

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-92640; File No. SR-NSCC-2021-005)

August 11, 2021

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Partial Amendment No. 1, to Increase the National Securities Clearing Corporation's Minimum Required Fund Deposit

**I. INTRODUCTION**

On April 26, 2021, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-NSCC-2021-005 (the "Proposed Rule Change") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup> to increase its minimum required fund deposit. The Proposed Rule Change was published for comment in the Federal Register on May 14, 2021,<sup>3</sup> and the Commission has received comments<sup>4</sup> on the changes proposed therein.<sup>5</sup> On June 24, 2021, pursuant to Section 19(b)(2) of the

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

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

<sup>3</sup> Securities Exchange Act Release No. 91809 (May 10, 2021), 86 Fed. Reg. 26588 (May 14, 2021) (File No. SR-NSCC-2021-005) ("Notice of Filing").

<sup>4</sup> See Letter from Parsons, Behle & Latimer, Counsel for Alpine Securities Corporation, dated June 4, 2021, to Vanessa Countryman, Secretary, Commission ("Alpine Letter"), available at <https://www.sec.gov/comments/sr-nsc-2021-005/srnsc2021005.htm>.

<sup>5</sup> NSCC appended an Exhibit 2 to the materials filed on April 26, 2021. The appended Exhibit 2 consists of a comment letter that NSCC received from one of its members objecting to NSCC's proposal in response to member outreach NSCC conducted in 2019 ("Wachtel Letter"). See Notice of Filing, supra note 3, at 26593. NSCC considered that comment in its Proposed Rule Change, and the Commission has considered the comment letter in making its determination, as discussed in Section III below. A copy of the comment letter is available at

Act,<sup>6</sup> the Commission designated a longer period within which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove the proposed rule change.<sup>7</sup> On August 5, 2021, NSCC filed a partial amendment (“Partial Amendment No. 1”) to modify the Proposed Rule Change.<sup>8</sup> The Commission is publishing this notice to solicit comments on Partial Amendment No. 1 from interested persons and is approving the Proposed Rule Change, as modified by Partial Amendment No. 1, on an accelerated basis.<sup>9</sup>

## II. DESCRIPTION OF THE PROPOSED RULE CHANGE

Currently, NSCC requires each Member to maintain a minimum Required Fund Deposit<sup>10</sup> amount of \$10,000.<sup>11</sup> NSCC proposes to increase each Member’s minimum

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<https://www.dtcc.com/~media/Files/Downloads/legal/rule-filings/2021/NSCC/SR-NSCC-2021-005.pdf>.

<sup>6</sup> 15 U.S.C. 78s(b)(2).

<sup>7</sup> Securities Exchange Act Release No. 92250 (June 24, 2021), 86 Fed. Reg. 34798 (June 30, 2021) (File No. SR-NSCC-2021-005).

<sup>8</sup> In Partial Amendment No. 1, NSCC updates the proposed rule text filed as Exhibit 5 to the proposed rule change to include a legend to indicate a delayed implementation date, specifically that the rule change would be implemented not later than 20 business days after Commission approval of the Proposed Rule Change. NSCC did not change the purpose or substance of, or basis for, the Proposed Rule Change.

<sup>9</sup> References to the Proposed Rule Change from this point forward refer to the Proposed Rule Change as modified by Partial Amendment No. 1.

<sup>10</sup> Capitalized terms not defined herein are defined in NSCC’s Rules and Procedures (“Rules”), available at [http://dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

<sup>11</sup> See Section 1 of Rule 4, id.

Required Fund Deposit amount to \$250,000.

**A. Background**

NSCC provides central counterparty (“CCP”) services, including clearing, settlement, risk management, and a guarantee of completion for virtually all broker-to-broker trades involving equity securities, corporate and municipal debt securities, and certain other securities. In its role as a CCP, a key tool NSCC uses to manage its credit exposure to its Members is determining and collecting an appropriate Required Fund Deposit (i.e., margin) from each Member.<sup>12</sup> A Member’s Required Fund Deposit serves as collateral to mitigate potential losses to NSCC associated with the liquidation of the Member’s portfolio should that Member default. The aggregate of all Members’ Required Fund Deposits constitutes NSCC’s Clearing Fund, which it would access, among other instances, should a defaulting Member’s own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that Member’s portfolio.<sup>13</sup>

NSCC conducts daily backtesting to evaluate whether each Member’s Required Fund Deposit is sufficient to cover NSCC’s credit exposures to that Member based on a simulated liquidation of the Member’s portfolio on that day.<sup>14</sup> Backtesting is an ex-post

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<sup>12</sup> See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules (“Procedure XV”), supra note 8. The minimum Required Fund Deposit amount is required to be in cash. See Section II.(A) of Procedure XV, supra note 8.

