SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71637; File No. SR-NSCC-2013-12)

February 28, 2014

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Provide Members with a Risk Management Tool that Will Enable Members to Monitor Trading Activity and Receive Notifications When Pre-Set Trading Limits Are Reached

I. Introduction

On November 15, 2013, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-NSCC-2013-12 ("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 in the Federal Register on December 3, 2013.[3] NSCC voluntarily extended the Commission's period of review of the Proposed Rule Change on January 9, 2014. The Commission received one comment letter to the Proposed Rule Change[4] and one response letter from NSCC.[5] This order approves the Proposed Rule Change.

II. Description

---

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.

[3] Release No. 34-70946 (Nov. 26, 2013), 78 FR 72737 (Dec. 3, 2013).

[4] Letter to Elizabeth M. Murphy, Secretary, Commission, from Manisha Kimmel, Executive Director, Financial Information Forum ("FIF") (Dec. 23, 2013) (hereinafter "FIF Letter").

[5] Letter to Elizabeth M. Murphy, Secretary, Commission, from Murray C. Pozmanter, Managing Director, Depository Trust and Clearing Corporation ("DTCC") (Jan. 15, 2014) (hereinafter "NSCC Response").

NSCC filed the Proposed Rule Change to amend its Rules & Procedures ("Rules") in order to implement DTCC Limit Monitoring, a risk management tool.[6] As discussed below, the tool will enable NSCC's members ("Members")[7] to view their trading exposure across markets and at the CUSIP and individual trade levels through Risk Entities created by the Member. DTCC Limit Monitoring will then alert the Member when trading limits for Risk Entities are approached and when limits are reached. Members have discretion to determine whether to take action in response to an alert.

A. Trading Data Captured

Through DTCC Limit Monitoring, Members will be able to monitor the intraday, post-trade[8] clearing activity of their own trading desks, their correspondents, and their clients.[9] The clearing activity captured by DTCC Limit Monitoring will include: (i) post-trade data relating to unsettled equity and fixed income securities trades that were compared or recorded through NSCC's trade capture mechanisms[10] on that day ("LM Trade Date Data"), and (ii) other

---

6 DTCC Limit Monitoring is separate from and will operate independently of other risk management tools developed by other market participants (e.g., registered securities exchanges). Release No. 34-70946, supra note 3, at 2 n.3.

7 Members that clear trades for others or participate in special representative transactions will be required to use DTCC Limit Monitoring. Approximately 85 percent of Members are in this category.

8 For the purposes of this Proposed Rule Change, "post-trade" refers to the period in a transaction lifecycle after it is submitted to NSCC for clearing and settlement. Release No. 34-70946, supra note 3, at 2 n.4.

9 In compliance with NSCC Rule 49, Members are only able to view trading activity with respect to their own clearing account(s).

10 Such mechanisms include NSCC's Universal Trade Capture and Real-Time Trade Matching trade capture and comparisons systems.

applicable trade positions that the Member chooses to input at the start of or throughout the day ("LM Member-Provided Data") (collectively, "LM Transaction Data").[11]

B. Establishing Risk Entities

A Member that uses DTCC Limit Monitoring will create Risk Entities for its own trading desks, each correspondent firm, and each client for which the Member clears trades. The Member will define each Risk Entity's rules for aggregating LM Trade Date Data and LM Member-Provided Data and set trading limits[12] based on the net notional value[13] of the aggregated LM Transaction Data. DTCC Limit Monitoring will provide Members a screen-based view of their LM Transaction Data for a given day, aggregated and organized according to trading limits set by the Member.

C. Trading Limits

DTCC Limit Monitoring will alert a Member when a pre-set trading limit with respect to the trading activity of one of its Risk Entities is approached and when it is reached. Specifically,

---

11 NSCC states that, since NSCC will not be the originator of the information made available through DTCC Limit Monitoring, NSCC will not be responsible for: (i) the completeness or accuracy of LM Trade Date Data; (ii) other information or data that it receives from Members or third parties and that is used in DTCC Limit Monitoring or received and compared or recorded by NSCC; or (iii) any errors, omissions, or delays that may occur in the transmission of such data or information, as provided in the Rules. Release No. 34-70946, supra note 3, at 7-8. Additionally, because not all transactions are submitted to NSCC in real-time, NSCC can only provide Members using DTCC Limit Monitoring with LM Trade Date Data as it is compared or recorded through NSCC; accordingly, LM Trade Date Data may not reflect all transactions. Id.

