

**The term “Distribution Amount” means, in respect of an SFT, an amount of cash equal to the product of:**

**(a) the amount per security in respect of (x) a cash dividend on the SFT Securities that are the subject of the SFT or (y) an exchange of the SFT Securities that are the subject of the SFT for cash; and**

**(b) the number of the relevant SFT Securities subject to the SFT.**

**Distribution Payment**

**The term “Distribution Payment” means an amount payable by one party to an SFT to the other party to the SFT during the term of the SFT in respect of a Distribution on the SFT Securities subject to the SFT.**

\*\*\*\*

**Existing Master Agreement**

**The term “Existing Master Agreement” means, in respect of an SFT, a written agreement that (i) exists at the time transaction data for the SFT is submitted to the Corporation by an Approved SFT Submitter, (ii) provides for, among other things, terms governing the payment and delivery obligations of the parties and (iii) the parties have established (by written agreement, oral agreement, course of conduct or otherwise) will govern such SFT.**

\*\*\*\*

**FFI Member**

The term “FFI Member” means any Member, ~~or~~ Limited Member **or Sponsored Member** that is treated as a non-U.S. entity for U.S. federal income tax purposes. For the avoidance of doubt, FFI Member includes any Member, ~~or~~ Limited Member **or Sponsored Member** that is a U.S. branch of an entity that is treated as a non-U.S. entity for U.S. federal income tax purposes.

**FICC**

**The term “FICC” means Fixed Income Clearing Corporation.**

**Final Net Settlement Position**

**The term “Final Net Settlement Position” shall have the meaning given to such term in Rule 2C.**

**Final Settlement**

**The term “Final Settlement” means the exchange of SFT Securities for SFT Cash described in clause (b) of the definition of Securities Financing Transaction or SFT.**

**Final Settlement Date**

**The term “Final Settlement Date” means the Business Day on which the final settlement of a transaction is scheduled to occur. If the transaction is an SFT, the Final Settlement Date means the Business Day on which the Final Settlement of the SFT is scheduled to occur in accordance with Rule 56 or, if the SFT is accelerated in accordance with Rule 56, the date to which the Final Settlement obligations have been accelerated.**

\*\*\*\*

**Former Sponsored Member**

**The term “Former Sponsored Member” shall have the meaning given to such term in Rule 2C.**

\*\*\*\*

**Index Receipt Agent**

**The term “Index Receipt Agent” has the meaning specified in Rule 7.**

\*\*\*\*

**Incremental Additional Independent Amount SFT Cash**

**The term “Incremental Additional Independent Amount SFT Cash” means:**

- (a) **in respect of a Linked SFT, the excess, if any, of the Independent Amount SFT Cash of the Linked SFT over the Independent Amount SFT Cash of the Settling SFT;**
- (b) **in respect of a Non-Returned SFT, the portion of the Price Differential payable by the Transferee, if any, that is attributable to the Independent Amount SFT Cash of the SFT (which shall be calculated by multiplying such Price Differential by the excess, if any, of the Independent Amount Percentage over 100%); and**

- (c) in respect of any other SFT, the Independent Amount SFT Cash of such SFT.

**Independent Amount Percentage**

The term “Independent Amount Percentage” means, in respect of an SFT, a percentage obtained by dividing the SFT Cash of such SFT by the Market Value SFT Cash of such SFT.

**Independent Amount SFT Cash**

The term “Independent Amount SFT Cash” means the portion, if any, of the SFT Cash for an SFT equal to the amount by which the SFT Cash for such SFT at the time of the Initial Settlement exceeds the Contract Price of the SFT Securities that are the subject of such SFT.

**Independent Amount SFT Cash Deposit**

The term “Independent Amount SFT Cash Deposit” shall have the meaning given to such term in Rule 56.

**Independent Amount SFT Cash Deposit Requirement**

The term “Independent Amount SFT Cash Deposit Requirement” shall have the meaning given to such term in Rule 56.

**Index Receipt Agent**

The term “Index Receipt Agent” has the meaning specified in Rule 7.

**Ineligibility Date**

The term “Ineligibility Date” means, with respect to an SFT, the date on which the SFT Security that is the subject of the SFT becomes an Ineligible SFT Security.

**Ineligible SFT**

The term “Ineligible SFT” means an SFT that has, as its subject, SFT Securities that have become Ineligible SFT Securities.

**Ineligible SFT Security**

The term “Ineligible SFT Security” means an SFT Security that is not eligible to be the subject of a novated SFT.

**Initial Settlement**

**The term “Initial Settlement” means the exchange of SFT Securities for SFT Cash described in clause (a) of the definition of Securities Financing Transaction or SFT.**

\*\*\*\*

**Linked SFT**

**The term “Linked SFT” means an SFT entered into by the pre-novation SFT Member parties to a Settling SFT that has the same Transferor, Transferee and subject SFT Securities (including CUSIP) as the Settling SFT. A Linked SFT shall include an SFT that has as its subject fewer SFT Securities than the corresponding Settling SFT but shall not include an SFT that has as its subject more SFT Securities than the corresponding Settling SFT.**

\*\*\*\*

**Market Value SFT Cash**

**The term “Market Value SFT Cash” means the portion of the SFT Cash for an SFT equal to the amount of the SFT Cash for such SFT minus the Independent Amount SFT Cash of such SFT.**

\*\*\*\*

**Net Capital**

**The term “Net Capital” means, as of a particular date, the amount equal to the net capital of a Registered Broker-Dealer as defined in Rule 15c3-1(c)(2) of the Exchange Act, or any successor rule or regulation thereto.**

\*\*\*\*

**Net Member Capital**

**The term “Net Member Capital” means Net Capital, net assets or equity capital, as applicable to a Member, based on the type of regulation, and in particular the capital requirements, to which the Member is subject.**

\*\*\*\*

**Net Worth**

**The term “Net Worth” means, as of a particular date, the amount equal to the excess of the assets of a Person over the liabilities of such Person, computed in accordance with generally accepted accounting principles. For Registered Broker-Dealers, Net Worth shall include liabilities that are subordinated to the**

**claims of creditors pursuant to a satisfactory subordination agreement, as defined in Appendix D to Rule 15c3-1 of the Exchange Act.**

**Non-Returned SFT**

**The term “Non-Returned SFT” shall have the meaning given to such term in Rule 56.**

\*\*\*\*

**Price Differential**

**The term “Price Differential” means:**

- (a) **for purposes of the discharge of offsetting Final Settlement and Initial Settlement obligations, (i) the SFT Cash for the Settling SFT (or if the Settling SFT has a greater quantity of SFT Securities as its subject than the corresponding Linked SFT, the Corresponding SFT Cash) minus (ii) the SFT Cash for the Linked SFT; and**
- (b) **for all other purposes, (i) the SFT Cash for the SFT minus (ii) the product of the Independent Amount Percentage, if any, and the Current Market Price of the SFT Securities.**

\*\*\*\*

**Qualified Securities Depository**

The term “Qualified Securities Depository” means a Registered Clearing Agency which has entered into an agreement with the Corporation pursuant to which it will act as a securities depository for the Corporation and effect book-entry transfers of securities to and by the Corporation in respect of the CNS System **and/or the SFT Clearing Service.**

**Rate Payment**

**The term “Rate Payment” means an amount payable from one party to an SFT to the other party to the SFT at the Final Settlement expressed as a percentage of the amount of SFT Cash for the SFT.**

\*\*\*\*

**Recall Date**

**The term “Recall Date” means, in respect of a Recall Notice, the second Business Day following the Corporation’s receipt of such Recall Notice.**

**Recall Notice**

**The term “Recall Notice” means a notice that triggers the provisions of Section 9(b) of Rule 56 relating to a Buy-In in respect of an SFT and that is submitted by an Approved SFT Submitter on behalf of a Transferor in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose.**

**Recalled SFT**

**The term “Recalled SFT” means an SFT that has been novated to the Corporation in respect of which a Recall Notice has been submitted.**

\*\*\*\*

**Required Fund Deposit**

The term “Required Fund Deposit” has the meaning specified in Rule 4. **Required Fund Deposit shall include the Sponsoring Member Required Fund Deposit, the Agent Clearing Member Required Fund Deposit and the Required SFT Deposit, if any, unless otherwise noted in these Rules.**

**Required SFT Deposit**

**The term “Required SFT Deposit” shall have the meaning given to that term in Rule 56 and includes any and all Independent Amount SFT Cash Deposit Requirements.**

\*\*\*\*

**Securities Financing Transaction or SFT**

**The term “Securities Financing Transaction” or “SFT” means a transaction between two SFT Members pursuant to which:**

- (a) **one SFT Member agrees to transfer specified SFT Securities to another SFT Member versus the SFT Cash; and**
- (b) **the Transferee agrees to retransfer such specified SFT Securities or equivalent SFT Securities (including quantity and CUSIP) to the Transferor versus the SFT Cash on the following Business Day.**

**Securities Financing Transaction Clearing Service or SFT Clearing Service**

**The term “Securities Financing Transaction Clearing Service” or “SFT Clearing Service” means the service offered by the Corporation to clear SFTs, as more fully described in Rule 56.**

\*\*\*\*



**Settling SFT**

**The term “Settling SFT” means, as of any Business Day, an SFT that has been novated to the Corporation, the Final Settlement of which is scheduled to occur on that Business Day.**

**SFT Account**

**The term “SFT Account” means a ledger maintained on the books and records of the Corporation that reflects the outstanding SFTs that an SFT Member enters into and that have been novated to the Corporation, the SFT Positions or SFT Cash associated with those transactions and any debits or credits of cash associated with such transactions effected pursuant to Rule 12. The term “SFT Account” shall include any Agent Clearing Member Customer Omnibus Account and any Sponsored Member Sub-Account.**

**SFT Cash**

**The term “SFT Cash” means the specified amount of U.S. dollars that the Transferee agrees to transfer to the Transferor at the Initial Settlement of an SFT, (i) plus any Price Differential paid by the Corporation to the SFT Member as Transferor or by the SFT Member as Transferee to the Corporation during the term of the SFT and (ii) less any Price Differential paid by the Corporation to the SFT Member as Transferee or by the SFT Member as Transferor to the Corporation during the term of the SFT.**

**SFT Close-out Value**

**The term “SFT Close-out Value” means, with respect to an SFT Position of an SFT Member, an amount equal to:**

- (i) if the SFT Member is the Transferor of the SFT Securities that are the subject of such SFT, (a) the CNS Market Value of the SFT Securities that are the subject of such SFT minus (b) the SFT Cash for such SFT; and**
  
- (ii) if the SFT Member is a Transferee of the SFT Securities that are the subject of such SFT, (a) the SFT Cash for such SFT minus (b) the CNS Market Value of the SFT Securities that are the subject of such SFT.**

**SFT Deposit**

**The term “SFT Deposit” shall have the meaning given to such term in Rule 56 and includes any and all Independent Amount SFT Cash Deposits.**

**SFT Long Position**

**The term “SFT Long Position” means the number of units of an SFT Security which an SFT Member is entitled to receive from the Corporation at Final Settlement of an SFT against payment of the SFT Cash.**

**SFT Member**

**The term “SFT Member” means any Member, Sponsored Member acting in its principal capacity, Sponsoring Member acting in its principal capacity or Agent Clearing Member acting on behalf of a Customer, in each case that is a party to an SFT, permitted to participate in the Corporation’s SFT Clearing Service.**

**SFT Position**

**The term “SFT Position” means an SFT Member’s SFT Long Position or SFT Short Position in an SFT Security that is the subject of an SFT that has been novated to the Corporation.**

**SFT Security**

**The term “SFT Security” shall mean a security that is eligible to be the subject of an SFT novated to the Corporation and is included in the list for which provision is made in Section 1(g) of Rule 3. If any new or different security is exchanged for any SFT Security in connection with a recapitalization, merger, consolidation or other corporate action, such new or different security shall, effective upon such exchange, become an SFT Security in substitution for the former SFT Security for which such exchange is made.**

**SFT Short Position**

**The term “SFT Short Position” means the number of units of an SFT Security that an SFT Member is obligated to deliver to the Corporation at Final Settlement of an SFT against payment of the SFT Cash.**

\*\*\*\*

**Sponsored Member**

**The term “Sponsored Member” means any Person that has been approved by the Corporation to be sponsored into membership by a Sponsoring Member pursuant to Rule 2C.**

**Sponsored Member Agreement**

**The term “Sponsored Member Agreement” shall have the meaning given to such term in Rule 2C.**

**Sponsored Member Liquidation Amount**

**The term “Sponsored Member Liquidation Amount” shall have the meaning given to such term in Rule 2C.**

**Sponsored Member Sub-Account**

**The term “Sponsored Member Sub-Account” means a ledger maintained on the books and records of the Corporation that reflects the outstanding SFTs that a Sponsoring Member enters into in respect of a Sponsored Member and that have been novated to the Corporation, the SFT Positions or SFT Cash associated with those transactions and any debits or credits of cash associated with such transactions effected pursuant to Rule 12.**

**Sponsored Member Termination Date**

**The term “Sponsored Member Termination Date” means the date on which the termination of a Sponsored Member becomes effective.**

**Sponsored Member Transaction**

**The term “Sponsored Member Transaction” shall have the meaning given to such term in Rule 2C.**

**Sponsored Member Voluntary Termination Notice**

**The term “Sponsored Member Voluntary Termination Notice” means a written notice from a Sponsored Member to the Corporation that the Sponsored Member is voluntarily electing to terminate its membership.**

**Sponsoring Member**

**The term “Sponsoring Member” means a Member whose application to become a Sponsoring Member has been approved by the Board of Directors or the Corporation, as applicable, pursuant to Rule 2C.**

**Sponsoring Member Agreement**

**The term “Sponsoring Member Agreement” means an agreement between the Corporation and a Member who is approved to become a Sponsoring Member and specifies the terms and conditions deemed by the Corporation to be necessary in order to protect itself and its participants.**

**Sponsoring Member Guaranty**

**The term “Sponsoring Member Guaranty” means a guaranty, in the form and substance acceptable to the Corporation, whereby the Sponsoring Member guarantees to the Corporation the payment and performance by its Sponsored**

**Members of their obligations under these Rules and Procedures in respect of the Sponsoring Member's Sponsored Member Sub-Accounts, including, without limitation all of the settlement obligations of its Sponsored Members in respect of such Sponsored Member Sub-Accounts.**

**Sponsoring Member Liquidation Amount**

**The term "Sponsoring Member Liquidation Amount" shall have the meaning given to such term in Rule 2C.**

**Sponsoring Member Required Fund Deposit**

**The term "Sponsoring Member Required Fund Deposit" shall have the meaning given to such term in Rule 2C.**

**Sponsoring Member Settling Bank Omnibus Account**

**The term "Sponsoring Member Settling Bank Omnibus Account" shall have the meaning given to such term in Rule 2C.**

**Sponsoring Member Termination Date**

**The term "Sponsoring Member Termination Date" means the date on which the termination of a Sponsoring Member's status as a Sponsoring Member becomes effective.**

**Sponsoring Member Voluntary Termination Notice**

**The term "Sponsoring Member Voluntary Termination Notice" means a written notice from a Sponsoring Member to the Corporation that the Sponsoring Member is voluntarily electing to terminate its status as a Sponsoring Member with respect to all of its Sponsored Members or with respect to one or more of its Sponsored Members.**

**Sponsoring/Sponsored Membership Program Indemnified Parties or SMP Indemnified Parties**

**The term "Sponsoring/Sponsored Membership Program Indemnified Parties" or "SMP Indemnified Parties" shall have the meaning given to such term in Rule 2C.**

\*\*\*\*

*Tax Certification*

The term "Tax Certification" means an executed copy of the relevant tax form required by the Internal Revenue Service, as in effect from time to time, that each Member, **and** Limited Member **and Sponsored Member** (or applicant to become such) shall provide from time to time to the Corporation as set forth under these Rules and Procedures.

\*\*\*\*

**Transferee**

**The term “Transferee” means the SFT Member party to an SFT that agrees to receive SFT Securities from the other SFT Member party to the SFT in exchange for SFT Cash in connection with the Initial Settlement of the SFT.**

**Transferor**

**The term “Transferor” means the SFT Member party to an SFT that agrees to transfer SFT Securities to the other SFT Member party to the SFT in exchange for SFT Cash in connection with the Initial Settlement of the SFT.**

**Volatility Charge**

**The term “Volatility Charge” means, in respect to a Member, the portion of its Required Fund Deposit calculated by the Corporation by applying Sections I.(A)(1)(a)(i) – (iii) of Procedure XV.**

\*\*\*\*

RULE 2. MEMBERS, ~~AND~~ LIMITED MEMBERS AND SPONSORED MEMBERS

\*\*\*\*

SEC. 2. Membership Types

The Corporation shall have the following membership types:

(i) Member –

A Member, unless otherwise limited by the Corporation pursuant to these Rules, may generally access all services made available by the Corporation. Only Members shall be entitled to settle contracts through the Corporation and to participate in the Comparison and Recording Operation and Accounting Operation.