<sup>13</sup> See id.

<sup>14</sup> See Securities Exchange Act Release No. 81485 (August 25, 2017), 82 Fed. Reg. 41433 (August 31, 2017) (NSCC-2017-008) (adopting Model Risk Management Framework and stating that Required Fund Deposit backtesting would be performed at least on a daily basis); Securities Exchange Act Release No. 84458

comparison of actual outcomes with expected outcomes derived from the use of margin models.<sup>15</sup> A backtesting deficiency occurs when NSCC determines that the projected liquidation losses to NSCC arising in the event of a Member's default would be greater than the Member's Required Fund Deposit.<sup>16</sup> Therefore, backtesting deficiencies highlight exposure that could subject NSCC to potential losses under normal market conditions in the event that a Member defaults.<sup>17</sup>

NSCC regularly reviews backtesting results to assess the effectiveness of its margining requirements.<sup>18</sup> As part of its review, NSCC investigates the causes of any backtesting deficiencies, paying particular attention to repeat backtesting deficiencies that would result in the Member's backtesting coverage to fall below the 99% confidence target to determine if there is an identifiable cause of repeat backtesting deficiencies.<sup>19</sup> NSCC also evaluates whether multiple Members may experience backtesting deficiencies

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(October 19, 2018), 83 Fed. Reg. 53925 (October 25, 2018) (File No. SR-NSCC-2018-009) (amending the Model Risk Management Framework to provide enhanced governance).

<sup>15</sup> See 17 CFR 240.17Ad-22(a)(1).

<sup>16</sup> See Notice of Filing, supra note 3, at 26589.

<sup>17</sup> See id.

<sup>18</sup> See Notice of Filing, supra note 3, at 26589.

<sup>19</sup> NSCC states a Member's backtesting coverage would fall below the 99% confidence target if the Member has more than two backtesting deficiency days in a rolling twelve-month period. See Notice of Filing, supra note 3, at 26589. In other words, if a Member has three or more backtesting deficiency days during a twelve-month period, then the Member's margin would not be sufficient 99% of the time. NSCC believes that its targeted 99% confidence level is consistent with its regulatory requirements under Rule 17Ad-22(e)(4)(i) and (e)(6)(iii). 17 CFR 240.17Ad-22 (e)(4)(i), and (e)(6)(iii).

for the same underlying reason.<sup>20</sup>

Based on its regular reviews, NSCC states it has found that Members with Required Fund Deposits below \$250,000 disproportionately experience repeat backtesting deficiencies because, should the Member's settlement activity abruptly increase, the additional exposure to NSCC would not be mitigated until the collection of the Required Fund Deposit either intraday or on the next business day.<sup>21</sup> NSCC states it has also found that its current minimum margin requirement of \$10,000 is disproportionately lower than the minimum margin requirements of other CCPs that clear similar securities products.<sup>22</sup>

Therefore, NSCC proposes to increase its minimum Required Fund Deposit from \$10,000 to \$250,000.

## **B. Impact Study Results**

To support its proposal, NSCC relies upon the results of recent backtesting

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<sup>20</sup> See Notice of Filing, supra note 3, at 26589.

<sup>21</sup> See id.

<sup>22</sup> See id. For example, the minimum initial contribution for The Options Clearing Corporation ("OCC") is \$500,000. See Rule 1002(d) of the OCC Rules, available at [https://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/occ\\_rules.pdf](https://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_rules.pdf). The minimum Required Fund Deposit for both the Government Securities Division ("GSD") and Mortgage-Backed Securities Division ("MBS") of Fixed Income Clearing Corporation ("FICC") is \$100,000. See Rule 4 of FICC GSD Rulebook, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_gov\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf) and Rule 4 of the FICC MBS Clearing Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc\\_mbsd\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf).

analyses.<sup>23</sup> Specifically, NSCC examines the backtesting coverage<sup>24</sup> of each of its Members during the period from June 3, 2019 to May 29, 2020, under the current \$10,000 minimum Required Fund Deposit amount compared to hypothetical (or “pro forma”) minimum Required Fund Deposit amounts, including the proposed \$250,000 amount and \$100,000 (“Impact Study Results”).<sup>25</sup> NSCC uses the Impact Study Results to show the number of Member backtesting deficiencies<sup>26</sup> that would have been eliminated during the period had NSCC’s minimum Required Fund Deposit been \$250,000 and compared to \$100,000. NSCC then uses the Impact Study Results to analyze the improvement to each Member’s backtesting coverage ratio<sup>27</sup> and, taking all Members’ backtesting coverage ratio results together, to analyze the improvement to NSCC’s Clearing Fund backtesting coverage.<sup>28</sup>

During the impact study period under the current minimum Required Fund

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<sup>23</sup> See supra text accompanying notes 12-16.