12 The rules governing DTCC Limit Monitoring will refer to such trading limits also as "parameters." Id. at 5.

13 For purposes of DTCC Limit Monitoring, "net notional" will mean the sum of the absolute value of exposure for each security ticker symbol. For example, a firm that is net-long in Company X for $50,000 and net-short in Company Z for $100,000 has a net notional exposure of $150,000. Id. at 5 n.5.

DTCC Limit Monitoring will alert a Member when the net notional value of aggregated LM Transaction Data for a Member's Risk Entity is:

- 50 percent of the trading limit set by the Member for that Risk Entity;
- 75 percent of the trading limit set by the Member for that Risk Entity;
- 90 percent of the trading limit set by the Member for that Risk Entity; and
- 100 percent of the trading limit set by the Member for that Risk Entity.[14]

Members may elect to receive such alerts through the DTCC Limit Monitoring interface, e-mail, and/or an automated electronic message. Members have the discretion to decide whether to take action pursuant to an alert.[15] Alerts do not trigger a block by NSCC on any trading activity processed through NSCC.

D. Risk Entity Reports

Risk Entity information, such as alert history, characteristics, and end-of-day positions, will be provided to Members in both an end-of-day report and a monthly report.[16] Members will be required to identify primary and secondary contacts within their firm to receive alerts and reports. Additionally, Members will be required to review their Risk Entities' alerts and reports

---

14 DTCC Limit Monitoring will also alert a Member when the trading activity of a Risk Entity returns below an alert threshold.

15 NSCC may discuss a Member's use of DTCC Limit Monitoring, including the trading limits set by that Member, with the Member.

16 NSCC states that reports and data provided to Members through DTCC Limit Monitoring are not intended to impact the timing or status of NSCC's guaranty of any transaction in NSCC's Continuous Net Settlement or Balance Order Securities. Release No. 34-70946, supra note 3, at 7. Furthermore, the issuance of information or data, or the lack thereof, to Members through DTCC Limit Monitoring will not in and of itself indicate or have any bearing on the status of any trade, including, but not limited to, the status of a trade as compared, locked-in, validated, guaranteed, or not guaranteed trades. Id.

on an on-going basis and, as deemed appropriate by the Member, modify trading limits to reflect current trading activities within each of their Risk Entities. Changes made by Members with respect to trading limits will be made in real-time. All other updates and changes made by Members to their Risk Entities will take effect overnight.

E. Mandatory Use

Although DTCC Limit Monitoring will be available to all Members,[17] NSCC will require the following Members to use the tool: (1) any NSCC full-service Member that clears for others; (2) any NSCC full-service Member that submits transactions to NSCC's trade capture system either as a Qualified Special Representative ("QSR") or Special Representative, pursuant to Procedure IV (Special Representative Service) of the Rules; and (3) any NSCC full-service Member that has established a 9A/9B relationship in order to allow another Member (either a QSR or Special Representative) to submit locked-in trade data on its behalf.[18] However, NSCC will not charge a fee for the use of DTCC Limit Monitoring, whether voluntary or mandatory, and, according to NSCC, implementation and use of the tool will require minimal, if any, changes to Members' current systems.

III. Comment Letter and Response

---

17 NSCC states that since the information provided by DTCC Limit Monitoring is to be used by the Member at the Member's discretion, the Proposed Rule Change provides that any Member that registers for DTCC Limit Monitoring shall indemnify NSCC, and any of NSCC's employees, officers, directors, shareholders, agents, and participants who may sustain any loss, liability, or expense as a result of a third party claim related to any act or omission by the Member made in reliance upon data or information transmitted to the Member through DTCC Limit Monitoring. Id. at 8.