**A Member shall include a Member in its capacity as a Sponsoring Member to the extent specified in Rule 2C and an Agent Clearing Member to the extent specified in Rule 2D.**

\*\*\*\*

**(iii) In addition to Members and Limited Members, the Corporation may approve a Person to become a Sponsored Member, whose use of the Corporation's services is limited to those services specified by the Corporation as follows:**

**Sponsored Member –**

**Participates in the Corporation's Securities Financing Transaction Clearing Service as provided for in Rule 56.**

When these Rules refer to "Members and Limited Members", the reference includes all member types **other than Sponsored Members**; when reference is made to "participants" in these Rules, the reference generally means all participants other than Settling Bank Only Members, unless the context makes clear it refers to one or more specific member types.

\*\*\*\*

SEC 4. Compliance with Applicable Law

(i) General

Members, ~~and~~ Limited Members **and Sponsored Members** may not submit or confirm any transaction, charge, request, instruction or transmission through the Corporation's services, nor otherwise utilize the Corporation's services, in contravention of any law, rule, regulation or statute, including, but not limited to,

those related to securities, taxation and money laundering, as well as sanctions administered and enforced by the Office of Foreign Assets Control (“OFAC”).

(ii) OFAC

All Members, ~~and~~ Limited Members **and Sponsored Members** must agree not to conduct any transaction or activity through NSCC that it knows to violate sanctions administered and enforced by OFAC.

All Members, ~~and~~ Limited Members **and Sponsored Members** subject to the jurisdiction of the U.S. (as defined by OFAC regulations), with the exception of Data Services Only Members, Municipal Comparison Only Members, Third Party Administrator Members and Investment Manager/Agent Member, are required to periodically confirm that they have implemented a risk-based program reasonably designed to comply with applicable OFAC sanctions regulations. Failure to do so in the manner and timeframes set forth by the Corporation from time to time will result in a fine.

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RULE 2B. ONGOING MEMBERSHIP REQUIREMENTS AND MONITORING

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SEC. 5. DTCC CONFIDENTIAL INFORMATION

Each Member, ~~and~~ Limited Member and Sponsored Member shall maintain DTCC Confidential Information in confidence to the same extent and using the same means it uses to protect its own confidential information, but no less than a reasonable standard of care, and shall not use DTCC Confidential Information or disclose DTCC Confidential Information to any third party except as necessary to perform such Member's, ~~or~~ Limited Member's or Sponsored Member's obligations under these Rules or as otherwise required by applicable law. Each Member, ~~and~~ Limited Member and Sponsored Member acknowledges that a breach of its confidentiality obligations under these Rules may result in serious and irreparable harm to the Corporation and/or DTCC for which there is no adequate remedy at law. In the event of such a breach by the Member, ~~or~~ Limited Member or Sponsored Member, the Corporation and/or DTCC shall be entitled to seek any temporary or permanent injunctive or other equitable relief in addition to any monetary damages hereunder.

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## **RULE 2C. SPONSORING MEMBERS AND SPONSORED MEMBERS**

### **SEC.1. General**

**The Corporation will permit the establishment of a sponsored membership relationship between a Member that is approved as a Sponsoring Member and one or more Persons that are accepted by the Corporation as Sponsored Members of that particular Sponsoring Member.**

**The rights, liabilities and obligations of Sponsoring Members and Sponsored Members shall be governed by this Rule 2C. References to a "Member" in other Rules and/or Procedures shall not apply to Sponsoring Members and to Sponsored Members, in their respective capacities as such, unless specifically noted as such in this Rule 2C or in such other Rules and/or Procedures.**

**A Sponsoring Member shall continue to have all of the rights, liabilities and obligations set forth in these Rules and Procedures and in any agreement between it and the Corporation pertaining to its status as a Member, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as a Sponsoring Member except as contemplated under Sections 7, 8 and 9 of Rule 2C and under the Sponsoring Member Guaranty.**

### **SEC. 2. Qualifications of Sponsoring Members, the Application Process and Continuance Standards.**

**(a) Any Member shall be eligible to apply to become a Sponsoring Member; however, if a Member is a Registered Broker-Dealer, it shall only be eligible to apply to become a Sponsoring Member if it has (1) Net Worth of at least \$25 million and (2) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million. The Corporation may require that a Person be a Member for a time period deemed necessary by the Corporation before that Person may be considered to become a Sponsoring Member.**

**(b) Each Member applicant to become a Sponsoring Member shall complete and deliver to the Corporation an application in such form as may be prescribed by the Corporation from time to time and any other information requested by the Corporation. An application to become a Sponsoring Member shall first be reviewed by the Corporation. Unless the Member is already an Agent Clearing Member under Rule 2D or a sponsoring member of FICC, the Corporation shall recommend approval or disapproval of the application to the Board of Directors.**

**(c) If the Board of Directors or the Corporation, as applicable, denies the application of a Member to become a Sponsoring Member, such denial shall be**

handled in the same way as set forth in Section 1 of Rule 2A with respect to membership applications.

(d) The Corporation may impose financial requirements on a Member applying to become a Sponsoring Member that are greater than the required minimum financial standards for being a Sponsoring Member set forth in Section 2(a) of this Rule, based upon the level of the anticipated positions and obligations of such applicant, the anticipated risk associated with the volume and types of transactions such applicant proposes to process through the Corporation as a Sponsoring Member and the overall financial condition of such applicant. With respect to an application of a Member to become a Sponsoring Member that requires the Board of Directors' approval, the Board of Directors shall approve any increased financial requirements imposed by the Corporation in connection with the approval of the application, and the Corporation shall thereafter regularly review such Sponsoring Member regarding its compliance with such increased financial requirements.

(e) Each Sponsoring Member, or any Member applicant to become such, shall also furnish to the Corporation such adequate assurances of its financial responsibility and operational capability within the meaning of Rule 15 as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation, its participants, creditors or investors, to safeguard securities and funds in the custody or control of the Corporation and for which the Corporation is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions.

(f) Each Member whose application is approved to become a Sponsoring Member shall sign and deliver to the Corporation a Sponsoring Member Agreement. Each Member to become a Sponsoring Member shall sign and deliver to the Corporation a Sponsoring Member Guaranty and a related legal opinion in a form satisfactory to the Corporation.

Nothing in these Rules and Procedures shall prohibit a Sponsoring Member from seeking reimbursement from a Sponsored Member for payments made by the Sponsoring Member (whether pursuant to the Sponsoring Member Guaranty, out of Clearing Fund deposits or otherwise) with respect to obligations as to which the Sponsored Member is a principal obligor under these Rules and Procedures, or as otherwise may be agreed by the Sponsored Member and Sponsoring Member.

(g) Each Sponsoring Member shall submit to the Corporation, within the timeframes and in the formats required by the Corporation, the reports and information that all Members are required to submit regardless of type of Member and the reports and information required to be submitted for its respective type of Member, all pursuant to Section 2 of Rule 2B and, if applicable, Addendum O.

**(h) A Sponsoring Member's books and records, insofar as they relate to the Sponsored Member Transactions submitted to the Corporation, shall be open to the inspection of the duly authorized representatives of the Corporation to the same extent provided in Rule 2A for other Members.**

**(i) A Sponsoring Member shall promptly inform the Corporation, both orally and in writing, if it is no longer in compliance with the relevant standards and qualifications for applying to become a Sponsoring Member set forth in this Rule. Notification must take place immediately and in no event later than 2 Business Days from the date on which the Sponsoring Member first learns of its non-compliance. The Corporation shall assess a fine in accordance with the Fine Schedule in Addendum P against any Sponsoring Member that fails to so notify the Corporation. If the Sponsoring Member fails to remain in compliance with the relevant standards and qualifications, the Corporation will, if necessary, undertake appropriate action to determine the status of the Sponsoring Member and its continued eligibility as such. In addition, the Corporation may review the financial responsibility and operational capability of the Sponsoring Member, and otherwise require from the Sponsoring Member additional reports of its financial or operational condition at such intervals and in such detail as the Corporation shall determine. In addition, if the Corporation has reason to believe that a Sponsoring Member may fail to comply with any of the Rules and Procedures applicable to Sponsoring Members, it may require the Sponsoring Member to provide it, within such timeframe, and in such detail, and pursuant to such manner as the Corporation shall determine, with assurances in writing of a credible nature that the Sponsoring Member shall not, in fact, violate any of these Rules and Procedures.**

**(j) In the event that a Sponsoring Member fails to remain in compliance with the relevant requirements of these Rules and Procedures, the Sponsoring Member Agreement or the Sponsoring Member Guaranty, the Corporation shall have the right to cease to act for the Sponsoring Member in its capacity as a Sponsoring Member pursuant to Section 10 of this Rule, unless the Sponsoring Member requests that such action not be taken and the Corporation determines that, depending upon the specific circumstances and the record of the Sponsoring Member, it is appropriate instead to establish for such Sponsoring Member a time period, which shall be determined by the Corporation and which shall be no longer than 30 calendar days unless otherwise determined by the Corporation, during which the Sponsoring Member must resume compliance with such requirements. In the event that the Sponsoring Member is unable to satisfy such requirements within the time period specified by the Corporation, the Corporation shall, pursuant to these Rules and Procedures, cease to act for the Sponsoring Member in its capacity as a Sponsoring Member pursuant to Section 10 of this Rule.**

**(k) If the sum of the Volatility Charges applicable to a Sponsoring Member's Sponsored Member Sub-Accounts and its other accounts at the Corporation exceeds its Net Member Capital, the Sponsoring Member shall not be**

permitted to submit activity into its Sponsored Member Sub-Accounts, unless otherwise determined by the Corporation in order to promote orderly settlement.

(l) A Sponsoring Member may voluntarily elect to terminate its status as a Sponsoring Member, with respect to all Sponsored Members or with respect to one or more Sponsored Members from time to time, by providing the Corporation with a Sponsoring Member Voluntary Termination Notice. The Sponsoring Member shall specify in the Sponsoring Member Voluntary Termination Notice the Sponsored Member(s) in respect of which the Sponsoring Member is terminating its status (the "Former Sponsored Members") and a desired date for such termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Sponsoring Member to the Corporation with respect to the Former Sponsored Members as of the time such Sponsoring Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than 10 Business Days after the receipt of the Sponsoring Member Voluntary Termination Notice from such Sponsoring Member. The Corporation's acceptance shall be evidenced by a notice to the Corporation's participants announcing the termination of the Sponsoring Member's status as such with respect to the Former Sponsored Members and the Sponsoring Member Termination Date. After the close of business on the Sponsoring Member Termination Date, the Sponsoring Member shall no longer be eligible to submit Sponsored Member Transactions on behalf of the Former Sponsored Members, and each Former Sponsored Member shall cease to be a Sponsored Member unless it is the Sponsored Member of another Sponsoring Member. If any Sponsored Member Transactions is submitted to the Corporation by the Sponsoring Member on behalf of a Former Sponsored Member that is scheduled to settle after the Sponsoring Member Termination Date, such Sponsoring Member's Sponsoring Member Voluntary Termination Notice will be deemed void, and the Sponsoring Member will remain subject to this Rule as if it had not given such Sponsoring Member Voluntary Termination Notice.

(m) A Sponsoring Member's voluntary termination of its status as such, in whole or in part, shall not affect its obligations to the Corporation, or the rights of the Corporation, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Transactions submitted to the Corporation before the applicable Sponsoring Member Termination Date. Any such Sponsored Member Transactions that have been novated to the Corporation shall continue to be processed by the Corporation. The return of the Sponsoring Member's Clearing Fund deposit shall be governed by Section 7 of Rule 4. If an Event Period were to occur after a Sponsoring Member has submitted the Sponsoring Member Voluntary Termination Notice but on or prior to the Sponsoring Member Termination Date, in order for the Sponsoring Member to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the Sponsoring Member will need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation

**Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Sponsoring Member Voluntary Termination Notice previously submitted by the Sponsoring Member.**

**(n) Any non-public information furnished to the Corporation pursuant to this Rule shall be held in confidence as may be required under the laws, rules and regulations applicable to the Corporation that relate to the confidentiality of records. Each Sponsoring Member shall maintain DTCC Confidential Information in confidence to the same extent and using the same means it uses to protect its own confidential information, but no less than a reasonable standard of care, and shall not use DTCC Confidential Information or disclose DTCC Confidential Information to any third party except as necessary to perform such Sponsoring Member's obligations under these Rules or as otherwise required by applicable law. Each Sponsoring Member acknowledges that a breach of its confidentiality obligations under these Rules may result in serious and irreparable harm to the Corporation and/or DTCC for which there is no adequate remedy at law. In the event of such a breach by the Sponsoring Member, the Corporation and/or DTCC shall be entitled to seek any temporary or permanent injunctive or other equitable relief in addition to any monetary damages hereunder.**

**SEC. 3. Qualifications of Sponsored Members, Approval Process and Continuance Standards.**

**(a) A Person shall be eligible to apply to become a Sponsored Member if: (x) it is sponsored into membership by a Sponsoring Member, and (y) it (1) is a "qualified institutional buyer" as defined by Rule 144A under the Securities Act of 1933, as amended, or (2) is a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act of 1933, as amended, satisfies the financial requirements necessary to be a "qualified institutional buyer" as specified in that paragraph. The Corporation shall have the right to rely on the representation provided by the Sponsoring Member regarding satisfaction of (y).**

**(b) Each time that a Sponsoring Member wishes to sponsor a Person into membership, it shall provide the Corporation with the representation referred to in Section 3(a) of this Rule, as well as any additional information in such form as may be prescribed by the Corporation. The Corporation shall approve or disapprove Persons as Sponsored Members. If the Corporation denies the request of a Sponsoring Member to add a Person as a Sponsored Member, such denial shall be handled in the same manner as set forth in Section 1 of Rule 2A with respect to membership applications except that the written statement referred to therein shall be provided to both the Sponsoring Member and the Person seeking to become a Sponsored Member.**

**(c) Each Person to become a Sponsored Member shall sign and deliver to the Corporation an agreement whereby the Person shall agree to any terms and conditions deemed by the Corporation to be necessary in order to protect**

itself and its participants (the “Sponsored Member Agreement”). Each Person to become a Sponsored Member that shall be an FFI Member must be FATCA Compliant.

(d) A Sponsored Member shall immediately inform its Sponsoring Member, both orally and in writing, if the Sponsored Member is no longer in compliance with the requirements of Section 3(a) of this Rule. A Sponsoring Member shall promptly inform the Corporation, both orally and in writing, if a Sponsored Member is no longer in compliance with the requirements of Section 3(a) of this Rule. Notification to the Corporation by the Sponsoring Member must take place within one (1) Business Day from the date on which the Sponsoring Member first learns of the Sponsored Member’s non-compliance. The Corporation shall assess a fine in accordance with the Fine Schedule in Addendum P against any Sponsoring Member that fails to so notify the Corporation.

(e) A Sponsored Member may voluntarily elect to terminate its membership by providing the Corporation with a Sponsored Member Voluntary Termination Notice. The Sponsored Member shall specify in the Sponsored Member Voluntary Termination Notice a desired date for the termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Sponsored Member to the Corporation as of the time such Sponsored Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than 10 Business Days after the receipt of the Sponsored Member Voluntary Termination Notice from such Sponsored Member. The Corporation’s acceptance shall be evidenced by a notice to the Corporation’s participants announcing the termination of the Sponsored Member and the Sponsored Member Termination Date. After the close of business on the Sponsored Member Termination Date, the relevant Sponsoring Member shall no longer be eligible to submit Sponsored Member Transactions on behalf of the Sponsored Member. If any Sponsored Member Transaction is submitted to the Corporation by the relevant Sponsoring Member on behalf of the Sponsored Member that is scheduled to settle after the Sponsored Member Termination Date, such Sponsored Member’s Sponsored Member Voluntary Termination Notice will be deemed void, and the Sponsored Member will remain subject to this Rule as if it had not given such Sponsored Member Voluntary Termination Notice.

(f) A Sponsored Member’s voluntary termination shall not affect its obligations to the Corporation, or the rights of the Corporation, including under the Sponsoring Member Guaranty, with respect to Sponsored Member Transactions submitted to the Corporation before the Sponsored Member Termination Date, and the Sponsoring Member Guaranty shall remain in effect to cover all outstanding obligations of the Sponsored Member to the Corporation that are within the scope of such Sponsoring Member Guaranty.