<sup>24</sup> See supra note 17 and accompanying text.

<sup>25</sup> NSCC provided a public summary of the information in this Section II.B in its Notice of Filing, upon which this discussion is based. See Notice of Filing, supra note 3, at 26590-92. NSCC filed the data underlying the Impact Study Results as a confidential Exhibit 3 to the Proposed Rule Change pursuant to 17 CFR 240.24b-2.

<sup>26</sup> See supra text accompanying notes 14-15.

<sup>27</sup> See supra note 17 and accompanying text.

<sup>28</sup> The Clearing Fund backtesting coverage represents the daily sufficiency of the aggregate of all Members’ margin over a rolling 12-month period. As described in Section II.A above, NSCC would be able to access the Clearing Fund to cover any losses to it should a Member with insufficient margin default. See supra text accompanying note 11.

Deposit, NSCC observed a total of 227 Member backtesting deficiencies, and 29 Members experienced repeat backtesting deficiencies causing them to fall below the 99% confidence target.<sup>29</sup> Members with a Required Fund Deposit lower than \$250,000 accounted for 22% of the total backtesting deficiencies and constituted approximately 45% of the Members whose margin levels fell below the 99% confidence target.<sup>30</sup> Additionally, NSCC's twelve-month aggregate Clearing Fund backtesting coverage was 99.28%.

A minimum requirement of \$250,000 would have eliminated 44 backtesting deficiencies across 13 Members and would have eliminated approximately 88% of the deficiencies that occurred on the days when Members maintained a Required Fund Deposit of less than \$250,000.<sup>31</sup> Additionally, a minimum requirement of \$250,000 would have improved NSCC's rolling twelve-month coverage for seven Members to above the 99% confidence interval.<sup>32</sup> NSCC states that, if the proposed \$250,000 minimum had been in place, the remaining Members still below the 99% confidence interval would constitute only 27% of Members that fell below the 99% confidence

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<sup>29</sup> See id.

<sup>30</sup> See id.

<sup>31</sup> See Notice of Filing, supra note 3, at 26590. Not all of the backtesting deficiencies would have been eliminated because if the Member's Required Fund Deposit calculation increases to above \$250,000 intraday, due to, for example, increases in trading volume and/or adverse mark-to-market adjustments, the \$250,000 proposed minimum Required Fund Deposit would still be insufficient to cover NSCC's exposure between margin collections. See supra text accompanying note 19.

<sup>32</sup> See Notice of Filing, supra note 3, at 26590.

target, which is comparable to those Members' overall representation as a class of NSCC's total Members.<sup>33</sup> Moreover, a minimum requirement of \$250,000 would have increased NSCC's twelve-month aggregate Clearing Fund backtesting coverage by 0.14% to 99.41%.<sup>34</sup>

An increase to \$250,000 compared to \$100,000 would have further reduced NSCC's credit exposure to its Members by eliminating ten additional backtesting deficiencies from 34 to 44 total backtesting deficiencies and resulting in increasing two additional Members' margin levels to above the 99% confidence interval from five Members to seven Members. Additionally, NSCC's aggregate Clearing Fund backtesting coverage would have improved from 99.38% to 99.41% representing an increase of 0.03%.

NSCC had approximately 150 total Members during the impact study period.<sup>35</sup> Of those, 46 Members would be impacted by the proposed \$250,000 minimum Required Fund Deposit.<sup>36</sup> On average, 18 Members maintained excess deposits greater than the proposed increase; therefore, 28 Members on average would have been required to deposit additional funds if the proposal had been implemented.<sup>37</sup> In addition, the 46

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<sup>33</sup> See id.

<sup>34</sup> See id.

<sup>35</sup> See CPMI IOSCO Quantitative Disclosure Results 2019 Q2 (September 25, 2019), available at <https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/CPMI-IOSCO-Quantitative-Disclosure-Results-2019-Q2-2.pdf>.