18 Members that are required to use DTCC Limit Monitoring will be required to create a Risk Entity for their own trading desks, as well as for all correspondents and clients for which the Members clear trades through NSCC.

The Commission received one comment letter to the Proposed Rule Change[19] and one response letter from NSCC.[20] Below is a summary of the concerns raised by the commenter regarding the Proposed Rule Change and NSCC's responses to those concerns.

A. Completeness of Trading Data

The commenter argues that DTCC Limit Monitoring will have incomplete trading information.[21] Specifically, the commenter claims that the tool will not capture Institutional Delivery ("ID") trades, options trades, or futures trades that may hedge or offset positions captured by the tool.[22] The commenter also states that certain information identifying the parties to a trade is not always required or validated by certain exchanges or other venues that submit trades to NSCC for clearing; thus, DTCC Limit Monitoring may not accurately account for such trades.[23] Furthermore, the commenter points out that not all trades are submitted to NSCC for clearance in real-time.[24] The commenter argues that these issues may result in DTCC Limit Monitoring presenting incomplete and/or inaccurate trade positions to Members.[25]

In response, NSCC acknowledges that certain transactions, such as ID trades, options trades, and futures trades are not within the scope of DTCC Limit Monitoring, but it believes that

---

19 See FIF Letter, supra note 4.

20 See NSCC Response, supra note 5.

21 FIF Letter, supra note 4, at 1-2.

22 Id. at 2.

23 Id.

24 Id.

25 See id. at 1-2.

Members will take that fact into consideration when setting trading limits and responding to alerts received.[26] Moreover, NSCC believes that implementation of DTCC Limit Monitoring should not be delayed in order to discuss the expansion of the tool to incorporate transactions outside the purview of NSCC, which would likely be a complex endeavor.[27] NSCC also states that it has recently implement a previously approved rule that requires all locked-in trade data submitted to NSCC for trade recording be submitted in real-time.[28] Although that rule does not apply to correspondent clearing trades, nor is there a rule that requires all information identifying parties to a transaction be included with each trade submission, NSCC explains that Members are permitted and encouraged to take such action and often do, given the associated benefits.[29] Accordingly, NSCC argues that DTCC Limit Monitoring, as currently structured, will offer Members significant risk management benefits by providing a single, centralized, and aggregated view of all equity transactions submitted to NSCC for clearance.[30]

B. Benefits of Trade Alerts

The commenter states that there are variable benefits offered by DTCC Limit Monitoring's post-trade alerts.[31] For example, the commenter argues that some Members have dedicated significant resources to proprietary risk management platforms based on pre-trade

---

26 NSCC Response, supra note 5, at 4.

27 Id.

28 See id.

29 Id. at 4-5.

30 Id. at 4.

31 FIF Letter, supra note 4, at 2.

and/or post-trade alerts, and such existing platforms may not incorporate the data provided by DTCC Limit Monitoring.[32] The commenter also asserts that Members with sophisticated risk management tools are capable of measuring, monitoring, and aggregating such trade data in more detail than DTCC Limit Monitoring.[33] Similarly, the commenter argues that DTCC Limit Monitoring does not provide sufficient granularity because it aggregates trades by clearing numbers or Market Participant Identifiers ("MPID"); thus, where a Member has multiple trading desks associated with a single MPID, it may prove difficult for the Member to identify the specific source that triggered a DTCC Limit Monitoring alert.[34] Accordingly, the commenter suggests that Members should have flexibility within the tool to determine the level of granularity of the sources with respect to Risk Entities, in accordance with each Member's risk management preferences.[35] Therefore, the commenter contends that the benefits of DTCC Limit Monitoring are limited, especially for self-clearing Members with no correspondents.[36]

In response, NSCC states that DTCC consulted with its Members and other industry participants when developing DTCC Limit Monitoring. Industry participants indicated that pre-trade monitoring, as a stand-alone risk management tool at the Member level, may not provide adequate protection for firms or against systemic risk.[37] NSCC also states that DTCC Limit