**SEC. 4. Compliance with Laws.**

**Each Sponsoring Member and Sponsored Member shall comply in all material respects with all applicable laws, including applicable laws relating to securities, taxation and money laundering, as well as global sanctions laws, in connection with the use of the Corporation's services.**

**SEC. 5. Sponsored Member Transactions.**

**A Sponsoring Member shall be permitted to submit to the Corporation Securities Financing Transactions between itself and its Sponsored Members ("Sponsored Member Transactions") in accordance with Rule 56. The Corporation directs each Sponsored Member and Sponsoring Member to settle all Final Settlement, Rate Payment, Price Differential, and other securities delivery and payment obligations arising under a Sponsored Member Transaction that has been novated to the Corporation by causing the relevant cash and securities to be transferred to the Transferor or Transferee, as applicable, on the books and records of the Sponsoring Member, and each Sponsored Member and Sponsoring Member agrees that any such transfer shall satisfy the Corporation's corresponding obligation with respect to such Sponsored Member Transaction.**

**SEC. 6. Sponsoring Member Agent Obligations.**

**A Sponsored Member shall appoint its Sponsoring Member to act as agent with respect to the Sponsored Member's satisfaction of its settlement obligations arising under Sponsored Member Transactions between the Sponsored Member and the Sponsoring Member and for performing all functions and receiving reports and information set forth in these Rules and Procedures. The Corporation's provision of such reports and information to the Sponsoring Member shall constitute satisfaction of any obligation of the Corporation to provide such reports and information to the affected Sponsored Members. Notwithstanding the foregoing and any other activities the Sponsoring Member may perform in its capacity as agent for Sponsored Members, each Sponsored Member shall be obligated as principal to the Corporation with respect to all settlement obligations under these Rules and Procedures, and the Sponsoring Member shall not be a principal under these Rules and Procedures with respect to settlement obligations of its Sponsored Members.**

**SEC. 7. Clearing Fund Obligations.**

**(a) The Corporation shall maintain one or more Sponsored Member Sub-Accounts for a Sponsoring Member. Each Sponsoring Member shall make and maintain so long as such Member is a Sponsoring Member a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in its Sponsored Member Sub-Accounts (the "Sponsoring Member Required Fund Deposit"). Each Sponsoring Member, so long as such Member is a Sponsoring Member, shall also provide Supplemental Liquidity Deposits to the Clearing Fund.**

as may be required pursuant to Rule 4A; however, the Supplemental Liquidity Deposits shall be calculated without regard to Sponsored Member Transactions. Deposits to the Clearing Fund shall be held by the Corporation or its designated agents, to be applied as provided in these Rules and Procedures.

(b) In the ordinary course, for purposes of satisfying the Sponsoring Member's Clearing Fund requirements under these Rules and Procedures for its Member activity, its Sponsoring Member activity, and, to the extent applicable, its Agent Clearing Member activity, the Sponsoring Member's proprietary accounts, its Sponsored Member Sub-Accounts, and its Agent Clearing Member Customer Omnibus Account(s), if any, shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, the Corporation may, in its sole discretion, at any time and without prior notice to the Sponsoring Member (but being obligated to give notice to the Sponsoring Member as soon as possible thereafter) and whether or not the Sponsoring Member or any of its Sponsored Members is in default of its obligations to the Corporation, treat the Sponsoring Member's accounts as a single account for the purpose of applying Clearing Fund deposits; apply Clearing Fund deposits made by the Sponsoring Member with respect to any account as necessary to ensure that the Sponsoring Member meets all of its obligations to the Corporation under any other account(s); and otherwise exercise all rights to offset and net against the Clearing Fund deposits any net obligations among any or all of the accounts, whether or not any other Person is deemed to have any interest in such account.

(c) The Sponsoring Member Required Fund Deposit for each Sponsored Member Sub-Account shall be calculated separately based on the Sponsored Member Transactions in such Sponsored Member Sub-Account, and the Sponsoring Member shall, as principal, be required to satisfy the Sponsoring Member Required Fund Deposit for each of the Sponsoring Member's Sponsored Member Sub-Accounts.

(d) Sections 1, 2, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of Rule 4 shall apply to the Sponsoring Member Required Fund Deposit with respect to obligations of a Sponsoring Member under these Rules and Procedures, including its obligations arising under the Sponsored Member Sub-Accounts, and the obligations of a Sponsoring Member under its Sponsoring Member Guaranty to the same extent as such sections apply to any Required Fund Deposit and any other obligations of a Member. For purposes of Section 1 of Rule 4, obligations and liabilities of a Member to the Corporation that shall be secured shall include, without limitation, a Member's obligations as a Sponsoring Member under these Rules and Procedures, including, without limitation, any obligation of any such Sponsoring Member to provide the Sponsoring Member Required Fund Deposit, such Sponsoring Member's obligations arising under the Sponsored Member Sub-Accounts of such Sponsoring Member and such Sponsoring Member's obligations under its Sponsoring Member Guaranty.



(e) A Sponsoring Member shall be subject to such fines as may be imposed in accordance with such Rules or Procedures of the Corporation for any late satisfaction of a Clearing Fund deficiency call.

SEC. 8. Right of Offset.

In the ordinary course, with respect to satisfaction of any Sponsored Member's obligations under these Rules and Procedures, the Sponsoring Member's Sponsored Member Sub-Accounts, the Sponsoring Member's proprietary accounts, and the Sponsoring Member's Agent Clearing Member Customer Omnibus Accounts, if any, at the Corporation shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, the Corporation may, in its sole discretion, at any time any obligation of the Sponsoring Member arises under the Sponsoring Member Guaranty to pay or perform thereunder with respect to any Sponsored Member, exercise a right of offset and net any such obligation of the Sponsoring Member under its Sponsoring Member Guaranty against any obligations of the Corporation to the Sponsoring Member in respect of such Sponsoring Member's proprietary accounts at the Corporation.

SEC. 9. Loss Allocation Obligations.

(a) Sponsored Members shall not be obligated for allocations, pursuant to Rule 4, of loss or liability incurred by the Corporation. To the extent that a loss or liability is determined by the Corporation to arise in connection with Sponsored Member Transactions (i.e., in connection with the insolvency or default of a Sponsoring Member), the Sponsored Members shall not be responsible for or considered in the loss allocation calculation, but rather such loss shall be allocated to other Members in accordance with the principles set forth in Section 4 of Rule 4.

(b) To the extent the Corporation incurs a loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event and a loss allocation obligation arises, that would be the responsibility of a Sponsored Member Sub-Account as if the Sponsored Member Sub-Account were a Member, the Corporation shall calculate such loss allocation obligation as if the affected Sponsored Member were subject to such allocations pursuant to Section 4 of Rule 4, but the Sponsoring Member shall be responsible for satisfying such obligations.

(c) The entire amount of the Required Fund Deposit associated with the Sponsoring Member's proprietary accounts at the Corporation and the entire amount of the Sponsoring Member Required Fund Deposit may be used to satisfy any amount allocated against a Sponsoring Member, whether in its capacity as a Member, a Sponsoring Member, or otherwise. With respect to an obligation to make payment due to any loss allocation amounts assessed on a Sponsoring Member pursuant to Section 9(b) of this Rule, the Sponsoring Member may

instead elect to terminate its membership in the Corporation pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Sponsoring Member, its Required Fund Deposit shall be the sum of its Required Fund Deposits associated with its proprietary accounts at the Corporation (including its proprietary SFT Account pursuant to Rule 56), its Sponsoring Member Required Fund Deposit, and its Agent Clearing Member Required Fund Deposits, if any, for each of its Agent Clearing Member Customer Omnibus Accounts.

SEC. 10. Restrictions on Access to Services by a Sponsoring Member.

(a) The Board of Directors may at any time, upon Corporation providing notice to a Sponsoring Member pursuant to Section 5 of Rule 45, suspend a Sponsoring Member in its capacity as a Sponsoring Member from any service provided by the Corporation either with respect to a particular transaction or transactions or with respect to transactions generally, or prohibit or limit such Sponsoring Member's access to services offered by the Corporation in the event that one or more of the factors set forth in Section 1 of Rule 46 is present with respect to the Sponsoring Member.

(b) Rule 46 shall apply with respect to a Sponsoring Member in the same way as it applies to Members, including the Board of Directors' right to summarily suspend the Sponsoring Member and to cease to act for such Sponsoring Member.

(c) If the Corporation ceases to act for a Sponsoring Member in its capacity as a Sponsoring Member, Section 14 of Rule 56 shall apply and the Corporation shall decline to accept or process data from the Sponsoring Member on Sponsored Member Transactions and the Corporation shall cease to act for all of the Sponsored Members of the affected Sponsoring Member (unless such Sponsored Members are also Sponsored Members of other Sponsoring Members). If the Corporation suspends, prohibits or limits a Sponsoring Member in its capacity as a Sponsoring Member with respect to such Sponsoring Member's access to services offered by the Corporation, the Corporation shall decline to accept or process data from the Sponsoring Member on Sponsored Member Transactions and shall suspend the Sponsored Members of the affected Sponsoring Member (unless they are also Sponsored Members of other Sponsoring Members) for so long as the Corporation is suspending, prohibiting or limiting the Sponsoring Member. Any Sponsored Member Transactions which have been novated to the Corporation shall continue to be processed by the Corporation. The Corporation, in its sole discretion, shall determine whether to close-out the affected Sponsored Member Transactions or permit the Sponsored Members to complete their settlement.

**SEC. 11. Restrictions on Access to Services by a Sponsored Member.**

**(a) The Board of Directors may at any time, upon Corporation providing notice to a Sponsored Member and its Sponsoring Member pursuant to Section 5 of Rule 45, suspend a Sponsored Member from any service provided by the Corporation either with respect to a particular transaction or transactions or with respect to transactions generally, or prohibit or limit such Sponsored Member with respect to access to services offered by the Corporation in the event that one or more of the factors set forth in Section 1 of Rule 46 is present with respect to the Sponsored Member.**

**(b) Rule 46 shall apply with respect to a Sponsored Member in the same way as it applies to Members, including the Board of Directors' right to summarily suspend a Sponsored Member and to cease to act for such Sponsored Member.**

**(c) If the Corporation ceases to act for a Sponsored Member, Section 14 of Rule 56 shall apply.**

**(d) The Corporation shall cease to act for a Sponsored Member that is no longer in compliance with the requirements of Section 3(a) of this Rule.**

**SEC. 12. Insolvency of a Sponsoring Member.**

**(a) A Sponsoring Member shall be obligated to immediately notify the Corporation that (a) it fails, or is unable, to perform its contracts or obligations or (b) it is insolvent, as required by Section 1 of Rule 20 for other Members. A Sponsoring Member shall be treated by the Corporation in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where the Corporation treats a Sponsoring Member as insolvent.**

**(b) In the event that the Corporation determines to treat a Sponsoring Member as insolvent pursuant to Rule 20, the Corporation shall have the right to cease to act for the insolvent Sponsoring Member pursuant to Section 10 of this Rule. If the Corporation ceases to act for the insolvent Sponsoring Member, the Corporation shall decline to accept or process data from the Sponsoring Member, including Sponsored Member Transactions, and the Corporation shall terminate the membership of all of the insolvent Sponsoring Member's Sponsored Members unless they are the Sponsored Members of another Sponsoring Member. Any Sponsored Member Transactions which have been novated to the Corporation shall continue to be processed by the Corporation. The Corporation, in its sole discretion, shall determine whether to close-out the affected Sponsored Member Transactions and/or permit the Sponsored Members to complete their settlement.**

**SEC. 13. Insolvency of a Sponsored Member.**

**(a) A Sponsored Member and its Sponsoring Member (to the extent it has knowledge thereof) shall be obligated to immediately notify the Corporation that the Sponsored Member is insolvent or that the Sponsored Member will be unable to perform any of its material contracts, obligations or agreements in the same manner as required by Section 1 of Rule 20 for other Members. For purposes of this section, a Sponsoring Member shall be deemed to have knowledge that a Sponsored Member is insolvent or will be unable to perform on any of its material contracts, obligations or agreements if one or more duly authorized representatives of the Sponsoring Member, in its capacity as such, has knowledge of such matters. A Sponsored Member shall be treated by the Corporation in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where the Corporation treats a Sponsored Member as insolvent.**

**(b) In the event that the Corporation determines to treat a Sponsored Member as insolvent pursuant to Rule 20, the Corporation shall have the right to cease to act for the insolvent Sponsored Member pursuant to Section 11 of this Rule. If the Corporation ceases to act for the insolvent Sponsored Member, Section 14 of Rule 56 shall apply with respect to the close-out of the insolvent Sponsored Member's Sponsored Member Transactions.**

**SEC. 14. Liquidation of Sponsored Member and Related Sponsoring Member Positions.**

**(a) The provisions of this Section 14, which shall supersede any conflicting provisions of this Rule 2C, Rule 18 and Rule 56, shall only apply (i) with respect to the liquidation of positions resulting from Sponsored Member Transactions that have been novated to NSCC, (ii) in the event a Sponsoring Member is not a Defaulting Member and the Corporation has not ceased to act for the Sponsoring Member and (iii) if a Corporation Default has not occurred. In addition, the Corporation may only cause the termination described in subsection (b) of this Section 14 if it has ceased to act for the Sponsored Member at issue and the Sponsoring Member has not performed the obligations of the Sponsored Member in respect of all positions guaranteed by such Sponsoring Member.**

**(b) Subject to the provisions of subsection (a) of this Section 14, on any Business Day, the Sponsoring Member or the Corporation may by written notice to the other cause the immediate termination of all, but not fewer than all, of the SFT Positions of the Sponsored Member established in the Sponsored Member Sub-Account. Any such notice shall also cause the immediate termination of all of the corresponding, offsetting SFT Positions of the Sponsoring Member established in the Sponsoring Member's proprietary SFT Account. Each such termination shall be effected by the Sponsoring Member's establishment of a final net settlement position for each eligible security with a distinct CUSIP number**

that shall equal the net of all outstanding deliver obligations and receive obligations of the parties thereto in each such eligible security (the “Final Net Settlement Position”).

(c) To liquidate the Final Net Settlement Positions of any Sponsored Member and the corresponding, offsetting Final Net Settlement Positions of the Sponsoring Member established pursuant to subsection (b) of this Section 14, a Sponsoring Member shall calculate a liquidation amount, which may be equal to zero. The liquidation amount in respect of the Final Net Settlement Positions of a Sponsored Member (the “Sponsored Member Liquidation Amount”) shall be due to or from the Corporation from or to the Sponsored Member. The liquidation amount in respect of the corresponding, offsetting Final Net Settlement Positions of the Sponsoring Member (the “Sponsoring Member Liquidation Amount”) shall be due to or from the Corporation from or to the Sponsoring Member. If the Sponsored Member Liquidation Amount in respect of the Final Net Settlement Positions of a Sponsored Member is due to the Corporation, the Sponsoring Member Liquidation Amount in respect of the corresponding Final Net Settlement Positions of the Sponsoring Member shall be due to the Sponsoring Member. If the Sponsored Member Liquidation Amount in respect of the Final Net Settlement Positions of a Sponsored Member is due to the Sponsored Member, the Sponsoring Member Liquidation Amount in respect of the Final Net Settlement Positions of the Sponsoring Member shall be due to the Corporation.

Any Sponsoring Member Liquidation Amount calculated by a Sponsoring Member pursuant to this subsection (c) may be based on prices obtained from a generally recognized source or the most recent closing bid or offer quotation from such a source and may include the losses (including costs such as fees, expenses and commissions) and/or gains realized by the Sponsoring Member in entering into replacement transactions and/or entering into or terminating hedge transactions in connection with or as a result of, and any other loss, damage, cost or expense directly arising or resulting from, the liquidation of the Sponsoring Member’s Final Net Settlement Positions. The Sponsored Member Liquidation Amount in respect of Final Net Settlement Positions of a Sponsored Member shall equal the Sponsoring Member Liquidation Amount in respect of the corresponding Final Net Settlement Positions of the Sponsoring Member. The Sponsoring Member’s calculation of any Sponsored Member Liquidation Amount or Sponsoring Member Liquidation Amount shall be conclusive and binding on all relevant parties, absent manifest error and subject to any right of the Corporation to indemnification under these Rules and Procedures.