<sup>36</sup> See Notice of Filing, supra note 3 at 26593.

<sup>37</sup> See id.



Members that would be impacted by the proposed \$250,000 minimum Required Fund Deposit maintained excess net capital or equity capital (as applicable) (“ENC”) in excess of \$800,000 on average over the Impact Study Period, ranging between an average of \$834,000 to \$211.5 billion, with 98% of the impacted Members having on average an ENC above \$2.5 million.<sup>38</sup> NSCC states it used ENC in its analysis to estimate impacted Members’ ability to satisfy additional Required Fund Deposit amounts required by the proposal.<sup>39</sup>

### III. DISCUSSION AND COMMISSION FINDINGS

Section 19(b)(2)(C) of the Act<sup>40</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. After careful consideration, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations applicable to NSCC.<sup>41</sup> In particular, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) and (b)(3)(I)<sup>42</sup> of the Act

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<sup>38</sup> See id.

<sup>39</sup> See id.

<sup>40</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>41</sup> The Commission’s findings are based on its review of the Proposed Rule Change, including its analysis of the Impact Study Results, which are summarized in Section II.B above. See supra note 23 and accompanying text.

<sup>42</sup> 15 U.S.C. 78q-1(b)(3)(F).

and Rules 17Ad-22(e)(4) and (e)(6) thereunder.<sup>43</sup>

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

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency, such as NSCC, be designed, in part, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.<sup>44</sup> The Commission believes that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act.

As discussed in Section II.A above, backtesting deficiencies highlight when a Member's margin is insufficient to cover NSCC's credit exposure to that Member.<sup>45</sup> If a defaulted Member's margin is insufficient to satisfy losses caused by the closeout of that Member's positions, NSCC and its non-defaulting Members may be subject to losses. As summarized in Section II.B above, the proposed increase would have provided NSCC with additional resources, which would have resulted in a decrease in backtesting deficiencies and thus a reduction in credit exposure to its Members under the proposal.<sup>46</sup> Therefore, the Commission believes NSCC would improve the probability that the increased minimum margin amount it collects is sufficient to cover NSCC's credit exposure to those Members, particularly in instances where the defaulted Member's clearing activity abruptly increases following a period of low or no activity. This increase, in turn, could reduce the possibility that NSCC or its non-defaulting Members

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<sup>43</sup> 17 CFR 240.17Ad-22(e)(4) and (e)(6).

<sup>44</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>45</sup> See supra text accompanying note 15.

<sup>46</sup> See supra text accompanying notes 29-31.

face losses from the close-out process.

Moreover, NSCC would continue to require that Members pay an amount equal to the minimum Required Fund Deposit amount in cash. Therefore, the proposal would enable NSCC to have available additional collateral that is easier for NSCC to access quickly to complete end of day settlement upon a Member's default, further reducing the risk of losses to NSCC or non-defaulting Members. Accordingly, the Commission believes the Proposed Rule Change would promote the safeguarding of securities and funds which are in the custody or control of NSCC or for which NSCC is responsible, consistent with Section 17A(b)(3)(F) of the Act.<sup>47</sup>

**B. Consistency with Section 17A(b)(3)(I) of the Act**

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the Act.<sup>48</sup> This provision does not require the Commission to find that a proposed rule

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<sup>47</sup> In addition to its arguments about the Proposed Rule Change, one commenter also asserts that NSCC's other recent efforts to increase capital or methodology-based margin requirements represent unfair discrimination against Members who deal in stocks trading in the OTC Markets, inconsistent with Section 17A(b)(3)(F) of the Act. See Alpine Letter, supra note 4, at 4-5. However, the Proposed Rule Change would not amend NSCC's capital or methodology-based margin requirements and is limited to the amendment of the minimum Required Fund Deposit amount. Therefore, the commenter's arguments pursuant to Section 17A(b)(3)(F) of the Act are outside the scope of this Proposed Rule Change. The commenter also argues that NSCC should instead eliminate risk by shortening the settlement cycle, rather than monetizing risk through increased margin requirements, such as under this Proposed Rule Change. See Alpine Letter, supra note 4, at 7-8. However, the Proposed Rule Change is limited to NSCC's minimum Required Fund Deposit amount in order to manage risk under the current settlement cycle. Therefore, the commenter's arguments related to shortening the settlement cycle are likewise outside the scope of this Proposed Rule Change.

