

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-98881; File No. SR-NSCC-2023-009)

November 8, 2023

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change Relating to the Schedule of Haircuts for Eligible Clearing Fund Securities

I. INTRODUCTION

On September 22, 2023, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NSCC-2023-009 to modify the schedule of haircuts for Eligible Clearing Fund Securities, and to remove it and the related concentration limits from Procedure XV of the NSCC Rules (“Procedure XV”), and make other clarifying changes (“Proposed Rule Change”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The Proposed Rule Change was published for comment in the Federal Register on October 4, 2023.³ The Commission has received no comments on the Proposed Rule Change. For the reasons discussed below, the Commission is approving the Proposed Rule Change.⁴

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 98589 (Sept. 28, 2023), 88 FR 68777 (Oct. 4, 2023) (File No. SR-NSCC-2023-009) (“Notice of Filing”).

⁴ Capitalized terms not defined herein are defined in the NSCC Rulebook (“NSCC Rules”), available at https://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf.

II. BACKGROUND

NSCC is a central counterparty (“CCP”), which means it interposes itself as the buyer to every seller and seller to every buyer for the financial transactions it clears. As such, NSCC is exposed to the risk that one or more of its members may fail to make a payment or to deliver securities.

A key tool that NSCC uses to manage its credit exposures to its members is the daily collection of margin (referred to as “Required Fund Deposit” in the NSCC Rules) from each member.⁵ The aggregated amount of all NSCC members’ margin constitutes the Clearing Fund. The objective of the Clearing Fund is to mitigate potential losses to NSCC associated with liquidating a member’s portfolio in the event NSCC ceases to act for that member (hereinafter referred to as a “default”).⁶ NSCC would be able to access the Clearing Fund should a defaulting member’s own margin be insufficient to satisfy losses to NSCC caused by the liquidation of that member’s portfolio.

A member may provide its required margin in the form of cash or an open account indebtedness secured by Eligible Clearing Fund Securities.⁷ Eligible Clearing Fund Securities are defined to include certain agency, mortgage-backed, and Treasury

⁵ See NSCC Rule 4, *supra* note 4 (requiring members to make Required Fund Deposits to the Clearing Fund with the amount of each member’s deposit being determined by NSCC in accordance with these rules).

⁶ The NSCC Rules identify when NSCC may cease to act for a member and the types of actions NSCC may take. For example, NSCC may suspend a firm’s membership with NSCC or prohibit or limit a member’s access to NSCC’s services in the event that member defaults on a financial or other obligation to NSCC. See NSCC Rule 46 (Restrictions on Access to Services), *supra* note 4.

⁷ See NSCC Rule 4, Section 1 (Required Fund Deposits), *supra* note 4.

securities.⁸ These securities are valued based on the prior Business Day's closing market price, less a haircut, and may be subject to a concentration limit.⁹ NSCC states that haircuts are used to protect NSCC and its members from price fluctuations, *i.e.*, if NSCC is required to liquidate collateral of an insolvent member and such collateral is worth less at the time of liquidation than when it is pledged to NSCC.¹⁰ NSCC also states that concentration limits are intended to reduce NSCC's risk by limiting the percentage of certain types of Eligible Clearing Fund Securities pledged by members to secure the Clearing Fund deposits, because when a member's portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular asset type, such securities could present additional risk to NSCC.¹¹

Currently, collateral haircuts applicable to relevant security types and remaining maturity terms are specified as fixed percentages in Section III.(A) of Procedure XV ("Section III.(A)").¹² According to NSCC and set forth in its internal risk management procedures, the sufficiency of collateral haircuts is evaluated through use of back-tests,

⁸ See NSCC Rule 1 (defining what constitutes Eligible Clearing Fund Securities and the components thereof, which are Eligible Clearing Fund Agency Securities, Eligible Clearing Fund Mortgage-Backed Securities, and Eligible Clearing Fund Treasury Securities), *supra* note 4.

⁹ See Section II.(A)1. of Procedure XV, *supra* note 4.

¹⁰ Notice of Filing, *supra* note 3, 88 FR at 68777.