If a Sponsored Member Liquidation Amount is due to the Corporation from the Sponsored Member, the Sponsoring Member shall be obligated to pay such Sponsored Member Liquidation Amount under its Sponsoring Member Guaranty, which obligation shall, notwithstanding anything to the contrary in the Sponsoring Member Guaranty, be payable without demand and (automatically and without further action by any Person) be set off against the obligation of the

**Corporation to pay the corresponding Sponsoring Member Liquidation Amount to the Sponsoring Member.**

**If a Sponsored Member Liquidation Amount is due to the Sponsored Member from the Corporation, the Corporation's sole obligation in respect of any such Sponsored Member Liquidation Amount shall be to transfer such amount to the applicable account of the Sponsoring Member at the Settling Bank acting on behalf of a Sponsoring Member (the "Sponsoring Member Settling Bank Omnibus Account"). The Corporation hereby instructs the Sponsoring Member to discharge its obligation to pay the Corporation any Sponsoring Member Liquidation Amount by transferring such amount to the Sponsoring Member's Sponsoring Member Settling Bank Omnibus Account for application to the Corporation's obligation to pay the corresponding Sponsored Member Liquidation Amount to the Sponsored Member. To the extent that the Sponsoring Member transfers such funds to the Sponsoring Member Settling Bank Omnibus Account as provided in this paragraph, (i) the obligations of the Corporation in respect of the Sponsored Member Liquidation Amount shall be discharged and (ii) the obligations of the Sponsoring Member in respect of the corresponding Sponsoring Member Liquidation Amount shall be discharged. The Sponsored Member agrees to accept the transfer of such funds to the Sponsoring Member Settling Bank Omnibus Account in full satisfaction of the obligation of the Corporation to pay the Sponsored Member Liquidation Amount to the Sponsored Member.**

**(d) The Sponsoring Member shall indemnify the Corporation, and its employees, officers, directors, shareholders, agents and Members (collectively, the "Sponsoring/Sponsored Membership Program Indemnified Parties" or "SMP Indemnified Parties"), for any and all losses, liability, or expenses of an SMP Indemnified Party arising from any claim by an affected Sponsored Member disputing the Sponsoring Member's calculation of any Sponsored Member Liquidation Amount or Sponsoring Member Liquidation Amount pursuant to this Section 14.**

**(e) The Corporation hereby acknowledges that a Sponsoring Member may take a security interest in the deliver, receive and related payment obligations owed by the Corporation to a Sponsored Member in respect of its transactions that have been novated to the Corporation by such Sponsoring Member and established in the Sponsoring Member's Sponsored Member Sub-Account for the Sponsored Member, including, but not limited to, such Sponsored Member's rights to receive payment of any Sponsored Member Liquidation Amount pursuant to this Section 14.**

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## RULE 2D. AGENT CLEARING MEMBERS

### SEC. 1. General.

The Corporation will permit a Member that is approved to be an Agent Clearing Member to submit transactions to the Corporation for novation on behalf of one or more its customers (each such customer, a "Customer").

The rights, liabilities and obligations of Agent Clearing Members shall be governed by this Rule 2D. References to a "Member" in other Rules and/or Procedures shall not apply to Agent Clearing Members, in their capacities as such, unless specifically noted as such in this Rule 2D or in such other Rules and/or Procedures.

An Agent Clearing Member shall continue to have all of the rights, liabilities and obligations set forth in these Rules and Procedures and in any agreement between it and the Corporation pertaining to its status as a Member, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as an Agent Clearing Member except as contemplated under Sections 6, 7 and 8 of Rule 2D.

### SEC. 2. Qualifications of Agent Clearing Members, the Application Process and Continuance Standards.

(a) Any Member shall be eligible to apply to become an Agent Clearing Member; however, if a Member is a Registered Broker-Dealer, it shall only be eligible to apply to become an Agent Clearing Member if it has (1) Net Worth of at least \$25 million and (2) excess net capital over the minimum net capital requirement imposed by the SEC (or such higher minimum capital requirement imposed by the Member's designated examining authority) of at least \$10 million. The Corporation may require that a Person be a Member for a time period deemed necessary by the Corporation before that Person may be considered to become an Agent Clearing Member.

(b) Each Member applicant to become an Agent Clearing Member shall complete and deliver to the Corporation an application in such form as may be prescribed by the Corporation from time to time and any other information requested by the Corporation. An application to become an Agent Clearing Member shall first be reviewed by the Corporation. Unless the Member is already a Sponsoring Member under Rule 2C or a sponsoring member of FICC, the Corporation shall recommend approval or disapproval of the application to the Board of Directors.

(c) If the Board of Directors or the Corporation, as applicable, denies the application of a Member to become an Agent Clearing Member, such denial shall be handled in the same way as set forth in Section 1 of Rule 2A with respect to membership applications.

**(d) The Corporation may impose financial requirements on a Member applying to become an Agent Clearing Member that are greater than the required minimum financial standards for being an Agent Clearing Member set forth in Section 2(a) of this Rule, based upon the level of the anticipated positions and obligations of such applicant, the anticipated risk associated with the volume and types of transactions such applicant proposes to process through the Corporation as an Agent Clearing Member and the overall financial condition of such applicant. With respect to an application of a Member to become an Agent Clearing Member, the Board of Directors shall approve any increased financial requirements imposed by the Corporation in connection with the approval of the application, and the Corporation shall thereafter regularly review such Agent Clearing Member regarding its compliance with such increased financial requirements.**

**(e) Each Agent Clearing Member, or any Member applicant to become such, shall also furnish to the Corporation such adequate assurances of its financial responsibility and operational capability within the meaning of Rule 15 as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation, its participants, creditors or investors, to safeguard securities and funds in the custody or control of the Corporation and for which the Corporation is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions.**

**(f) Each Member whose application is approved to become an Agent Clearing Member shall sign and deliver to the Corporation an Agent Clearing Member Agreement and a related legal opinion in a form satisfactory to the Corporation.**

**(g) Each Agent Clearing Member shall submit to the Corporation, within the timeframes and in the formats required by the Corporation, the reports and information that all Members are required to submit regardless of type of Member and the reports and information required to be submitted for its respective type of Member, all pursuant to Section 2 of Rule 2B and, if applicable, Addendum O.**

**(h) An Agent Clearing Member's books and records, insofar as they relate to the Agent Clearing Member Transactions submitted to the Corporation, shall be open to the inspection of the duly authorized representatives of the Corporation to the same extent provided in Rule 2A for other Members.**

**(i) An Agent Clearing Member shall promptly inform the Corporation, both orally and in writing, if it is no longer in compliance with the relevant standards and qualifications for applying to become an Agent Clearing Member set forth in this Rule. Notification must take place immediately and in no event later than 2 Business Days from the date on which the Agent Clearing Member first learns of its non-compliance. The Corporation shall assess a fine in accordance with the Fine Schedule in Addendum P against any Agent Clearing**



Member that fails to so notify the Corporation. If the Agent Clearing Member fails to remain in compliance with the relevant standards and qualifications, the Corporation will, if necessary, undertake appropriate action to determine the status of the Agent Clearing Member and its continued eligibility as such. In addition, the Corporation may review the financial responsibility and operational capability of the Agent Clearing Member, and otherwise require from the Agent Clearing Member additional reports of its financial or operational condition at such intervals and in such detail as the Corporation shall determine. In addition, if the Corporation has reason to believe that an Agent Clearing Member may fail to comply with any of the Rules and Procedures applicable to Agent Clearing Members, it may require the Agent Clearing Member to provide it, within such timeframe, and in such detail, and pursuant to such manner as the Corporation shall determine, with assurances in writing of a credible nature that the Agent Clearing Member shall not, in fact, violate any of these Rules and Procedures.

(j) In the event that an Agent Clearing Member fails to remain in compliance with the relevant requirements of these Rules and Procedures or the Agent Clearing Member Agreement, the Corporation shall have the right to cease to act for the Agent Clearing Member in its capacity as an Agent Clearing Member pursuant to Section 9 of this Rule or as a Member more generally, unless the Agent Clearing Member requests that such action not be taken and the Corporation determines that, depending upon the specific circumstances and the record of the Agent Clearing Member, it is appropriate instead to establish for such Agent Clearing Member a time period, which shall be determined by the Corporation and which shall be no longer than 30 calendar days unless otherwise determined by the Corporation, during which the Agent Clearing Member must resume compliance with such requirements. In the event that the Agent Clearing Member is unable to satisfy such requirements within the time period specified by the Corporation, the Corporation shall, pursuant to these Rules and Procedures, cease to act for the Agent Clearing Member in its capacity as an Agent Clearing Member pursuant to Section 9 of this Rule or as a Member more generally.

(k) If the sum of the Volatility Charges applicable to an Agent Clearing Member's Agent Clearing Member Customer Omnibus Account(s) and its other accounts at the Corporation exceeds its Net Member Capital, the Agent Clearing Member shall not be permitted to submit activity into its Agent Clearing Member Customer Omnibus Account(s), unless otherwise determined by the Corporation in order to promote orderly settlement.

(l) An Agent Clearing Member may voluntarily elect to terminate its status as an Agent Clearing Member by providing the Corporation with an Agent Clearing Member Voluntary Termination Notice. The Agent Clearing Member shall specify in the Agent Clearing Member Voluntary Termination Notice the desired date for such termination, which date shall not be prior to the scheduled Final Settlement Date of any remaining obligation owed by the Agent Clearing Member in respect of Agent Clearing Member Transactions entered into on behalf

of Customers as of the time such Agent Clearing Member Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than 10 Business Days after the receipt of the Agent Clearing Member Voluntary Termination Notice from such Agent Clearing Member. The Corporation's acceptance shall be evidenced by a notice to the Corporation's participants announcing the termination of the Agent Clearing Member's status as such and the Agent Clearing Member Termination Date. After the close of business on the Agent Clearing Member Termination Date, the Agent Clearing Member shall no longer be eligible to submit Agent Clearing Member Transactions. If any Agent Clearing Member Transaction is submitted to the Corporation by the Agent Clearing Member on behalf of a Customer that is scheduled to settle after the Agent Clearing Member Termination Date, such Agent Clearing Member's Agent Clearing Member Voluntary Termination Notice will be deemed void, and the Agent Clearing Member will remain subject to this Rule as if it had not given such Agent Clearing Member Voluntary Termination Notice.

(m) An Agent Clearing Member's voluntary termination of its status as such shall not affect its obligations to the Corporation, or the rights of the Corporation with respect to Agent Clearing Member Transactions submitted to the Corporation before the Agent Clearing Member Termination Date. Any such Agent Clearing Member Transactions that have been novated to the Corporation shall continue to be processed by the Corporation. The return of the Agent Clearing Member's Clearing Fund deposit shall be governed by Section 7 of Rule 4. If an Event Period were to occur after an Agent Clearing Member has submitted the Agent Clearing Member Voluntary Termination Notice but on or prior to the Agent Clearing Member Termination Date, in order for the Agent Clearing Member to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the Agent Clearing Member will need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Agent Clearing Member Voluntary Termination Notice previously submitted by the Agent Clearing Member.

(n) Any non-public information furnished to the Corporation pursuant to this Rule shall be held in confidence as may be required under the laws, rules and regulations applicable to the Corporation that relate to the confidentiality of records. Each Agent Clearing Member shall maintain DTCC Confidential Information in confidence to the same extent and using the same means it uses to protect its own confidential information, but no less than a reasonable standard of care, and shall not use DTCC Confidential Information or disclose DTCC Confidential Information to any third party except as necessary to perform such Agent Clearing Member's obligations under these Rules or as otherwise required by applicable law. Each Agent Clearing Member acknowledges that a

breach of its confidentiality obligations under these Rules may result in serious and irreparable harm to the Corporation and/or DTCC for which there is no adequate remedy at law. In the event of such a breach by the Agent Clearing Member, the Corporation and/or DTCC shall be entitled to seek any temporary or permanent injunctive or other equitable relief in addition to any monetary damages hereunder.

SEC. 3. Compliance with Laws.

Each Agent Clearing Member shall comply in all material respects with all applicable laws, including applicable laws relating to securities, taxation and money laundering, as well as global sanctions laws, in connection with the use of the Corporation's services.

SEC. 4. Agent Clearing Member Transactions.

An Agent Clearing Member shall be permitted to submit to the Corporation on behalf of one or more Customers' Securities Financing Transactions ("Agent Clearing Member Transactions") in accordance with Rule 56.

SEC. 5. Agent Clearing Member Agent Obligations.

(a) An Agent Clearing Member shall be permitted to submit to the Corporation for novation Agent Clearing Member Transactions entered into by the Agent Clearing Member as agent on behalf of one or more Customers. Any such submission shall be in accordance with this Rule. Subject to the provisions of these Rules and Procedures, the Customer Clearing Service may be provided by an Agent Clearing Member to its Customers on any terms and conditions mutually agreed to by the Agent Clearing Member and its Customers; provided, that each Agent Clearing Member shall, before providing Customer Clearing Service to any Customer, enter into an agreement with that Customer that binds the Customer to the provisions of these Rules and Procedures applicable to Agent Clearing Member Transactions and Customers.

(b) With respect to an Agent Clearing Member that submits Agent Clearing Member Transactions to the Corporation for novation on behalf of its Customers, the Corporation shall maintain one or more Agent Clearing Member Customer Omnibus Accounts in the name of the Agent Clearing Member for the benefit of its Customers.

(c) The Agent Clearing Member shall act solely as agent of its Customers in connection with the clearing of Agent Clearing Member Transactions; provided, that the Agent Clearing Member shall remain fully liable for the performance of all obligations to the Corporation arising in connection with Agent Clearing Member Transactions; and provided further, that the liabilities and obligations of the Corporation with respect to Agent Clearing Member Transactions entered into by the Agent Clearing Member shall extend only to the Agent Clearing Member. Without limiting the generality of the

foregoing, the Corporation shall not have any liability or obligation arising out of or with respect to any Agent Clearing Member Transaction to any Customer on behalf of whom an Agent Clearing Member entered into the Agent Clearing Member Transaction.

(d) Nothing in these Rules and Procedures shall prohibit an Agent Clearing Member from seeking reimbursement from a Customer for payments made by the Agent Clearing Member (whether out of Clearing Fund deposits or otherwise) under these Rules and Procedures, or as otherwise may be agreed between the Agent Clearing Member and the Customer.

#### SEC. 6. Clearing Fund Obligations.

(a) The Corporation shall maintain one or more Agent Clearing Member Customer Omnibus Accounts for an Agent Clearing Member. Each Agent Clearing Member shall make and maintain so long as such Member is an Agent Clearing Member, a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in its Agent Clearing Member Customer Omnibus Account(s) (the "Agent Clearing Member Required Fund Deposit"). Each Agent Clearing Member, so long as such Member is an Agent Clearing Member, shall also provide Supplemental Liquidity Deposits to the Clearing Fund, as may be required pursuant to Rule 4A, to support the activity in its Agent Clearing Member Customer Omnibus Account(s). Deposits to the Clearing Fund shall be held by the Corporation or its designated agents, to be applied as provided in these Rules and Procedures.

(b) In the ordinary course, for purposes of satisfying the Agent Clearing Member's Clearing Fund requirements under these Rules and Procedures for its Member activity, its Agent Clearing Member activity, and, to the extent applicable, its Sponsoring Member activity, the Agent Clearing Member's proprietary accounts, its Agent Clearing Member Customer Omnibus Account(s), and its Sponsored Member Sub-Accounts, if any, shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, the Corporation may, in its sole discretion, at any time and without prior notice to the Agent Clearing Member (but being obligated to give notice to the Agent Clearing Member as soon as possible thereafter) and whether or not the Agent Clearing Member is in default of its obligations to the Corporation, treat the Agent Clearing Member's accounts as a single account for the purpose of applying Clearing Fund deposits; apply Clearing Fund deposits made by the Agent Clearing Member with respect to any account as necessary to ensure that the Agent Clearing Member meets all of its obligations to the Corporation under any other account(s); and otherwise exercise all rights to offset and net against the Clearing Fund deposits any net obligations among any or all of the accounts, whether or not any other Person is deemed to have any interest in such account.

(c) The Agent Clearing Member Required Fund Deposit for each Agent Clearing Member Customer Omnibus Account shall be calculated separately

**based on the Agent Clearing Member Transactions in such Agent Clearing Member Customer Omnibus Account, and the Agent Clearing Member shall, as principal, be required to satisfy the Agent Clearing Member Required Fund Deposit for each of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts.**

**(d) Sections 1, 2, 4, 5, 6, 7, 8, 9, 10, 11 and 12 of Rule 4 shall apply to the Agent Clearing Member Required Fund Deposit with respect to obligations of an Agent Clearing Member under these Rules and Procedures, including its obligations arising under the Agent Clearing Member Customer Omnibus Accounts, to the same extent as such sections apply to any Required Fund Deposit and any other obligations of a Member. For purposes of Section 1 of Rule 4, obligations and liabilities of a Member to the Corporation that shall be secured shall include, without limitation, a Member's obligations as an Agent Clearing Member under these Rules and Procedures, including, without limitation, any obligation of any such Agent Clearing Member to provide the Agent Clearing Member Required Fund Deposit and such Agent Clearing Member's obligations arising under SFTs established in the Agent Clearing Member Customer Omnibus Accounts of such Agent Clearing Member.**

**(e) An Agent Clearing Member shall be subject to such fines as may be imposed in accordance with such Rules or Procedures of the Corporation for any late satisfaction of a Clearing Fund deficiency call.**

#### **SEC. 7. Right of Offset.**

**In the ordinary course, with respect to satisfaction of any Customer's obligations under these Rules and Procedures, the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts, the Agent Clearing Member's proprietary accounts, and the Agent Clearing Member's Sponsored Member Sub-Accounts, if any, at the Corporation shall be treated separately, as if they were accounts of separate entities. Notwithstanding the previous sentence, however, the Corporation may, in its sole discretion, at any time any obligation of the Agent Clearing Member arises in respect of any Agent Clearing Member Customer Omnibus Account, exercise a right of offset and net any such obligation against any obligations of the Corporation to the Agent Clearing Member in respect of such Agent Clearing Member's proprietary accounts at the Corporation.**

#### **SEC. 8. Loss Allocation Obligations.**

**(a) To the extent the Corporation incurs a loss or liability from a Defaulting Member Event or a Declared Non-Default Loss Event and a loss allocation obligation arises, that would be the responsibility of the Agent Clearing Member Customer Omnibus Account as if the Agent Clearing Member Customer Omnibus Account were a Member, the Corporation shall calculate such loss**

allocation obligation and the Agent Clearing Member shall, as principal, be responsible for satisfying such obligations.