<sup>48</sup> 15 U.S.C. 78q-1(b)(3)(I).

change represents the least anti-competitive means of achieving the goal.<sup>49</sup> Rather, it requires the Commission to balance the competitive considerations against other relevant policy goals of the Act.<sup>50</sup>

The Commission acknowledges that the impact of increased margin requirements will likely present higher costs to some Members with lower operating margins, lower cash reserves or higher costs of capital compared to other Members, which may weaken those Members' competitive positions relative to others. For example, certain smaller Members could be required to make and hold an additional deposit of up to \$240,000 to the Clearing Fund, which would limit the smaller Member's ability to utilize that cash for other operating or investing purposes. Although some of NSCC's Members could experience a burden on competition because of these higher costs, the Commission concludes any burden to these Members is necessary and appropriate in furtherance of the policy goals under the Act<sup>51</sup> for the following reasons.

As discussed in Section II.A above, NSCC seeks to maintain sufficient resources (i.e., margin) to cover its credit exposures to its Members fully with a high degree of confidence. Conversely, NSCC uses backtesting to determine when a Member's margin

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<sup>49</sup> See Bradford National Clearing Corp., 590 F.2d 1085, 1105 (D.C. Cir. 1978) ("Bradford").

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<sup>51</sup> 15 U.S.C. 78q-1(b)(3)(I). Specifically, as discussed in greater detail in Section III.C and III.D below, the Proposed Rule Change is necessary and appropriate to further the policy goals under Rule 17Ad-22(e)(4)(i) and (e)(6)(iii). 17 CFR 240.17Ad-22(e)(4)(i) and (e)(6)(iii).

would have been insufficient to cover NSCC's credit exposure to that Member.<sup>52</sup> As previously discussed, the Impact Study Results show the proposed \$250,000 minimum Required Fund Deposit would have decreased the number of backtesting deficiencies, thereby increasing the number of Members for which NSCC maintained sufficient coverage at a confidence level of at least 99%.<sup>53</sup> Therefore, the Proposed Rule Change would enable NSCC to better manage its credit exposure to its Members by ensuring it holds sufficient collateral to cover that exposure, thereby reducing the likelihood that NSCC or non-defaulting Members would incur losses resulting from a Member default.

Additionally, based on the information set forth in Section II.B above regarding the average ENC of the impacted Members,<sup>54</sup> the Commission believes that the vast majority of impacted Members likely would not experience a weakened competitive position compared to others as a result of the Proposed Rule Change. The average ENC data shows that almost all of the impacted Members would likely be able to satisfy the additional cash deposits needed to comply with the Proposed Rule Change with minimal

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<sup>52</sup> See supra text accompanying notes 12-15.

<sup>53</sup> See supra text accompanying note 44. See also, supra text accompanying notes 29-31.

<sup>54</sup> See supra notes 34-37 and accompanying text. 98% of the impacted Members had, on average, an ENC above \$2.5 million. Therefore, on average, 2% of the 46 impacted Members would maintain ENC below \$2.5 million, which equals approximately one Member who could be required to hold 9.6% or more of its ENC on deposit at NSCC.

impact to the Members' financials.<sup>55</sup>

Commenters have raised concerns regarding the Proposed Rule Change in light of its potential competitive impact on certain NSCC Members. Specifically, one commenter objects to the proposed increase to \$250,000, stating that NSCC's current Rules are more than adequate to guard against risk at the small firm-level and that the increase would be purely a tax on the smallest, inactive and lowest risk firms.<sup>56</sup> Another commenter similarly objects to the proposed change stating the increase would disproportionately affect NSCC's smallest Members.<sup>57</sup> The Commission disagrees for the reasons discussed above, which indicate that the proposed increase would increase Members' Required Fund Deposits proportional to the risks posed by those Members.

Moreover, as discussed in Section II.A above, it is possible that, in certain circumstances, the current minimum Required Fund Deposit amount would be insufficient to manage NSCC's credit exposure to participants between margin collections should, for example, the Member's clearing activity abruptly increase.<sup>58</sup> As summarized in Section II.B above, the Impact Study Results show that approximately 88% of the deficiencies that occurred on the days when Members maintained a Required

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<sup>55</sup> NSCC represents it would continue to require that Members pay an amount equal to the minimum Required Fund Deposit amount in cash. See Notice of Filing, supra note 3, at 26590.

<sup>56</sup> See Wachtel Letter, supra note 5.

<sup>57</sup> The commenter concludes the Proposed Rule Change will "undoubtedly put some members out of business." See Alpine Letter, supra note 4, at 5. Based on its consideration of the ENC data, as discussed above, the Commission does not agree with the commenter's argument. See supra text accompanying notes 51-52.