¹¹ *Id.*

¹² See Section III.(A) of Procedure XV, *supra* note 4. Section III.(A) was last modified in 2011 in order to conform the haircuts to requirements of NSCC's lenders under its credit facilities. See Securities Exchange Act Release No. 64487 (May 13, 2011), 76 FR 29019 (May 19, 2011) (SR-NSCC-2011-02).

stress-tests and market observations.¹³ Specifically, NSCC conducts daily backtesting analysis by comparing the collateral haircut for each member in simulated liquidations with the member's actual collateral held on deposit at NSCC.¹⁴ NSCC escalates any exceptions that it observes to assess the root cause and determine whether further analysis and/or review would be appropriate, taking into account whether a particular security may present inherent volatility and/or liquidity risks that could likely result in an erosion in the value of the security exceeding the applicable collateral haircut.¹⁵ On a quarterly basis, NSCC reviews the composition of the Eligible Clearing Fund Securities that members have pledged to secure their Required Fund Deposits in order to assess the sufficiency of the collateral haircuts applied and whether any haircut changes would be needed, taking into account backtesting results, any instances where the simulated losses from available historical stress testing scenario dates have exceeded the collateral haircut values, and market conditions.¹⁶

In addition to collateral haircuts, NSCC applies concentration limits to certain Eligible Clearing Fund Securities set forth in the NSCC Rules. Under these limits, no more than 20 percent of a member's Required Fund Deposit may be in the form of Eligible Clearing Fund Agency Securities that are of a single issuer and no member may post as eligible collateral Eligible Clearing Fund Agency Securities of which it is the

¹³ Notice of Filing, *supra* note 3, 88 FR at 68777. NSCC also filed excerpts from its internal market risk management procedures as Confidential Exhibit 3b to its filing.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 68778.

issuer.¹⁷ In addition, any deposits of Eligible Clearing Fund Agency Securities or Eligible Clearing Fund Mortgage-Backed Securities in excess of 25 percent of a member's Required Fund Deposit will be subject to a haircut that is twice the amount of the percentage noted in Section III.(A), and a member may deposit Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, however such securities will be subject to a premium haircut, with the initial haircut being 14 percent, and if a member also exceeds the 25 percent concentration limit, the haircut shall be 21 percent.¹⁸

Changes to the collateral haircuts and concentration limits are subject to NSCC's internal governance process.¹⁹ According to NSCC and based on its internal risk management procedures, if NSCC determines that, based on the analyses that it performs, there is insufficient/excessive collateral haircut/concentration due to an identifiable cause that affected multiple members and such cause would likely persist based on NSCC's assessment of market conditions, such outcome or result could cause NSCC to amend the haircuts/concentration limits in the haircut schedule.²⁰ If NSCC determines that a change to the haircut schedule is warranted, it would document the recommendation and rationale for the change at the time of such determination and obtain approval from an executive director or above with a notice to the risk management committee.²¹ Before

¹⁷ See Section II.(A)1. of Procedure XV, *supra* note 4.

¹⁸ *Id.*

¹⁹ Notice of Filing, *supra* note 3, 88 FR at 68778; *see also* note 13 *supra*.

²⁰ *Id.*

²¹ *Id.*

making adjustments to the haircut schedule, NSCC measures the potential impact of such adjustments to ensure any impact is both necessary and appropriate.²²

III. DESCRIPTION OF THE PROPOSED RULE CHANGE

In the Notice of Filing, NSCC states that it has observed that under volatile market conditions with elevated frequency and magnitude of securities price movements, the collateral value of Eligible Clearing Fund Securities may shift in a relatively short period of time and the current haircuts may not sufficiently account for the change in value.²³ When the erosion in the value of the Eligible Clearing Fund Securities exceeds the relevant haircuts, NSCC is exposed to increased risk of potential losses associated with liquidating a member's portfolio in the event of a member default when the defaulting member's own margin is insufficient to satisfy losses to NSCC caused by the liquidation of that member's portfolio.²⁴ Similarly, when a member's portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular asset type, such securities could present additional risk to NSCC.²⁵ The additional risk exposures associated with liquidating a member's portfolio in the event of a member default could lead to an increase in the likelihood that NSCC would need to mutualize losses among non-defaulting members during the liquidation process.²⁶

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

However, any changes to the haircuts and/or concentration limits currently requires a proposed rule change to be filed with the Commission.