(b) The entire amount of the Required Fund Deposit associated with the Agent Clearing Member's proprietary accounts at the Corporation and the entire amount of the Agent Clearing Member Required Fund Deposit may be used to satisfy any amount allocated against an Agent Clearing Member, whether in its capacity as a Member, an Agent Clearing Member, or otherwise. With respect to an obligation to make payment due to any loss allocation amounts assessed on an Agent Clearing Member pursuant to Section 8(a) of this Rule, the Agent Clearing Member may instead elect to terminate its membership in the Corporation pursuant to Section 6 of Rule 4 and thereby benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4; however, for the purpose of determining the Loss Allocation Cap for such Agent Clearing Member, its Required Fund Deposit shall be the sum of its Required Fund Deposits associated with its proprietary accounts at the Corporation (including its proprietary SFT Account pursuant to Rule 56), its Agent Clearing Member Required Fund Deposits for each of its Agent Clearing Member Customer Omnibus Accounts, and its Sponsoring Member Required Fund Deposit, if any.

SEC. 9. Restrictions on Access to Services by an Agent Clearing Member.

(a) The Board of Directors may at any time, upon the Corporation providing notice to an Agent Clearing Member pursuant to Section 5 of Rule 45, suspend an Agent Clearing Member in its capacity as an Agent Clearing Member from any service provided by the Corporation either with respect to a particular transaction or transactions or with respect to transactions generally, or prohibit or limit such Agent Clearing Member's access to services offered by the Corporation in the event that one or more of the factors set forth in Section 1 of Rule 46 is present with respect to the Agent Clearing Member.

(b) Rule 46 shall apply with respect to an Agent Clearing Member in the same way as it applies to Members, including the Board of Directors' right to summarily suspend the Agent Clearing Member and to cease to act for such Agent Clearing Member.

(c) If the Corporation ceases to act for an Agent Clearing Member in its capacity as an Agent Clearing Member, Section 14 of Rule 56 shall apply and the Corporation shall decline to accept or process data from the Agent Clearing Member on Agent Clearing Member Transactions and close-out any Agent Clearing Member Transactions that have been novated to the Corporation. If the Corporation suspends, prohibits or limits an Agent Clearing Member in its capacity as an Agent Clearing Member with respect to such Agent Clearing Member's access to services offered by the Corporation, the Corporation shall decline to accept or process data from the Agent Clearing Member on Agent Clearing Member Transactions for so long as the Corporation is suspending, prohibiting or limiting the Agent Clearing Member. The Corporation shall close-

**out any Agent Clearing Member Transactions which have been novated to the Corporation.**

**SEC. 10. Insolvency of an Agent Clearing Member.**

**(a) An Agent Clearing Member shall be obligated to immediately notify the Corporation that (a) it fails, or is unable, to perform its contracts or obligations or (b) it is insolvent as required by Section 1 of Rule 20 for other Members. An Agent Clearing Member shall be treated by the Corporation in all respects as insolvent under the same circumstances set forth in Section 2 of Rule 20 for other Members. Section 3 of Rule 20 shall apply, in the same manner in which such section applies to other Members, in the case where the Corporation treats an Agent Clearing Member as insolvent.**

**(b) In the event that the Corporation determines to treat an Agent Clearing Member as insolvent pursuant to Rule 20, the Corporation shall have the right to cease to act for the insolvent Agent Clearing Member pursuant to Section 9 of this Rule. If the Corporation ceases to act for the insolvent Agent Clearing Member, the Corporation shall decline to accept or process data from the Agent Clearing Member, including Agent Clearing Member Transactions. The Corporation shall close-out any Agent Clearing Member Transactions which have been novated to the Corporation.**

**SEC. 11. Transfer of Agent Clearing Member Transactions in Agent Clearing Member Customer Omnibus Accounts.**

**(a) The provisions of this Section 11 shall only apply (i) with respect to Agent Clearing Member Transactions that have been novated to NSCC, (ii) in the event the relevant Agent Clearing Member is not a Defaulting Member and (iii) a Corporation Default has not occurred.**

**(b) To the extent permitted under applicable laws and regulations, an Agent Clearing Member may, upon a default of a Customer and the consent of the Corporation, transfer the Agent Clearing Member Transactions of the Customer established in one or more of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts from such Agent Clearing Member Customer Omnibus Accounts to the Agent Clearing Member's proprietary account at the Corporation as a Member. Any such transfer shall occur by novation, such that the obligations between the Corporation and the relevant Customer in respect of the Agent Clearing Member Transactions shall be terminated and replaced with identical obligations between the Corporation and the Agent Clearing Member, acting as principal. The Agent Clearing Member shall indemnify the Corporation, and its employees, officers, directors, shareholders, agents and Members, for any and all losses, liability, or expenses incurred by them arising from, or in relation to, any such transfer.**

**SEC. 12. Customer Acknowledgments**

**Each Agent Clearing Member on behalf of each of its Customers agrees that such Customer, by participating in and entering into Agent Clearing Member Transactions through the Agent Clearing Member, understands, acknowledges, and agrees that:**

**(a) the service provided by the Corporation with regard to the Customer Clearing Service will be subject to and governed by these Rules and Procedures;**

**(b) these Rules and Procedures shall govern the novation of Agent Clearing Member Transactions and all transactions between the Customer and its Agent Clearing Member resulting in the novation of such transactions, and at the time of novation of an Agent Clearing Member Transaction, the Customer on whose behalf it was submitted will be bound by the Agent Clearing Member Transaction automatically and without any further action by the Customer or by its Agent Clearing Member, and the Customer agrees to be bound by the applicable provisions of these Rules and Procedures in all respects;**

**(c) the Corporation shall be under no obligation to deal directly with the Customer, and the Corporation may deal exclusively with the Customer's Agent Clearing Member;**

**(d) the Corporation shall have no obligations to the Customer with respect to any Agent Clearing Member Transactions submitted by an Agent Clearing Member on behalf of the Customer, including with respect to any payment or delivery obligations; and**

**(e) the Customer shall have no right to receive from the Corporation, or any right to assert a claim against the Corporation with respect to, nor shall the Corporation be liable to the Customer for, any payment or delivery obligation in connection with any Agent Clearing Member Transactions submitted by an Agent Clearing Member on behalf of the Customer, and the Corporation shall make any such payments or redeliveries solely to the relevant Agent Clearing Member.**

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### RULE 3. LISTS TO BE MAINTAINED

SEC. 1. (a) The Corporation shall maintain a list of the securities which may be the subject of contracts cleared through the Corporation (hereinafter referred to as "Cleared Securities"), and may from time to time add securities to such list or remove securities therefrom. Unless the Corporation shall otherwise determine, Cleared Securities may only be those issues of securities the issuer of which is subject to, or regularly complies with, Rule 10b-17 of the SEC, promulgated pursuant to the Exchange Act. The Corporation shall accept an issue of securities as a Cleared Security only upon a determination by the Corporation that it has the existing operational capability to do so and to continue successfully to provide its services to Members.

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(f) The Corporation shall maintain a list of Eligible ID Net Securities as defined in Rule 65 and may from time to time add CNS Securities to such list or remove CNS Securities therefrom.

**(g) The Corporation shall maintain a list of the securities that may be the subject of a novated Securities Financing Transaction and may from time to time add securities to such list or remove securities therefrom.**

SEC. 2. The Corporation shall maintain a list of Eligible Clearing Fund Securities.

SEC. 3. (a) The Corporation shall maintain a list of those Persons who are entitled under the provisions of New York law to pay New York State stock transfer taxes through the facilities of the Corporation.

(b) The Corporation shall maintain a list of Members, **and** Limited Members, **and Sponsored Members** as set forth in Rule 2.

(c) The Corporation shall maintain a list of broker dealers and others on whose behalf Members have indicated they will act in comparing, clearing and/or settling trades. Members shall provide the Corporation with such information, in accordance with the Procedures as may be adopted from time to time by the Corporation, or pursuant to agreement.

(d) The Corporation shall maintain a list of Members and Settling Bank Only Members that have agreed to act as Settling Banks.

SEC. 4. Members, **Sponsored Members**, Mutual Fund/Insurance Services Members, Fund Members, Insurance Carrier/Retirement Services Members, Municipal Comparison Only Members, TPA Members, TPP Members, Investment Manager/Agent Members, and AIP Members shall not:

(a) submit to the Corporation for processing, or

(b) request the inclusion on any list maintained pursuant to this Rule 3 of, any security or other financial instrument if its issuer is: (i) listed on the Office of Foreign Assets Control ("OFAC") list of specially designated nationals distributed by the U.S. Department of the Treasury, or (ii) incorporated in a country that is on the OFAC list of countries subject to comprehensive sanctions.

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## 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.<sup>1</sup> 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, **excluding Required SFT Deposit**, for each Member shall be \$250,000. 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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<sup>1</sup> 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.

## RULE 5. GENERAL PROVISIONS

SEC. 1. Receive data covering the buy side and deliver data covering the sell side of any contract calling for delivery of Cleared Securities may be sent for comparison by a Member to the Corporation; such contracts shall be compared by the Corporation to the extent provided for under these Rules and the Procedures. Trade Data may also be provided to the Corporation on a locked-in basis as provided pursuant to the Rules and the Procedures. Output made available by the Corporation on: (i) contracts compared by the Corporation, and (ii) locked-in transactions recorded by the Corporation from data received from a Member or Self-Regulatory Organization (collectively, "Compared Contracts"), shall evidence valid, binding and enforceable compared transactions for purposes of these Rules (notwithstanding with respect to locked-in transactions that the underlying data is not matched with corresponding data submitted to the Corporation by the affected contra-Member). Compared Contracts for CNS Securities and other transactions in respect of CNS Securities submitted to the Corporation under these Rules ("CNS Contracts") shall be accounted for in the CNS System; Compared Contracts for Balance Order Securities and other transactions in respect of Balance Order Securities submitted to the Corporation under these Rules ("Balance Order Contracts") shall be accounted for in the Balance Order System; Compared Contracts for Foreign Securities and other transactions in respect of Foreign Securities submitted to the Corporation under these Rules ("Foreign Security Contracts") shall be accounted for in the Foreign Security System. Delivery of CNS Securities to the Corporation, except as specified in Section 9 of Rule 11, shall be made through the facilities of the Corporation or a Qualified Securities Depository and payment therefore shall be made through the Corporation or such agent as it may designate; delivery of Balance Order Securities may be made through the Corporation in which case payment therefore shall be made through the Corporation or such agent as it may designate; delivery of Foreign Securities shall be made pursuant to arrangements mutually agreed upon by the parties, and the Rules of the Corporation shall not govern such delivery or the failure to deliver such securities; **delivery of SFT Securities and SFT Cash to the Corporation shall be made through the facilities of a Qualified Securities Depository.** Such comparison, accounting, and, with respect to CNS Securities, **and Balance Order Securities, SFT Securities and SFT Cash,** delivery and payment shall be effected as hereinafter prescribed in these Rules, in such regulations with respect thereto as the Corporation may from time to time adopt and in the Procedures.

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RULE 24. CHARGES FOR SERVICES RENDERED

SEC. 1. Each Member, **Sponsored Member**, Mutual Fund/Insurance Services Member, Municipal Comparison Only Member, Insurance Carrier/Retirement Services Member, TPA Member, TPP Member, Investment Manager/Agent Member, Fund Member, Data Services Only Member and AIP Member (each hereinafter referred to as a “participant” for purposes of this Rule 24) shall pay such fees and charges to the Corporation as shall be specified by the Corporation or in the Procedures and approved by the Board of Directors on a reasonable and non-discriminatory basis.

**Members shall be responsible for all fees pertaining to their respective Sponsoring Member activity or Agent Clearing Member activity, if applicable, as set forth in the Corporation’s Fee Structure.**

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RULE 26. BILLS RENDERED

The Corporation will render bills to Members, **Sponsored Members**, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members, TPA Members, TPP Members, Investment Manager/Agent Members, Fund Members and AIP Members for charges on account of the business of any month and will charge their respective accounts with the amounts thereof on or before such date as determined by the Corporation from time to time. **Members shall receive bills for their respective aggregate Sponsoring Member activity and Agent Clearing Member activity, if applicable, as set forth in the Fee Structure.**

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## RULE 32. SIGNATURES

With respect to any and all agreements and other documents entered into between a Member, **Sponsored Member** and Limited Member and the Corporation, or otherwise delivered to or by the Corporation pursuant to these Rules and Procedures, the use of an electronic signature shall have the same validity and effect as the use of a signature affixed by hand.

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RULE 38. GOVERNING LAW AND CAPTIONS

SEC. 1 Governing Law

These Rules and Procedures and all agreements and other documents entered into between a Member, **Sponsored Member** or Limited Member and the Corporation, or otherwise delivered to or by the Corporation pursuant to these Rules and Procedures, and the rights and obligations under the Rules and Procedures thereunder, shall be governed by, and construed in accordance with, the laws of the State of New York applicable to contracts executed and performed therein, unless otherwise expressly provided.

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## RULE 39. RELIANCE ON INSTRUCTIONS

The Corporation may accept or rely upon any instruction given to the Corporation by a Member, **Sponsored Member**, Mutual Fund/Insurance Services Member, Municipal Comparison Only Member, Fund Member, Insurance Carrier/Retirement Services Member, TPA Member, TPP Member, Data Services Only Member, AIP Member or Special Representative, ~~or~~ Index Receipt Agent **or Approved SFT Submitter** (each hereinafter referred to as a “participant” for purposes of this Rule 39), including wire transmission, physical delivery or delivery by other means of instructions recorded on magnetic tape or other media or of facsimile copies of instructions, in form acceptable to the Corporation and in accordance with the Procedures, which reasonably is understood by the Corporation to have been delivered to the Corporation by such participant. In the case of instructions given by a Special Representative, ~~or~~ Index Receipt Agent **or Approved SFT Submitter**, Investment Manager/Agent Member, TPP Member, or TPA Member, the Corporation shall be entitled to act pursuant to any such instruction as though such instruction had been received from the Member **or Sponsored Member** for which the Special Representative, ~~or~~ Index Receipt Agent **or Approved SFT Submitter** or TPP Member, TPA Member or Investment Manager/Agent Member is acting.

Any participant delivering instructions as provided above, or on whose behalf a Special Representative, **Approved SFT Submitter**, TPA Member, TPP Member, or Investment Manager/Agent Member, shall deliver instructions as provided above, shall indemnify the Corporation, and any of its employees, officers, directors, shareholders, agents, and participants who may sustain any loss, liability or expense as a result of (a) any act done in reliance upon the authenticity of any instruction received by the Corporation, (b) the inaccuracy of the information contained therein or (c) effecting transactions in reliance upon such information or instruction against any such loss, liability or expense so long as such transactions are effected in accordance with such information and instructions even though they are inaccurate or not authentic and so long as the person asserting a right to indemnification shall not have knowledge of such inaccuracy or lack of authenticity at the time of the event or events giving rise to such loss, liability or expense.

Notwithstanding the foregoing, the Corporation will not act upon any instruction purporting to have been given by a participant which is received by wire transmission or in the form of facsimile copies or magnetic tape or media other than written instructions or from a Special Representative, **Approved SFT Submitter**, TPA Member, TPP Member, or Investment Manager/Agent Member, commencing one Business Day after the Corporation receives written notice from the participant that the Corporation shall not accept such instructions until such time as the participant shall withdraw such notice.

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RULE 42. WIND-DOWN OF THE CORPORATION

SEC 1. Defined Terms

(a) For purposes of this Rule 42:

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“Limited Member” means a Limited Member or Sponsored Member of the Corporation (other than a Settling Bank Only Member) or a Limited Member or Sponsored Member of the Transferee (other than a Settling Bank Only Member), as the context requires.