---

32 Id.

33 Id.

34 Id.

35 Id. at 3.

36 Id. at 2.

37 See NSCC Response, supra note 5, at 5.

Monitoring was not developed to replace pre-trade and real-time risk management tools, but as an independent, standardized, post-trade surveillance tool that would contribute to a multi-layered risk management system, in efforts to avoid a single point of failure within such a system.[38] Additionally, NSCC highlights that Members will be able to integrate the data and information provided by DTCC Limit Monitoring with their own risk management processes as they see fit.[39] Finally, NSCC states that DTCC Limit Monitoring uses the MPID to allocate transactions because the MPID is the standard industry identifier used by exchanges and other execution platforms for identifying the origin of an executed trade.[40] Therefore, NSCC believes that each of its Members, including those with sophisticated, internal risk management tools, will benefit from using DTCC Limit Monitoring.[41] The commenter acknowledges that some Members "believe post-trade alerts disseminated by DTCC would increase market stability by offering an added level of protection against clearing firm failure."[42]

C. Operational Burdens

The commenter argues that the requirement to set and maintain trading limits imposes a significant operational burden on Members.[43] Specifically, the commenter states that establishing meaningful trading limits is not a trivial task and will require the input of staff from

---

38 Id.

39 Id.

40 Id.

41 See id.

42 FIF Letter, supra note 4, at 2.

43 Id. at 3.

operations, "front office," risk, and compliance.[44] Accordingly, the commenter contends that sufficient implementation time would be required in order to set meaningful trading limits that are consistent with the Member's existing risk management platforms.[45] Furthermore, the commenter states that there will be costs associated with the maintenance of trading limits, including communications with NSCC regarding the reasonableness of such limits.[46]

In response, NSCC states that Members should not incur a significant burden in initiating and maintaining their Risk Entities in DTCC Limit Monitoring.[47] For example, NSCC states that subscribing to the tool will not require any system changes for Members.[48] NSCC also states that it has made available various information documents, conducted numerous webinars, held group and one-on-one information and training sessions, and met with industry groups and individual Members to discuss DTCC Limit Monitoring and to support Members in anticipation of implementing the tool and reducing efforts needed to maintain it.[49] NSCC asserts that it will continue to provide such support.[50] NSCC also states that many Members already have risk management staff in place to manage proprietary risk management platforms, but NSCC acknowledges that the use of DTCC Limit Monitoring will require additional time and effort by

44 Id.

45 Id.

46 Id.

47 NSCC Response, supra note 5, at 6.

48 Id.

49 Id.

50 See id.

such staff.[51] Nevertheless, NSCC believes that any time spent using DTCC Limit Monitoring is justified by the risk management benefits offered by the tool to Members and the industry.[52]

D. Consistency of Mandatory Requirement with Industry Practice

The commenter argues that the mandatory use of DTCC Limit Monitoring for certain Members is inconsistent with other risk management tools offered by other self-regulatory organizations ("SRO").[53] For example, the commenter references risk management tools by NYSE[54] and BATS,[55] neither of which are mandatory for their respective members.[56] However, the commenter acknowledges the unique position of NSCC as an industry-wide utility that impacts a greater breadth of participants than any single exchange.[57]

In response, NSCC highlights that trading activity processed through those SROs is subject to other mandatory risk management requirements (e.g., exchange rules regarding "clearly erroneous" trades).[58] NSCC also notes that those SROs do not assume the same level of risks as NSCC, which, as a central counterparty ("CCP"), has a greater stake in ensuring that its

---

51 Id.

52 Id.

53 FIF Letter, supra note 4, at 3.

54 See Release No. 34-71164 (Dec. 20, 2013), 78 FR 79044 (Dec. 27, 2013) (SR-NYSE-2013-08).

55 See Release No. 34-68330 (Nov. 30, 2012), 77 FR 72894 (Dec. 6, 2012) (SR-BATS-2012-045).

56 FIF Letter, supra note 4, at 3.

57 Id.

58 NSCC Response, supra note 5, at 7.

Members implement effective risk management tools.[59] NSCC believes that Members that clear for others or participate in special representative transactions must use DTCC Limit Monitoring for it to be maximally effective because those Members have less control when clearing and settling trading activity that is executed by another firm.[60]