Therefore, to provide NSCC with more flexibility in adjusting the haircuts and concentration limits so NSCC can respond to changing market conditions more promptly in order to mitigate the additional risk exposure, NSCC is proposing to remove Section III.(A) and concentration limits from the Rules, and to publish the haircuts and concentration limits in a haircut schedule on NSCC's website.²⁷

In addition, NSCC is proposing to add language in Section II.(A)1. that makes it clear that all Eligible Clearing Fund Securities pledged to secure Clearing Fund deposits shall, for collateral valuation purposes, be subject to a haircut and may be subject to a concentration limit. The proposed language would provide that NSCC shall determine the applicable haircuts and any concentration limits from time to time in accordance with its internal policy and governance process, based on factors determined to be relevant by NSCC, which may include, for example, backtesting results and NSCC's assessment of market conditions, in order to set appropriately conservative haircuts and/or concentration limits for the Eligible Clearing Fund Securities and minimize backtesting deficiency occurrences. The proposed language would also provide that the haircuts and

²⁷ Specifically, NSCC is proposing to delete subsections (a) and (b) of Section II.(A)1. of Procedure XV (Special Provisions Related to Eligible Clearing Fund Securities), and delete Section III of Procedure XV (Collateral Value of Eligible Clearing Fund Securities) to remove all haircuts and concentration limits from the Rules. NSCC is also proposing to (i) remove references to Section III of Procedure XV in two places in Rule 4, and replace them with a reference to Section II.(A) of Procedure XV; (ii) remove references to subsections 1(a) and (b) of Section II.(A) of Procedure XV and references to Section III of Procedure XV in Rule 56; and (iii) remove a reference to Section III of Procedure XV in Section II.(A) of Procedure XV, and replace it with a reference to the proposed haircut schedule, to reflect the proposed changes described above.

any concentration limits prescribed by NSCC shall be set forth in a haircut schedule that is published on NSCC’s website. The proposed language would also state that it shall be the member’s responsibility to retrieve the haircut schedule, and that NSCC would provide members with at a minimum one Business Day’s advance notice of any change in the haircut schedule.

NSCC states that the proposed change to move the haircuts and concentration limits from the Rules to the website would enable NSCC to adjust the haircuts and concentration limits without undergoing a rule filing process (although it could still necessitate an advance notice under Title VIII of the Dodd-Frank Act, if a change materially affects the nature or level of risks presented by NSCC).²⁸ NSCC states that by being able to make appropriate and timely adjustments to the haircuts and concentration limits, it would have the flexibility to respond to changing market conditions more promptly.²⁹ Having the flexibility to respond to changing market conditions more promptly would in turn help better ensure that NSCC collects sufficient margin from members as well as risk manages its credit exposures to its members.³⁰

In its Notice of Filing, NSCC also provides an overview regarding its changes to the categories relating to Treasury Inflation-Protected Securities (“TIPS”).³¹ NSCC states that, as part of its daily backtesting regarding the adequacy of collateral haircuts, NSCC has

²⁸ Notice of Filing, *supra* note 3, 88 FR at 68779 and n. 11 (citing 12 U.S.C. 5465(e)(1) and 17 CFR 240.19b-4(n)(1)(i)).

²⁹ *Id.*

³⁰ *Id.*

³¹ TIPS are a type of Treasury security issued by the U.S. government that are indexed to inflation such that the principal value of the security rises as inflation rises.

determined that in periods where the inflation rate fluctuates, the current haircut levels for TIPS have been inadequate to address the fluctuations from time to time.³² This is because TIPS are indexed to the inflation rate, and prices on TIPS move inversely to their yields, e.g., when the inflation rate increases, prices on TIPS decrease. When the decline in market value of TIPS exceeds the haircut for TIPS, NSCC would be exposed to potential liquidation losses.³³

Accordingly, NSCC is planning to address haircuts for TIPS in a separate category, as opposed to as part of a category also including Treasury Bills, Notes, and Bonds, and to increase the haircut levels for TIPS to ensure that the haircut levels would be commensurate with the particular risk attributes of TIPS.³⁴ NSCC describes the new TIPS haircut categories as follows:³⁵

	Maturity	Current	Proposed
TIPS	Zero to 1 year	2.0%	2.0%
	1 year to 2 years	2.0%	3.0%
	2 years to 5 years	3.0%	5.0%
	5 years to 10 years	4.0%	7.0%
	10 years to 15 years	6.0%	7.0%
	15 years or greater	6.0%	10.0%

³² Notice of Filing, *supra* note 3, 88 FR at 68779.