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RULE 49. RELEASE OF CLEARING DATA AND CLEARING FUND DATA

(a) Absent valid legal process or as provided in paragraph (b) hereof, the Corporation will only release Clearing Data relating to transactions of a particular participant and Clearing Fund Data to such participant upon his written request; **however, if the participant is a Sponsored Member, the Corporation will also release Clearing Data relating to transactions of such participant to such participant's Sponsoring Member upon the Sponsoring Member's written request.**

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~~RULE 56. (RULE NUMBER RESERVED FOR FUTURE USE)~~

**RULE 56. SECURITIES FINANCING TRANSACTION CLEARING SERVICE**

**SEC. 1. General.**

**(a) The Corporation may accept for novation Securities Financing Transactions (SFTs) entered into between (i) a Member and another Member, (ii) a Sponsoring Member and its Sponsored Member, or (iii) an Agent Clearing Member acting on behalf of a Customer and either (x) a Member or (y) the same or another Agent Clearing Member acting on behalf of a Customer.**

**(b) Any SFT that is submitted to the Corporation for novation, and any Member and Sponsored Member that enters into an SFT (and any Customer on behalf of whom an Agent Clearing Member enters into an SFT) shall be subject to the provisions of this Rule 56; provided that Sections 15 and 16 of this Rule shall only apply to Sponsoring Members, Agent Clearing Members, Sponsored Members and Customers, as applicable.**

**(c) Any amount of cash described in this Rule 56 may be rounded up to the nearest one cent, five cents, 10 cents, 25 cents or dollar according to the rounding convention requested by the SFT Member parties to the relevant SFT as conveyed to the Corporation in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose.**

**SEC. 2. Eligibility for SFT Clearing Service: SFT Member.**

**The Corporation may permit any Member acting in its principal capacity, Sponsored Member acting in its principal capacity or Agent Clearing Member acting on behalf of a Customer to be an SFT Member and participate in the SFT Clearing Service.**

**The rights, liabilities and obligations of SFT Members in their capacity as such shall be governed by this Rule 56. References to a Member in other Rules and Procedures shall not apply to an SFT Member in its capacity as such, unless specifically noted in this Rule or in such other Rules and Procedures as applicable to an SFT Member.**

**An SFT Member that participates in the Corporation in another capacity pursuant to another Rule or Procedure of this Corporation, or which has entered into an agreement with the Corporation independent from this Rule, shall continue to have all the rights, liabilities and obligations set forth in such other Rule or Procedure or pursuant to such agreement, and such rights, liabilities and obligations shall be separate from its rights, liabilities and obligations as an SFT Member, except as contemplated under Sections 15 and 16 of this Rule.**

**SEC. 3. Membership Documents.**

**To become an SFT Member, each applicant shall complete and deliver to the Corporation documents in such forms as may be prescribed by the Corporation from time to time and any other information requested by the Corporation.**

**SEC. 4. Securities Financing Transaction Data Submission.**

**(a) In order for an SFT to be submitted to the Corporation, the transaction data for the SFT must be submitted to the Corporation by an Approved SFT Submitter in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose. Any such transaction data shall be submitted to the Corporation on a locked-in basis. In determining whether to accept transaction data from an Approved SFT Submitter, the Corporation may require the Approved SFT Submitter to provide a Cybersecurity Confirmation, as described in Rule 2B, Section 2.A.**

**(b) The Corporation will not act upon any instruction received from an Approved SFT Submitter in respect of an SFT unless each SFT Member (other than an SFT Member that is a Sponsored Member) designated by the Approved SFT Submitter as a party to such SFT has consented, in a writing delivered to the Corporation, to the Approved SFT Submitter acting on behalf of the SFT Member in respect of SFTs.**

**(c) The obligations reflected in the transaction data on an SFT shall be deemed to have been confirmed and acknowledged by each SFT Member designated by the Approved SFT Submitter as a party thereto and to have been adopted by such SFT Member and, for the purposes of determining the rights and obligations between the Corporation and such SFT Member under this Rule and such other Rules or Procedures applicable to SFTs, shall be valid and binding upon such SFT Member. An SFT Member which has been so designated by an Approved SFT Submitter shall resolve any differences or claims regarding the rights and obligations reflected in the transaction data submitted by the Approved SFT Submitter with the Approved SFT Submitter, and the Corporation shall have no responsibility in respect thereof or to adjust its records or the accounts of the SFT Member in any way, other than pursuant to the instructions of the Approved SFT Submitter. Any such adjustment shall be in the sole discretion of the Corporation.**

**(d) The Corporation makes no representation, whether expressed or implied, as to the complete and timely performance of an Approved SFT Submitter's duties and obligations. The Corporation assumes no liability to any SFT Member for any act or failure to act by an Approved SFT Submitter in connection with any information received by the Corporation or given to the SFT Member by the Corporation via the Approved SFT Submitter, as the case may be.**

(e) The submission of each SFT to the Corporation and the performance of any obligation under such SFT shall constitute a representation to the Corporation and covenant by the Transferor and the Transferee, any Sponsoring Member that is acting on behalf of the Transferor or Transferee and any Agent Clearing Member that is acting on behalf of a Customer in connection with such SFT that its participation in such SFT is in compliance, and will continue to comply, with all applicable laws and regulations, including without limitation Rule 15c3-3 and all other applicable rules and regulations of the SEC, any applicable provisions of Regulation T, Regulation U and Regulation X of the Board of Governors of the Federal Reserve System, and the rules of FINRA and any other regulatory or self-regulatory organization to which the Transferor, the Transferee, any Sponsoring Member that is acting on behalf of the Transferor or Transferee or any Agent Clearing Member that is acting on behalf of a Customer is subject.

(f) The submission of each SFT to the Corporation shall constitute an authorization to the Corporation by the Transferor, the Transferee and any Agent Clearing Member that is acting on behalf of a Customer for the Corporation to give instructions regarding the SFT to DTC in respect of the relevant accounts of the Transferor, Transferee and Agent Clearing Member at DTC.

#### SEC. 5. Novation of Securities Financing Transactions.

(a) The Corporation will only novate an SFT if, at the time of novation, the Final Settlement of such transaction is scheduled to occur one Business Day following the Initial Settlement and the SFT Cash is no less than 100% of the Contract Price of the SFT.

(b) Each SFT that is a Bilaterally Initiated SFT, including any Sponsored Member Transaction, and validated pursuant to these Rules and Procedures shall be novated to the Corporation as of the time the Corporation provides the Approved SFT Submitter for such SFT a report confirming such novation in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose. Each SFT that is neither a Bilaterally Initiated SFT nor a Sponsored Member Transaction and that is validated pursuant to these Rules and Procedures shall be novated to the Corporation as of the time (x) the Initial Settlement of such SFT has completed by (i) the Transferor instructing DTC to deliver from the relevant DTC account of the Transferor to the Corporation's account at DTC the subject SFT Securities versus payment of the amount of the SFT Cash, (ii) the Corporation instructing DTC to deliver from the Corporation's account at DTC to the relevant DTC account of the Transferee the subject SFT Securities versus payment of the amount of SFT Cash and (iii) DTC processes the deliveries in accordance with the rules and procedures of DTC, or (y) the Initial Settlement obligations of such SFT have been discharged in accordance with Section 8 of this Rule. If the Initial Settlement obligations of an SFT that is neither a Bilaterally Initiated SFT nor a Sponsored Member Transaction are not discharged in accordance with clause (x) or (y), then such SFT shall be deemed void *ab initio*.

(c) Subject to subsections (d) and (e) below of this Section 5, the novation of SFTs shall consist of the termination of the Final Settlement, Rate Payment and Distribution Payment obligations and entitlements between the parties to the SFT with respect to such SFT and their replacement with obligations and entitlements to and from the Corporation to perform, in accordance with these Rules and Procedures, the Final Settlement, Rate Payment, and Distribution Payment obligations and entitlements under the SFT.

(d) Novation in Respect of SFTs Having Incremental Additional Independent Amount SFT Cash

(i) If an SFT has Incremental Additional Independent Amount SFT Cash, then, unless the SFT is a Sponsored Member Transaction and the Sponsoring Member is the Transferee, the obligation of the Transferor to return the Incremental Additional Independent Amount SFT Cash to the Transferee shall not be terminated and novated to the Corporation (nor shall the Corporation otherwise be required to return such Incremental Additional Independent Amount SFT Cash), except to the extent that the Transferor, Sponsoring Member or Agent Clearing Member, as applicable, has satisfied the associated Independent Amount SFT Cash Deposit Requirement.

(ii) To the extent the Transferor, Sponsoring Member or Agent Clearing Member has not satisfied the associated Independent Amount SFT Cash Deposit Requirement, the Transferor's (or in the case of a Non-Returned SFT, the Corporation's) obligation to return the Incremental Additional Independent Amount SFT Cash shall:

1. If the SFT is an Agent Clearing Member Transaction for which the Agent Clearing Member, acting on behalf of the Customer, is the Transferor, be terminated and replaced with an obligation of the Agent Clearing Member, in its capacity as principal, to return the Incremental Additional Independent Amount SFT Cash to the Transferee; or

2. Otherwise, remain (or in the context of a Non-Returned SFT, be terminated and replaced with) a bilateral obligation of the Transferor to the Transferee.

(iii) Each SFT Member agrees that any obligation to return Incremental Additional Independent Amount SFT Cash that is novated to an Agent Clearing Member or that remains (or becomes) a bilateral obligation of the Transferor to the Transferee in accordance with (ii) above is a binding and enforceable obligation of the Agent Clearing Member or Transferor, as applicable, regardless of whether the Transferee has entered into an Existing Master Agreement with the Agent Clearing Member or Transferor. Each SFT Member further agrees that any such obligation shall

only be due and payable to the Transferee upon the final discharge of the Corporation's Final Settlement obligations to the Transferor under the portion of the SFT that has been novated to the Corporation in accordance with Section 5(b) of this Rule.

(iv) Until the Transferor, Sponsoring Member or Agent Clearing Member has satisfied in full its Independent Amount SFT Cash Deposit Requirement, the SFT Cash of the SFT shall, for purposes of determining the obligations owing to and from the Corporation under such SFT, equal the SFT Cash of the SFT less the Incremental Additional Independent Amount SFT Cash.

(v) Once the Transferor, Sponsoring Member or Agent Clearing Member, as applicable, has satisfied in full its Independent Amount SFT Cash Deposit Requirement, the obligation of the Transferor to return the Incremental Additional Independent Amount SFT Cash to the Transferee (or, in the case of an SFT that is an Agent Clearing Member Transaction, any obligation of the Agent Clearing Member to return the Incremental Additional Independent Amount SFT Cash to the Transferee) shall be novated to the Corporation, and the SFT Cash of the SFT shall, for purposes of determining the obligations owing to and from the Corporation under the SFT, include the full amount of the SFT Cash of such SFT.

(e) Novation in Respect of Certain Corporate Actions

(i) Regardless of anything to the contrary in any Existing Master Agreement (including a provision addressing when an issuer pays different amounts to different security holders due to withholding tax or other reasons), the Distribution Payment obligations and entitlements between the Corporation and each party to an SFT that has been novated to the Corporation shall be the obligation of the Corporation to pay to the Transferor and the obligation of the Transferee to pay to the Corporation the Distribution Amount in respect of each Distribution and the corresponding entitlements of the Transferor and the Corporation, in each case, in accordance with these Rules and Procedures.

(ii) The Corporation shall maintain a list of corporate actions and distributions that the Corporation does not support with respect to SFTs. No Final Settlement, Rate Payment, Distribution Payment or other obligation resulting from a corporate action or distribution that is not supported by the Corporation shall be novated to the Corporation. Nor shall any such corporate action modify the Final Settlement, Rate Payment, Distribution Payment or other obligations of the Corporation, Transferor and Transferee under an SFT that has been novated to the Corporation. Each SFT Member agrees that any obligation under an SFT resulting from a corporate action or distribution not supported by the Corporation shall remain a binding and enforceable bilateral obligation between the



**Transferor and the Transferee, regardless of whether the Transferor and Transferee have entered into an Existing Master Agreement.**

**(f) The novation of SFTs shall not affect the fundamental substance of the SFT as a transfer of securities by one party in exchange for a transfer of cash by the other party and an agreement by each party to return the property it received and shall not affect the economic obligations or entitlements of the parties under the SFT except that following novation, the Final Settlement, Rate Payment and Distribution Payment obligations and entitlements shall be owed to and by the Corporation rather than the original counterparty under the SFT.**

**(g) The representations and warranties made by each of the parties to an SFT that has been novated to the Corporation under the parties' Existing Master Agreement, if any, shall (x) to the extent that they are inconsistent with the Rules and Procedures of the Corporation, be eliminated and replaced with the Rules and Procedures of the Corporation and (y) to the extent that they are not inconsistent with the Rules and Procedures of the Corporation, remain in effect as between the parties to the original SFT, but shall not impose any additional obligations on the Corporation.**

**SEC. 6. Rate and Distributions.**

**(a) The Corporation shall debit and credit the Rate Payment from and to the SFT Accounts of the SFT Member parties to an SFT that has been novated to the Corporation as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII on the scheduled Final Settlement Date for the SFT, irrespective of whether Final Settlement of such SFT occurs on such date.**

**(b) If (x) a cash dividend is made on or in respect of an SFT Security that is the subject of an SFT that has been novated to the Corporation or (y) cash is exchanged, in whole or in part, for such an SFT Security in a merger, consolidation or similar transaction, and the Transferor under the SFT would have been entitled to a cash payment related to the event described in clause (x) or (y) had it not transferred the SFT Securities that are the subject of the SFT to the Transferee in the Initial Settlement, then the Corporation shall, within the time period determined by the Corporation from time to time, credit the Distribution Amount to the Transferor's SFT Account and debit the Distribution Amount from the Transferee's SFT Account as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII. If cash is exchanged in whole for such an SFT Security, then the completion of the actions described in the preceding sentence shall discharge the Corporation's Final Settlement obligations to the relevant Transferor and the Transferee's Final Settlement obligations to the Corporation.**

**SEC. 7. Final Settlement of Securities Financing Transactions.**

**Subject to the provisions of Section 11 of this Rule, the Final Settlement of an SFT that has been novated to the Corporation shall be scheduled to occur on the Business Day immediately following the date the SFT was novated to the Corporation. Unless the Final Settlement obligations under such an SFT are discharged in accordance with Section 8 of this Rule, Final Settlement of the SFT shall occur by (x) the Corporation instructing DTC to (i) deliver from the relevant DTC account of the Transferee to the Corporation's account at DTC the subject SFT Securities versus payment of the amount of SFT Cash and (ii) deliver from the Corporation's account at DTC to the relevant DTC account of the Transferor the subject SFT Securities versus payment of the amount of SFT Cash, and (y) the processing of such deliveries by DTC in accordance to the rules and procedures of DTC; provided that if such transfers do not occur and a Buy-In does not occur in respect of the SFT, then the Final Settlement Date shall be rescheduled for the following Business Day as described in Section 9 of this Rule. The obligation of a Transferor (or a Sponsoring Member that guarantees to the Corporation the obligation of a Transferor or an Agent Clearing Member that is responsible for the performance of the obligation under an SFT that is an Agent Clearing Member Transaction to return SFT Cash to the Corporation) in respect of the Final Settlement of an SFT that has been novated to the Corporation shall be to pay the SFT Cash and, if applicable, the Rate Payment to the Corporation against the transfer of the relevant SFT Securities by the Corporation. The obligation of a Transferee (or a Sponsoring Member that guarantees to the Corporation the obligation of a Transferee or an Agent Clearing Member that is responsible for the performance of the obligation under an SFT that is an Agent Clearing Member Transaction to return SFT Securities to the Corporation) in respect of the Final Settlement of an SFT that has been novated to the Corporation shall be to transfer the SFT Securities and, if applicable, the Rate Payment to the Corporation against the transfer of SFT Cash by the Corporation.**

**An SFT, or a portion thereof, shall be deemed complete and final upon Final Settlement of the SFT, or such portion, whether pursuant to this Section 7, Section 8, Section 9(d) or Section 13(c). From and after the Final Settlement of an SFT, or a portion thereof, pursuant to any such section, the Corporation shall be discharged from its obligations to the Transferor and the Transferee, and the Corporation shall have no further obligation in respect of the SFT, or such portion.**

**SEC. 8. Discharge of Offsetting Final Settlement and Initial Settlement Obligations.**

**(a) Subject to the provisions of Section 13(c) of this Rule, if, on any Business Day, the pre-novation SFT Member parties to a Settling SFT enter into a Linked SFT and the Approved SFT Submitter provides an appropriate instruction to the Corporation in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose, the**