E. Additional Time to Discuss

Finally, given the concerns it raises, the commenter believes that additional discussion is necessary before use of DTCC Limit Monitoring is required and that an opportunity exists for a phased implementation of the tool that will balance the needs of the Members.[61]

NSCC responded that it does not believe the concerns raised by the commenter warrant additional discussion before making DTCC Limit Monitoring a requirement for certain Members.[62] NSCC states that the launch of DTCC Limit Monitoring will be followed by a six-month phase-in period, during which Members can seek additional support from NSCC in establishing any internal procedures with respect to DTCC Limit Monitoring.[63]

IV. Discussion and Commission Findings

Section 19(b)(2)(C)(i) of the Act[64] directs the Commission to approve a proposed rule change of an SRO if the Commission finds the proposed rule change consistent with the

---

59 Id.

60 Id. at 3, 7.

61 FIF Letter, supra note 4, at 4.

62 NSCC Response, supra note 5, at 7.

63 Id. at 6.

64 15 U.S.C. 78s(b)(2)(C)(i).

requirements of the Act and the rules and regulations thereunder applicable to such an organization. After a thorough review and careful consideration of the comments received, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act, in particular the requirements of Section 17A of the Act, and the applicable rules and regulations thereunder.[65] Specifically, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act[66] and Commission Rule 17Ad-22(b)(1),[67] as discussed below.

A. Assessment of the Commenter's Concerns and NSCC's Responses

The Commission fully considered the comment letter and NSCC's response as it carefully assessed the Proposed Rule Change for consistency with the Act. The commenter raises no issues, as detailed above and addressed below, that convinced the Commission that the Proposed Rule Change is inconsistent with the Act and the applicable rules and regulations thereunder – the standard by which the Commission must evaluate proposed rule changes.[68] Additionally, the Commission believes that NSCC articulates colorable arguments in its response to the concerns expressed by the commenter,[69] thus satisfying NSCC's burden to demonstrate that the Propose Rule Change is adequately designed to comply with the Act.

---

65 15 U.S.C. 78q-1. In approving the Proposed Rule Change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

66 15 U.S.C. 78q-1(b)(3)(F).

67 17 CFR 240.17Ad-22(b)(1).

68 15 U.S.C. 78s(b)(2)(C)(i).

69 See generally NSCC Response, supra note 5.

First, the Commission understands that the trading information captured by DTCC Limit Monitoring will not reflect every trade or every detail of every trade made by Members, as identified by the commenter and acknowledged by NSCC.[70] Nevertheless, the Commission believes that the information captured is sufficiently extensive to provide a useful risk management tool for Members. Furthermore DTCC Limit Monitoring permits Members to input LM Member-Provided Data.

Second, the Commission recognizes that Members may disagree on the usefulness of DTCC Limit Monitoring. The Commission believes that DTCC Limit Monitoring will serve as a practical risk management tool for Members that do not currently employ such a tool. Alternatively, for Members that already use an internal risk management system, DTCC Limit Monitoring can serve as a meaningful backstop to that system in the event of failure, thus increasing market stability, as acknowledged by the commenter.[71]

Third, regarding the operational costs that DTCC Limit Monitoring may impose on Members, the Commission understands that: (i) access to the tool will require little, if any, changes to a Member's systems; (ii) NSCC has provided and will continue to provide support for all Members implementing and using the tool; and (iii) a six-month "phase-in" period will follow the enactment of the tool, in order to accommodate Members that need additional time or assistance. Consequently, the Commission believes that Members should experience minimal additional costs, either in time or money, in implementing and maintaining DTCC Limit Monitoring.

---

[70] See FIF Letter, supra note 4, at 1-2; NSCC Response, supra note 5, at 3-4.

[71] See FIF Letter, supra note 4, at 2.