³³ *Id.*

³⁴ *Id.* NSCC also stated that its review of TIPS haircuts at other registered clearing agencies demonstrate that NSCC’s current haircut levels for TIPS are generally lower than the TIPS haircuts required by other clearing agencies and foreign CCPs, particularly with respect to maturity ranges of 10 years or longer. *Id.* (summarizing and citing various other clearing agency rules).

³⁵ *Id.* NSCC also reflected the changes with respect to haircuts for TIPS on the haircut schedule filed as Exhibit 3c to the Notice of Filing, which would be posted to its website if the Proposed Rule Change were approved.

NSCC conducted an impact study for the period from September 1, 2021 through August 31, 2022 (“Impact Study”).³⁶ The results of the Impact Study indicate that, if the haircut changes for TIPS had been in place, it would have resulted in an average daily increase of \$197,000 in the Clearing Fund assuming TIPS were deposited.³⁷

Finally, NSCC is proposing to clarify language in Sections I.(B)(1), II.(A), II.(B), II.(C) and II.(D) of Procedure XV to reflect that Mutual Fund/Insurance Services Members and other Limited Members are no longer required to make deposits into the Clearing Fund. In 2022, NSCC removed the requirement that any Limited Members, including Mutual Fund/Insurance Services Members, make any deposits to the Clearing Fund.³⁸ Sections I.(B)(1), II.(A), II.(B), II.(C) and II.(D) of Procedure XV still contain references to Mutual Fund/Insurance Service Members and/or Limited Members making deposits into the Clearing Fund, and NSCC states that it would remove those references for clarity.³⁹

IV. DISCUSSION AND COMMISSION FINDINGS

Section 19(b)(2)(C) of the Act⁴⁰ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is

³⁶ NSCC filed this Impact Study as confidential Exhibit 3a to the Notice of Filing.

³⁷ Notice of Filing, *supra* note 3, 88 FR at 68780 (also providing a more detailed summary of the Impact Study).

³⁸ *See* Securities Exchange Act Release No. 93722 (Dec. 6, 2021), 86 FR 70548 (Dec. 10, 2021) (SR-NSCC-2021-015).

³⁹ Notice of Filing, *supra* note 3, 88 FR at 68779.

⁴⁰ 15 U.S.C. 78s(b)(2)(C).

consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considering the Proposed Rule Change, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NSCC. In particular, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F)⁴¹ of the Act and Rules 17Ad-22(e)(5) and (e)(23), each promulgated under the Act.⁴²

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

Section 17A(b)(3)(F) of the Act⁴³ requires that the rules of a clearing agency, such as NSCC, be designed to, among other things, promote the prompt and accurate clearance and settlement of securities transactions and assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.⁴⁴ The Commission believes that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act for the reasons stated below.

As stated in Part II *supra*, a key tool that NSCC uses to manage its credit exposures to its members is the daily collection of margin from each member described above, and NSCC applies haircuts to securities collected as margin to protect NSCC and its members from price fluctuations, *i.e.*, if NSCC is required to liquidate collateral of an

⁴¹ 15 U.S.C. 78q-1(b)(3)(F).

⁴² 17 CFR 240.17Ad-22(e)(5) and (e)(23).

⁴³ 15 U.S.C. 78q-1(b)(3)(F).

⁴⁴ *Id.*

insolvent member and such collateral is worth less at the time of liquidation than when it is pledged to NSCC.