**Final Settlement obligations of the parties to the Settling SFT and the Initial Settlement obligations of the parties to the Linked SFT shall be discharged once the Corporation has instructed DTC to debit and credit the relevant DTC accounts, of the SFT Member parties, as described in subsection (b) of this Section 8 and DTC processes such debits and credits in accordance with the rules and procedures of DTC. To the extent the Price Differential is not processed by DTC in accordance with the rules and procedures of DTC, the Corporation shall debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII. If the Price Differential is positive, the Corporation shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account. If the Price Differential is negative, the Corporation shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account. However, if the Linked SFT has as its subject fewer SFT Securities than the Settling SFT, then only the following Final Settlement obligations under the Settling SFT shall be discharged in accordance with this Section 8: (i) the Transferee's and Corporation's Final Settlement obligations in respect of a quantity of SFT Securities equal to the quantity of SFT Securities that are the subject of the Linked SFT and (ii) the Transferor's and Corporation's Final Settlement obligations in respect of the Corresponding SFT Cash.**

**(b) If the Price Differential is positive, the Corporation shall (x) instruct DTC to debit an amount equal to the Price Differential from the Corporation's account at DTC and credit such amount to the relevant DTC account of the Transferee and (y) instruct DTC to debit an amount equal to the Price Differential from the relevant DTC account of the Transferor and credit such amount to the Corporation's account at DTC. If the Price Differential is negative, the Corporation shall (x) instruct DTC to debit an amount equal to the absolute value of the Price Differential from the Corporation's account at DTC and credit such amount to the relevant DTC account of the Transferor and (y) instruct DTC to debit an amount equal to the absolute value of the Price Differential from the relevant DTC account of the Transferee and credit such amount to the Corporation's account at DTC.**

#### **SEC. 9. Non-Returned Securities Financing Transactions and Recalls.**

**(a) If (x) the Transferee does not satisfy its Final Settlement obligations in respect of an SFT that has been novated to the Corporation on the Final Settlement Date, (y) such Final Settlement obligations have not been discharged in accordance with the provisions of Section 8 of this Rule, and (z) a Buy-In has not occurred in respect of such SFT or a portion thereof (such SFT, a "Non-Returned SFT"), the Final Settlement Date of the Non-Returned SFT shall be rescheduled for the following Business Day, and the Corporation shall instruct DTC to debit and credit the relevant DTC accounts of the SFT Member parties, as**

described in subsection (b) of Section 8. To the extent the Price Differential is not processed by DTC in accordance with the rules and procedures of DTC, the Corporation shall debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the Non-Returned SFT as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII. If the Price Differential is positive, the Corporation shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account. If the Price Differential is negative, the Corporation shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account.

(b) If the Corporation receives a Recall Notice in respect of an SFT that has been novated to the Corporation and the Transferee does not satisfy its Final Settlement obligations by the Recall Date for the Recall Notice, the Transferor may, in a commercially reasonable manner, purchase some or all of the SFT Securities that are the subject of the SFT or elect to be deemed to have purchased the SFT Securities, in each case in accordance with such timeframes and deadlines as established by the Corporation for such purpose (a "Buy-In"); provided that in the case of a Default-Related SFT, the commercial reasonableness of a Buy-In shall be determined by the Corporation based on whether, in the opinion of the Corporation, such Buy-In would create a disorderly market in the relevant SFT Security. Following such purchase or deemed purchase, the Transferor shall (x) give written notice to the Corporation of the Transferor's costs to purchase the relevant SFT Securities (including the price paid by the Transferor and any broker's fees and commissions and reasonable out-of-pocket transaction costs, fees or interest expenses incurred in connection with such purchase) (such costs, the "Buy-In Costs") or, if the Transferor elects to be deemed to have purchased the SFT Securities, the Deemed Buy-In Costs, and (y) indemnify the Corporation, and its employees, officers, directors, shareholders, agents and Members (collectively the "Buy-In Indemnified Parties"), for any and all losses, liability or expenses of a Buy-In Indemnified Party arising from any claim disputing the calculation of the Buy-In Costs, the Deemed Buy-In Costs or the method or manner of effecting the Buy-In. Each SFT Member acknowledges and agrees that each SFT Security is of a type traded in a recognized market and that, in the absence of a generally recognized source for prices or bid or offer quotations for any SFT Security, the Transferor may, for purposes of a Buy-In, establish the source therefor in its commercially reasonable discretion. Each SFT Member further acknowledges and agrees that the Corporation will not calculate any Buy-In Costs or Deemed Buy-In Costs and shall have no liability for any such calculation. The Corporation hereby assigns to any Transferee whose SFT is subject to a Buy-In any rights it may have against the Transferor to dispute the Transferor's calculation of the Buy-In Costs or Deemed Buy-In Costs.

(c) On the Business Day following the Corporation's receipt of written notice of the Transferor's Buy-In Costs, the Corporation shall debit and credit the Buy-In Amount from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII. If the Buy-In Amount is positive, the Corporation will (x) credit the value of the Buy-In Amount to the Transferor's SFT Account and (y) debit the value of the Buy-In Amount from the Transferee's SFT Account. If the Buy-In Amount is negative, the Corporation will (x) credit the value of the Buy-In Amount to the Transferee's SFT Account and (y) debit the value of the Buy-In Amount from the Transferor's SFT Account.

(d) Following the application of such Buy-In Amount, the Final Settlement obligations under the SFT shall be discharged; provided that if the Transferor effected a Buy-In in respect of some but not all of the SFT Securities that are the subject of an SFT, then only the following obligations shall be discharged: (i) the Transferee's and Corporation's Final Settlement obligations in respect of the SFT Securities for which the Transferor effected the Buy-In and (ii) the Transferor's and Corporation's Final Settlement obligations in respect of the Corresponding SFT Cash.

(e) A Recalled SFT shall be treated as a Non-Returned SFT by the Corporation until the earlier of the time that the SFT settles or a Buy-In is processed by the Corporation in accordance with this Section 9, except that the additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of this Rule shall not apply. If the Transferor effects the Buy-In in respect of some, but not all, of the SFT Securities that are the subject of a Recalled SFT, the Final Settlement obligations of the Recalled SFT that are not discharged in accordance with subsection (d) of this Section 9 shall be treated as a Non-Returned SFT until the SFT settles or a Buy-In is processed by the Corporation in accordance with this Section 9, and the additional SFT Deposit required under Section 12(c) of this Rule for Non-Returned SFTs shall apply.

#### SEC. 10. Cancellation, Modification and Termination of Securities Financing Transactions.

(a) Transaction data on an SFT that has not been novated to the Corporation may be cancelled upon receipt by the Corporation of appropriate instructions from the Approved SFT Submitter with respect to such SFT on behalf of both SFT Member parties thereto, submitted in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose. An SFT that is so cancelled by the Corporation will be deemed to be void *ab initio*.

(b) The Rate Payment on an SFT that has been novated to the Corporation may be modified upon receipt by the Corporation of appropriate instructions from the Approved SFT Submitter with respect to such SFT, submitted in accordance with the communication links, formats, timeframes and

deadlines established by the Corporation for such purpose. Any instructions submitted by an Approved SFT Submitter to modify the Rate Payment of an SFT must be submitted on behalf of both SFT Member parties to the SFT.

(c) An SFT that has been novated to the Corporation in accordance with Section 5 of this Rule may be terminated upon receipt by the Corporation of appropriate instructions from the Approved SFT Submitter with respect to such SFT on behalf of both SFT Member parties thereto, submitted in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purposes. Following any such termination, no amounts or further obligations shall be owing in respect of the SFT between the Corporation and Transferor or the Corporation and the Transferee.

#### SEC. 11. Accelerated Final Settlement.

The Transferee may accelerate the scheduled Final Settlement of an SFT that has been novated to the Corporation upon receipt by the Corporation of appropriate instruction from the Approved SFT Submitter with respect to such SFT, submitted in accordance with the communication links, formats, timeframes and deadlines established by the Corporation for such purpose. Such accelerated Final Settlement shall be effected by the Corporation in accordance with the provisions of Section 7 of this Rule.

#### SEC. 12. Clearing Fund Obligations.

(a) Each SFT Member, other than an SFT Member that is a Sponsored Member, shall make and maintain on an ongoing basis a deposit to the Clearing Fund with respect to its SFT Positions (the "SFT Deposit"). For the avoidance of doubt, the SFT Positions for an SFT Member that is a Sponsoring Member shall include all SFT Positions held in its Sponsored Member Sub-Account(s) in addition to its proprietary account(s).

(b) The SFT Deposit shall be held by the Corporation or its designated agents as part of the Clearing Fund, to be applied as provided in Sections 1 through 12 of Rule 4.

(c) The Corporation shall calculate the amount of each such SFT Member's required deposit for SFT Positions, subject to a \$250,000 minimum (excluding the minimum contribution to the Clearing Fund as required by Procedure XV, Section II.(A)), by applying the Clearing Fund formula for CNS

**Transactions in Sections I.(A)(1)(a),<sup>2</sup> (b), (c), (e), (f), (g)<sup>3</sup> of Procedure XV as well as the additional Clearing Fund formula in Section I.(B)(5) (Intraday Mark-to-Market Charge) of Procedure XV, except as noted otherwise, in the same manner as such sections apply to CNS Transactions submitted to the Corporation for regular way settlement, plus, with respect to any Non-Returned SFT, an additional charge that is calculated by (x) multiplying the Current Market Price of the SFT Securities that are the subject of such Non-Returned SFTs by the number of such SFT Securities that are the subject of the SFT and (y) multiplying such product by (i) 5% for SFT Members rated 1 through 4 on the Credit Risk Rating Matrix, (ii) 10% for SFT Members rated 5 or 6 on the Credit Risk Rating Matrix, or (iii) 20% for SFT Members rated 7 on the Credit Risk Rating Matrix shall be applied to each SFT Member that is a party thereto (collectively, the “Required SFT Deposit”); provided, however, notwithstanding anything to the contrary, (x) a minimum of 40% of an SFT Member’s Required SFT Deposit shall be made in the form of cash and/or Eligible Clearing Fund Treasury Securities and (y) the lesser of \$5,000,000 or 10% of an SFT Member’s Required SFT Deposit, with a minimum of \$250,000, must be made and maintained in cash; provided, further, the additional Clearing Fund formula in Sections I.(B)(1) (Additional Deposits for Members on the Watch List); (2) (Excess Capital Premium); (3) (Backtesting Charge); (4) (Bank Holiday Charge); Minimum Clearing Fund and Additional Deposit Requirements in Sections II.(A)1(a) – (b), II.(B), II.(C), and II.(D); as well as Section III (Collateral Value of Eligible Clearing Fund Securities) of Procedure XV shall apply to SFT Members in the same manner as such sections apply to Members.**

**(d) The Corporation shall have the discretion to require an SFT Member to post its Required SFT Deposit in proportion of cash higher than as required under subsection (c) of this Section 12, as determined by the Corporation from time to time in view of market conditions and other financial and operational capabilities of the SFT Member. The Corporation shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time.**

**(e) If an SFT has Incremental Additional Independent Amount SFT Cash, the Transferor shall make an additional deposit to the Clearing Fund that equals the amount of the Incremental Additional Independent Amount SFT Cash for such**

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<sup>2</sup> **For the purpose of applying Section I.(A)(1)(a)(i) of Procedure XV (Value-at-Risk (VaR) charge), the volatility of an SFT Member’s SFT Positions shall be the sum of (a) the highest resultant value between Section I.(A)(1)(a)(i). (Core Parametric Estimation) and Section I.(A)(1)(a)(i)III. (Margin Floor) and (b) the resultant value of Section I.(A)(1)(a)(i)II. (Gap Risk Measure).**

<sup>3</sup> **For the purpose of applying Section I.(A)(1)(g) of Procedure XV (Margin Liquidity Adjustment (MLA) charge), SFT Positions shall be aggregated with Net Unsettled Positions, as defined in Rule 1, in the same asset group or subgroup; provided, however, in the event such aggregation results in a reduction of the aggregate positions in the relevant asset group or subgroup, the Corporation shall apply the greater of (a) the sum of MLA charges separately calculated for SFT Positions and Net Unsettled Positions in the asset group or subgroup and (b) the MLA charge calculated from aggregating the SFT Positions and the Net Unsettled Positions in the asset group or subgroup.**

SFT (“Independent Amount SFT Cash Deposit”, and such requirement the “Independent Amount SFT Cash Deposit Requirement”). The Independent Amount SFT Cash Deposit Requirement must be satisfied in cash and may, at the discretion of the Corporation, be satisfied using Independent Amount SFT Cash Deposits that have previously been made by the Transferor in respect of SFTs with the same Transferee that have since settled. The Transferor shall satisfy any Independent Amount SFT Cash Deposit Requirement in respect of an SFT on the date that the SFT is novated to the Corporation pursuant to the timeframes and deadlines established by the Corporation for such purpose. If, on a given day, the Transferor satisfies its Independent Amount SFT Cash Deposit Requirement for some, but not all, SFTs novated to the Corporation on that day, the Corporation will consider the Transferor to have satisfied its Independent Amount SFT Cash Deposit Requirement for none of the SFTs that were novated to the Corporation on that day.

(f) Each SFT Member, other than an SFT Member that is a Sponsored Member, so long as such Member is an SFT Member, shall also provide Supplemental Liquidity Deposits to the Clearing Fund, as may be required pursuant to Rule 4A. References to Clearing Fund in the other Rules and Procedures shall include and apply to SFT Deposit, and references to Required Fund Deposit shall include and apply to Required SFT Deposit, unless specifically noted otherwise in this Rule 56 or in such other Rules and Procedures.

### SEC. 13. Ineligible SFT Securities and Supported Corporate Actions.

(a) The Corporation will remove an Ineligible SFT Security from the list maintained by the Corporation as set forth in Rule 3; provided that the Corporation may not be able to identify that an SFT Security is an Ineligible SFT Security and remove such SFT Security from the list maintained by the Corporation if the reason for the ineligibility is that the SFT Security is undergoing a corporate action or distribution not supported by the Corporation and the Corporation is not in receipt of reasonably advanced notice of such corporate action or distribution.

(b) Notwithstanding Section 12 of this Rule, if an SFT Security becomes an Ineligible SFT Security because the Current Market Price of the SFT Security falls below the threshold established by the Corporation from time to time, the Required SFT Deposit of each SFT Member party to an SFT which has such Ineligible SFT Security as its subject shall include an additional amount equal to the product of 100% of the Current Market Price of such Ineligible SFT Security and the number of such Ineligible SFT Securities that the SFT has as its subject.

(c) If the Corporation declares that an SFT Security has or will become an Ineligible SFT Security because the security is or will become ineligible for processing or is or will be undergoing a corporate action or distribution that is not supported by the Corporation, the Final Settlement of all SFTs that have been



novated to the Corporation and have such SFT Security as their subject must occur before the Ineligibility Date. If following such declaration the Transferee does not satisfy its Final Settlement obligations in respect of any such SFT as provided in Section 7 of this Rule by the Ineligibility Date, the Corporation shall, unless the Corporation has previously debited and credited the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT in accordance with Section 8 of this Rule on Ineligibility Date, debit and credit the Price Differential from and to the SFT Accounts of the SFT Member parties to the SFT as part of its end of day final money settlement process in accordance with Rule 12 and Procedure VIII. If the Price Differential is positive, the Corporation shall (x) credit an amount equal to the Price Differential to the Transferee's SFT Account and (y) debit an amount equal to the Price Differential from the Transferor's SFT Account. If the Price Differential is negative, the Corporation shall (x) credit an amount equal to the absolute value of the Price Differential to the Transferor's SFT Account and (y) debit an amount equal to the absolute value of the Price Differential from the Transferee's SFT Account. Following the application of Price Differential to an Ineligible SFT on or after the relevant Ineligibility Date, all rights and obligations as between the Corporation and the SFT Member parties thereto with respect to such SFT shall be discharged.

(d) If a corporate action supported by the Corporation in respect of the SFT Securities that are the subject of an SFT is scheduled to occur, the Corporation may cease to permit the discharge of the SFT's Final Settlement obligations, whether pursuant to Section 8 of this Rule or otherwise, and treat the SFT as a Non-Returned SFT for such period of time determined by the Corporation as necessary to process the corporate action, except that the additional SFT Deposit required for Non-Returned SFTs under Section 12(c) of this Rule shall not apply. Notwithstanding the foregoing, the Corporation shall not limit the ability of a Member to accelerate the Final Settlement of an SFT in accordance with Section 11 of this Rule, provided that any Price Differential for the SFT has settled in accordance with Section 9(a) of this Rule and that such accelerated Final Settlement is permitted in accordance with the rules and procedures of DTC.

SEC. 14. Cease to Act Procedures for SFT Members with Open Securities Financing Transactions.