Fourth, the Commission understands that NSCC will require approximately 85 percent of its Members to use DTCC Limit Monitoring. Given the unique risks carried by NSCC as a prominent CCP, which the commenter acknowledges,[72] and given that there will be no fee charged for using DTCC Limit Monitoring, the Commission finds that the mandatory nature of the tool for Members that clear trades for other firms or allow special representative transactions is reasonable and appropriate.[73]

Finally, the Commission does not believe that further discussions are needed prior to approving the Proposed Rule Change and the implementation of DTCC Limit Monitoring because the Commission finds the Proposed Rule Change consistent with the Act, even in consideration of the concerns raised by the commenter, and because DTCC Limit Monitoring will be phased in over a six-month period.

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

Section 17A(b)(3)(F) of the Act[74] requires, among other things, that the rules of a registered clearing agency "are designed to promote the prompt and accurate clearance and settlement of securities transactions…, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible."[75]

---

72 FIF Letter, supra note 4, at 3.

73 The Commission notes that other SROs have implemented mandatory risk management tools. See, e.g., Release Nos. 34-70132 (Aug. 7, 2013), 78 FR 49311 (Aug. 13, 2013) (SR-ISE-2013-38) and 34-71252 (Jan. 7, 2014), 79 FR 2224 (Jan. 13, 2014) (SR-NYSEMKT-2013-106).

74 15 U.S.C. 78q-1(b)(3)(F).

75 Id.

As a CCP, NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions, thereby reducing certain risks faced by Members and contributing to global financial stability. In this role, NSCC is necessarily subject to certain risks in the event of a Member default – risks that could also affect other Members and the marketplace as a whole. DTCC Limit Monitoring is designed to help mitigate the risk of a Member default by providing all Members with a tool to monitor their aggregated net notional trading activity, via Risk Entities, for transactions submitted to NSCC and any other transactions included by the Member as LM Member-Provided Data. By enabling all Members to monitor intraday trading activity for their Risk Entities and by alerting a Member when its activity approaches and breaches Member-set trading limits, DTCC Limit Monitoring can notify a Member of trading abnormalities that could threaten the stability of the Member and, potentially, NSCC's ability to clear and settle transactions or safeguard securities in its possession. Therefore, the Commission finds the Proposed Rule Change compliant with Section 17A(b)(3)(F) of the Act.[76]

C. Compliance with Commission Rule 17Ad-22(b)(1)

Commission Rule 17Ad-22(b)(1) regarding measurement and management of credit exposure requires a CCP to establish, implement, maintain, and enforce written policies and procedures reasonably designed to measure its credit exposures to its participants at least once a day and limit its exposures to potential losses from defaults by its participants under normal

[76] 15 U.S.C. 78q-1(b)(3)(F).

market conditions so that the operations of the CCP would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.[77]

DTCC Limit Monitoring will enable Members to monitor intraday trading activity for each of their Risk Entities and will alert Members when such activity approaches and breaches Member-set trading limits. At NSCC, that trading activity manifests as credit risk borne by NSCC. Therefore, by providing Members notification of possible trading abnormalities, DTCC Limit Monitoring serves as an NSCC risk management tool. Moreover, absent the tool's alert feature, particularly where a Member lacks an internal risk management system or such system has failed, trading abnormalities may go unnoticed, which could increase the likelihood of a Member default, including NSCC's and non-defaulting Members' risk. As such, the Commission finds the Proposed Rule Change consistent with Rule 17Ad-22(b)(1).[78]

V. Conclusion

On the basis of the foregoing, the Commission finds the Proposed Rule Change consistent with the requirements of the Act, particularly with the requirements of Section 17A of the Act,[79] and the rules and regulations thereunder.

---

77 17 CFR 240.17Ad-22(b)(1). Commission Rule 17Ad-22(b)(1) was adopted as part of the Clearing Agency Standards. Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (Nov. 2, 2012).

78 Id.

79 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[80] that the proposed rule change SR-NSCC-2013-12 be and hereby is APPROVED as of the date of this order.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[81]

Kevin M. O'Neill
Deputy Secretary

---

80 15 U.S.C. 78s(b)(2).

81 17 CFR 200.30-3(a)(12).