By moving the location where collateral haircuts and concentration limits are published from NSCC's Rules to its website, the Proposed Rule change would add flexibility for NSCC to make timely adjustments to collateral haircuts and concentration limits during a time of potentially deteriorating market or other conditions, while preserving notice requirements to ensure that members are aware of risk management changes. This added flexibility should allow NSCC to continue to ensure that it can address changing market conditions rapidly and ensure that it is collecting sufficient margin to cover its credit exposures to members and minimizing exposures from members with large collateral positions in a particular group of securities with a similar risk profile or in a particular asset type.⁴⁵

By helping NSCC to collect sufficient margin, the Proposed Rule Change would better ensure that, in the event of a member default, NSCC's operation of its critical clearance and settlement services would not be disrupted because of insufficient financial resources. Accordingly, the Proposed Rule Change should help NSCC to continue providing prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.⁴⁶

⁴⁵ In addition, the Commission believes that the changes relating to the haircuts for TIPS would allow NSCC to ensure that the haircut levels would be commensurate with the particular risk attributes of TIPS, and thereby assure the safeguarding of securities and funds that are in its custody or control.

⁴⁶ 15 U.S.C. 78q-1(b)(3)(F).

Moreover, because the Proposed Rule Change would continue to ensure that NSCC collects sufficient margin from members, it should also help minimize the likelihood that NSCC would have to access the Clearing Fund, thereby limiting non-defaulting members' exposure to mutualized losses. By helping to limit the exposure of NSCC's non-defaulting members to mutualized losses, the Proposed Rule Change should help NSCC assure the safeguarding of securities and funds which are in its custody or control, consistent with Section 17A(b)(3)(F) of the Act.⁴⁷

Finally, the proposed clarifying changes should help to ensure that NSCC's Rules are clear to members. When members better understand their rights and obligations regarding the Rules, members are more likely to act in accordance with the Rules, which should promote the prompt and accurate clearance and settlement of securities transactions. As such, the proposed clarifying changes are consistent with Section 17A(b)(3)(F) of the Act.⁴⁸

B. Consistency with Rule 17Ad-22(e)(5)

Rule 17Ad-22(e)(5) under the Act⁴⁹ requires, in part, a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its or its participants' credit exposure. As described in Part II *supra*, the proposed changes to move the collateral haircuts and concentration limits from NSCC's Rules should provide NSCC with more

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ 17 CFR 240.17Ad-22(e)(5).

flexibility to respond to changing market conditions because adjustments to the haircuts and concentration limits would no longer require a rule change. By being able to make appropriate and timely adjustments to the haircuts and concentration limits, NSCC would have the flexibility to respond to changing market conditions more promptly. Specifically, NSCC would have the ability to promptly set and enforce conservative collateral haircuts and concentration limits that are reflective of the current market conditions. In this way, the proposed changes to move the collateral haircuts and concentration limits from the Rules to the website should help NSCC set and enforce appropriately conservative collateral haircuts and concentration limits, consistent with the requirements of Rule 17Ad-22(e)(5) under the Act.⁵⁰

C. Consistency with Rule 17Ad-22(e)(23)

Rule 17Ad-22(e)(23)(i) and (ii)⁵¹ under the Act requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to, among other things, publicly disclose all relevant rules and material procedures; and provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency. Based on its review of the record, and for the reasons described below, the Commission finds that the proposed changes, taken together, are consistent with the requirements of Rule 17Ad-22(e)(23)(i) and (ii).⁵²

⁵⁰ *Id.*

⁵¹ 17 CFR 240.17Ad-22(e)(23)(i) and (ii).

⁵² *Id.*

By adopting rules that require NSCC to provide prior notice through public disclosures on its website relating to information on collateral haircuts and concentration limits, NSCC's Rules would support the communication of information that its members may use to identify and evaluate the haircuts and concentration limits resulting from NSCC's processes. As such, the Proposed Rule Change is consistent with publicly disclosing all relevant rules and material procedures; and providing sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs incurred with participation in the covered clearing agency. The Commission finds, therefore, that the Proposed Rule Change is consistent with the requirements of Rule 17Ad-22(e)(23)(i) and (ii) under the Act.⁵³

IV. CONCLUSION

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act⁵⁴ and the rules and regulations promulgated thereunder.

⁵³ *Id.*

⁵⁴ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act⁵⁵ that proposed rule change SR-NSCC-2023-009, be, and hereby is, APPROVED.⁵⁶

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁷

Sherry R. Haywood,

Assistant Secretary.

⁵⁵ 15 U.S.C. 78s(b)(2).

⁵⁶ In approving the Proposed Rule Change, the Commission considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁵⁷ 17 CFR 200.30-3(a)(12).