(a) The provisions of Rule 18 shall not apply to the SFTs, with the exception of Sections 1 and 8 thereof.

(b) If the Corporation has ceased to act for an SFT Member and subject to Section 14 of Rule 2C:

(i) Except as otherwise may be determined by the Board of Directors, any SFT entered into by the SFT Member that, at the time the Corporation ceased to act for such SFT Member, has not been novated to the Corporation pursuant to this Rule

shall be excluded from all operations of the Corporation applicable to such SFT.

- (ii) The Corporation may decline to act upon any instructions, transaction data or notices submitted by such SFT Member or an Approved SFT Submitter on behalf of such SFT Member.
- (iii) The Corporation shall close-out such SFT Member's proprietary SFT Positions as well as any SFT Positions established in the SFT Member's Agent Clearing Member Customer Omnibus Account by (x) buying in or selling out, as applicable, some or all of the SFT Securities that are the subject of each SFT of the SFT Member that has been novated to the Corporation but for which the Final Settlement has not occurred, (y) deeming the Corporation to have bought in or sold out some or all such SFT Securities at the bid or ask price therefor, respectively, from a generally recognized source or at such price or prices as the Corporation is able to purchase or sell, respectively, some such SFT Securities, or (z) otherwise liquidating such SFT Member's SFT Positions.
- (iv) Any Sponsored Member Transactions for which a Defaulting SFT Member is the Sponsoring Member and which have been novated to the Corporation shall continue to be processed by the Corporation. The Corporation, in its sole discretion, will determine whether to close-out the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts (if any), which close-out shall be effected in accordance with the provisions of subsection (b)(iii) above, or instead permit the relevant Sponsored Members to complete settlement of the relevant Sponsored Member Transactions.
- (v) If, in the aggregate, the close-out of a Defaulting SFT Member's proprietary SFT Positions results in a profit to the Corporation, such profit shall be applied to any loss to the Corporation arising from the closing out of such Defaulting SFT Member (including losses arising from closing out the SFT Positions established in any of the Defaulting SFT Member's Agent Clearing Member Customer Omnibus Accounts or Sponsored Member Sub-Accounts or losses arising from closing out any Net Close Out Positions of the Defaulting SFT Member). If, in the aggregate, the close-out of a Defaulting SFT Member's proprietary SFT Positions results in a loss to the Corporation, such loss shall be netted against, or otherwise applied to, any amounts owed by the Corporation to such SFT Member in its proprietary capacity and thereafter

debited from such Defaulting SFT Member's Clearing Fund deposit at the Corporation.

- (vi) If, in the aggregate, the close-out of the SFT Positions established in the Agent Clearing Member Customer Omnibus Accounts of a Defaulting SFT Member results in a profit to the Corporation, such profit shall be credited to the Agent Clearing Member Customer Omnibus Accounts. If, in the aggregate, the close-out of the SFT Positions established in the Agent Clearing Member Customer Omnibus Accounts of a Defaulting SFT Member results in a loss to the Corporation, such loss shall be netted against, or otherwise applied to, any amounts owed by the Corporation to such SFT Member in its proprietary capacity and thereafter debited from the Defaulting SFT Member's Clearing Fund deposit at the Corporation.
- (vii) If, in the aggregate, the close-out of the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts results in a profit to the Corporation, such profit shall be credited to the Sponsored Member Sub-Accounts. If, in the aggregate, the closing out of the SFT Positions established in a Defaulting SFT Member's Sponsored Member Sub-Accounts results in a loss to the Corporation, such loss shall be netted against, or otherwise applied to, any amounts owed by the Corporation to such SFT Member in its proprietary capacity and thereafter debited from such Defaulting SFT Member's Clearing Fund deposit at the Corporation.
- (viii) The Final Settlement Date of each SFT that has been novated to the Corporation and that, prior to novation, was with a Defaulting SFT Member (each, a "Default-Related SFT") shall be the Business Day following the day on which the Corporation ceased to act for the Defaulting SFT Member.
- (ix) Until Final Settlement, each Default-Related SFT shall be treated as a Non-Returned SFT, and the Corporation will pay and collect the Price Differential amounts described in Section 9(a) of this Rule. The Corporation shall have all of the rights of a Transferor in relation to any Default-Related SFT in respect of which the Defaulting SFT Member was the Transferor, including the ability to deliver a Recall Notice in relation to such Default-Related SFT and to effect a Buy-In, and all of the rights of a Transferee in relation to any Default-Related SFT in respect of which the Defaulting SFT Member was the Transferee, including the ability to accelerate the scheduled Final Settlement Date of the Default-Related SFT. However, no additional SFT Deposit required for

**Non-Returned SFTs under Section 12(c) of this Rule shall apply to any Default-Related SFT, and no Rate Payments shall accrue on Default-Related SFTs after the date on which the Corporation ceases to act for the Defaulting SFT Member.**

**SEC. 15. Sponsored Member SFT Clearing.**

**(a) A Sponsoring Member shall be permitted to submit, either directly as an Approved SFT Submitter or via another Approved SFT Submitter, to the Corporation Sponsored Member Transactions between itself and its Sponsored Member in accordance with the provisions of this Rule and Rule 2C.**

**(b) The Corporation shall maintain for the Sponsoring Member one or more Sponsored Member Sub-Accounts. The SFT Deposits for each Sponsored Member Sub-Account shall be calculated separately based on the SFT Positions in such Sponsored Member Sub-Account, and the Sponsoring Member, as principal, shall be required to satisfy the SFT Deposits for each of the Sponsoring Member's Sponsored Member Sub-Accounts.**

**(c) Settlement of the Final Settlement, Rate Payment, Price Differential, Distribution Payment and other obligations of a Sponsored Member Transaction that have been novated to the Corporation shall be effected by the Sponsoring Member, as settlement agent for the relevant Sponsored Member, crediting and debiting the account the Sponsoring Member maintains for the Sponsored Member on the Sponsoring Member's books and records.**

**SEC. 16. Customer SFT Clearing.**

**(a) An Agent Clearing Member shall be permitted to submit, either directly as an Approved SFT Submitter or via another Approved SFT Submitter, to the Corporation for novation SFTs that are Agent Clearing Member Transactions. Any such submission shall be in accordance with this Rule and Rule 2D.**

**(b) With respect to an Agent Clearing Member that submits SFTs to the Corporation for novation on behalf of its Customers, the Corporation shall maintain one or more Agent Clearing Member Customer Omnibus Accounts in the name of the Agent Clearing Member for the benefit of its Customers in which all SFT Positions and SFT Cash carried by the Agent Clearing Member on behalf of its Customers are reflected; provided, that each Agent Clearing Member Customer Omnibus Account may only contain activity where the Agent Clearing Member is acting as Transferor on behalf of its Customers, or as Transferee on behalf of its Customers, but not both.**

**(c) With respect to SFTs entered into on behalf of its Customers and maintained in the Agent Clearing Member Customer Omnibus Account, the Agent Clearing Member shall act solely as agent of its Customers in connection with the clearing of such SFTs; provided, that the Agent Clearing Member shall remain**

fully liable for the performance of all obligations to the Corporation arising in connection with such SFTs; and provided further, that the liabilities and obligations of the Corporation with respect to such SFTs entered into by the Agent Clearing Member on behalf of its Customers shall extend only to the Agent Clearing Member. Without limiting the generality of the foregoing, the Corporation shall not have any liability or obligation arising out of or with respect to any SFT to any Customer of an Agent Clearing Member.

(d) The SFT Deposits for each Agent Clearing Member Customer Omnibus Account shall be calculated separately based on the SFT Positions in such Agent Clearing Member Customer Omnibus Account, and the Agent Clearing Member shall, as principal, be required to satisfy the SFT Deposit for each of the Agent Clearing Member's Agent Clearing Member Customer Omnibus Accounts.

#### SEC. 17. Corporation Default.

(a) If a "Corporation Default" occurs pursuant to Section 2 of Rule 41, all SFTs that have been novated to the Corporation but not yet settled, and all obligations and rights arising thereunder which have been assumed by the Corporation pursuant to this Rule, shall be immediately terminated, and the Board of Directors shall determine the Aggregate Net SFT Close-out Value owed by or to each SFT Member with respect to each of its SFT Positions.

(b) For purposes of this Section 17, a Member shall be considered a different SFT Member in respect of each of (i) its proprietary SFT Positions; (ii) the SFT Positions established in its Agent Clearing Member Customer Omnibus Accounts (if any); and (iii) the SFT Positions established in its Sponsored Member Sub-Accounts (if any).

(c) Each SFT Member's Aggregate Net SFT Close-out Value shall be netted and offset as described in Section 14(b)(v) through Section 14(b)(vii) of this Rule, as though the Corporation had ceased to act for each SFT Member.

(d) The Board of Directors shall notify each SFT Member of the Aggregate SFT Close-out Value, taking into account the netting and offsetting provided for above. SFT Members that have been notified that they owe an amount to the Corporation shall pay that amount on or prior to the date specified by the Board of Directors, subject to any applicable setoff rights. SFT Members who have a net claim against the Corporation shall be entitled to payment thereof along with other Members' and any other creditors' claims pursuant to the underlying contracts with respect thereto, these Rules and Procedures and applicable law. Nothing herein shall limit the rights of the Corporation upon an SFT Member default (including following a Corporation Default), including any rights under any Clearing Agency Cross-Guaranty Agreement or otherwise.

#### SEC. 18. Other Applicable Rules, Procedures, and Addendums.

**In addition to this Rule 56, the Rules, Procedures, and Addendums referenced in this section shall also apply to SFTs and SFT Members, unless expressly stated otherwise.**

**Rule 1 (Definitions and Descriptions), Rule 2 (Members, Limited Members and Sponsored Members), Rule 5 (General Provisions), Rule 12 (Settlement), Rule 13 (Exception Processing), Rule 17 (Fine Payments), Rule 19 (Miscellaneous Rights of the Corporation), Rule 21 (Honest Broker), Rule 22 (Suspension of Rules), Rule 23 (Action by the Corporation), Rule 24 (Charges for Services Rendered), Rule 26 (Bills Rendered), Rule 27 (Admission to Premises of the Corporation - Powers of Attorney, Etc.), Rule 28 (Forms), Rule 29 (Qualified Securities Depositories), Rule 32 (Signatures), Rule 33 (Procedures), Rule 34 (Insurance), Rule 35 (Financial Reports), Rule 36 (Rule Changes), Rule 37 (Hearing Procedures), Rule 38 (Governing Law and Captions), Rule 39 (Reliance on Instructions), Rule 40 (Wind-Down of a Member, Fund Member or Insurance Carrier/Retirement Services Member), Rule 41 (Corporation Default), Rule 42 (Wind-down of the Corporation), Rule 45 (Notice), Rule 47 (Interpretation of Rules), Rule 48 (Disciplinary Proceedings), Rule 49 (Release of Clearing Data and Clearing Fund Data), Rule 55 (Settling Banks and AIP Settling Banks), Rule 58 (Limitations on Liability), Rule 60 (Market Disruption and Force Majeure), Rule 60A (Systems Disconnect: Threat of Significant Impact to the Corporation's Systems), Rule 63 (SRO Regulatory Reporting), Procedure I (Introduction), Procedure VIII (Money Settlement Service), Procedure XII (Time Schedule), Procedure XIII (Definitions), Procedure XIV (Forms, Media and Technical Specifications), Procedure XV (Clearing Fund Formula and Other Matters), Addendum B (Qualifications and Standards of Financial Responsibility, Operational Capability and Business History), Addendum H (Interpretation of the Board of Directors Release of Clearing Data), Addendum L (Statement of Policy Pertaining to Information Sharing), and Addendum P (Fine Schedule) shall apply to SFTs and SFT Members, unless the context otherwise requires.**

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RULE 58. LIMITATIONS ON LIABILITY

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SEC. 2. Notwithstanding any other provision in the Rules:

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**(j) The Corporation will not be responsible for the completeness or accuracy of the transaction data received from the Approved SFT Submitters, nor shall the Corporation, absent gross negligence on the Corporation's part, be responsible for any errors, omissions or delays that may occur in the transmission of transaction data from any Approved SFT Submitter.**

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RULE 64. DTCC SHAREHOLDERS AGREEMENT

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SEC. 4. This Rule 64 shall have no application to a **Sponsored Member**, Data Services Only Member, Settling Bank Only Member, Investment Manager/Agent Member, TPP Member, TPA Member, AIP Member.<sup>1</sup>

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<sup>1</sup> Note that, if a Fund Member, Insurance Carrier/Retirement Services Member, Municipal Comparison Only Member or Mutual Fund/Insurance Services Member is also a member or participant of another clearing agency subsidiary of DTCC, such Fund Member, Insurance Carrier/Retirement Services Member, Municipal Comparison Only Member or Mutual Fund/Insurance Services Member may be a Mandatory Purchaser Participant pursuant to the terms of the Shareholders Agreement and the rules and procedures of such other subsidiary. If a **Sponsored Member**, Data Services Only Member, Settling Bank Only Member, Investment Manager/Agent Member, TPP Member, TPA Member or AIP Member is also a member or participant of another clearing agency subsidiary of DTCC, such **Sponsored Member**, Data Services Only Member, Settling Bank Only Member, Investment Manager/Agent Member, TPP Member, TPA Member or AIP Member may be a Mandatory Purchaser Participant or a Voluntary Purchaser Participant pursuant to the terms of the Shareholders Agreement and the rules and procedures of such other subsidiary.



PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS<sup>1</sup>

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II. Minimum Clearing Fund and Additional Deposit Requirements

- (A) Each Member of the Corporation shall be required to contribute a minimum of \$250,000 (the "minimum contribution"), **excluding Required SFT Deposit**. The first 40% (but no less than \$250,000) of a Member's Required Fund Deposit **(excluding Required SFT 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.

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

ADDENDUM B

QUALIFICATIONS AND STANDARDS OF FINANCIAL RESPONSIBILITY,  
OPERATIONAL CAPABILITY AND BUSINESS HISTORY

MEMBERS (Section 1);

MUTUAL FUND/INSURANCE SERVICES MEMBERS (Section 2);

FUND MEMBERS (Section 3);

INSURANCE CARRIER/RETIREMENT SERVICES MEMBERS (Section 4);

MUNICIPAL COMPARISON ONLY MEMBERS (Section 5);

DATA SERVICES ONLY MEMBERS (Section 6);

SETTLING BANK ONLY MEMBERS (Section 7);

THIRD PARTY ADMINISTRATOR MEMBERS (Section 8);

INVESTMENT MANAGER/AGENT MEMBERS (Section 9);

AIP MEMBERS (Section 10); and

THIRD PARTY PROVIDER MEMBERS (Section 11)

**SPONSORED MEMBERS (Section 12)**

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SEC. 3. FUND MEMBERS

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B. Financial Responsibility

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4. Investment Advisers:

**have An applicant or Fund Member that is an investment adviser must have and maintain at all times** a minimum of \$25,000,000 in assets under management and \$100,000 in total **nNet wWorth**.

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## **SEC. 12. SPONSORED MEMBERS**

### **A. Qualification**

**To qualify for membership, a Sponsored Member (x) shall be sponsored into membership by a Sponsoring Member and (y)(1) is a “qualified institutional buyer” as defined by Rule 144A under the Securities Act of 1933, as amended, or (2) is a legal entity that, although not organized as an entity specifically listed in paragraph (a)(1)(i)(H) of Rule 144A under the Securities Act of 1933, as amended, satisfies the financial requirements necessary to be a “qualified institutional buyer” as specified in that paragraph.**

### **B. Operational Capability<sup>11</sup>**

**An applicant shall be qualified for membership if it is able to satisfactorily communicate with the Corporation and fulfill anticipated commitments to and meet the operational requirements of the Corporation with necessary promptness and accuracy and to conform to any condition and requirement that the Corporation reasonably deems necessary for its protection.**

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<sup>11</sup> **An applicant must have the operational capability for membership or have arrangement, concerning the provision of operational support services to such applicant, with an entity acceptable to the Corporation and which may not be replaced without prior approval by the Corporation.**

ADDENDUM P

FINE SCHEDULE

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2) General Continuance Standards-Fine for failure to notify pursuant to Section 2(B)(a)(i) of Rule 2B, **Section 2(i) of Rule 2C, Section 3(d) of Rule 2C, or Section 2(i) of Rule 2D**: Each single offense, \$1,000 fine. If the Member's failure to notify applies to more than one DTCC clearing agency subsidiary (DTC, NSCC and/or FICC), the fine amount will be divided equally among the clearing agencies. Where the Member is a participant of DTC and is a common member of one or more of the other clearing agencies, the fine would be collected by DTC and allocated equally among other clearing agencies, as appropriate. If the member is not a DTC participant, but is a common member between NSCC and FICC, NSCC will collect the fine and allocate the appropriate portion to FICC.

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