<sup>58</sup> See supra text accompanying notes 17-19.

Fund Deposit of less than \$250,000 would have been eliminated, which indicates the proposed increase to \$250,000 would have mitigated this risk.<sup>59</sup> Seven of the 28 Members that would have to provide some additional funding still held an average actual clearing fund deposit of above \$250,000 during the Impact Study Period, ranging from approximately \$315,000 to \$1.7M. In other words, there would have been many days during the study period where those seven Members would not have to provide additional funding. Additionally, four of the remaining 21 Members that would have to provide some additional funding had an average ENC below \$5 million, ranging from \$834,000 to \$4.8 million, during the Impact Study Period, while 11 of the 21 Members had an average ENC above \$100 million during the same period.

For those 28 Members, the number of backtesting deficiencies ranged from zero and 22 based on the \$10,000 minimum Required Fund Deposit compared to zero and five had the \$250,000 minimum Required Fund Deposit been in place during the Impact Study Period. Moreover, the average number of backtesting deficiencies of the 28 Members would have decreased from 1.54 to 0.41 per Member had the \$250,000 minimum Required Fund Deposit been in place during the study period. For the 14 Members impacted with backtesting deficiencies, the largest deficiency was \$1.3 million and the smallest deficiency was \$11,000 (out of 50 total deficiencies). Under the proposed minimum Required Fund Deposit of \$250,000, there would only be six deficiencies across four members, with a maximum deficiency of \$1.1 million and a minimum deficiency of \$11,000.

One commenter further states that it would not object to an increase to a \$100,000

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<sup>59</sup> See supra text accompanying note 29.

Required Fund Deposit. However, as discussed in Section II.B above, an increase to \$250,000 compared to \$100,000 would have further reduced NSCC's credit exposure to its Members by eliminating ten additional backtesting deficiencies resulting in NSCC maintaining sufficient margin levels for two additional Members to above the 99% confidence interval. Therefore, the Commission concludes that any competitive burden to Members imposed by the Proposed Rule Change is necessary and appropriate in furtherance of the Act. Accordingly, the Commission finds that the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(I) of the Act.<sup>60</sup>

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

Rule 17Ad-22(e)(4)(i) requires that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>61</sup>

As described above in Section II.A, NSCC and its non-defaulting Members may be subject to losses should a defaulted Member's own Required Fund Deposit be insufficient to satisfy losses caused by the liquidation of that Member's portfolio. As summarized in Section II.B above,<sup>62</sup> the Impact Study Results show a \$250,000 minimum Required Fund Deposit would have decreased the number of backtesting

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<sup>60</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>61</sup> 17 CFR 240.17Ad-22(e)(4)(i).

<sup>62</sup> See supra text accompanying notes 29-32.



deficiencies, which would likely help NSCC better manage its credit exposure to each of its Members and credit exposures arising from its payment, clearing, and settlement processes.

Additionally, as discussed in Sections II.A and III.B above, NSCC would continue to require that Members pay an amount equal to the minimum Required Fund Deposit amount in cash,<sup>63</sup> which should enable NSCC to better maintain sufficient prefunded margin to mitigate potential future exposures to its Members. Therefore, requiring the proposed minimum \$250,000 deposit to be made in cash should reduce the probability that NSCC or non-defaulting Members would incur losses resulting from a Member default. Accordingly, the Commission finds that NSCC's proposed increase to its minimum Required Fund Deposit would be consistent with Rule 17Ad-22(e)(4)(i).<sup>64</sup>

**D. Consistency with Rule 17Ad-22(e)(6)(iii)**

Rule 17Ad-22(e)(6)(iii) under the Act requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, calculates margin sufficient to cover its potential future exposure to Members in the interval between the last margin collection and the

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<sup>63</sup> See supra note 52. See also, Notice of Filing, supra note 3, at 26590.

<sup>64</sup> 17 CFR 240.17Ad-22(e)(4)(i).

close out of positions following a Member default.<sup>65</sup>

As summarized in Section III.B above,<sup>66</sup> NSCC employs daily backtesting to determine the adequacy of each Member's Required Fund Deposit paying particular attention to Members that have backtesting deficiencies below the 99% confidence target.<sup>67</sup> Such backtesting deficiencies highlight exposure that could subject NSCC to potential losses if a Member defaults.

Based on the Impact Study Results, which the Commission has reviewed and analyzed, approximately 22% of all backtesting deficiencies occur for those Members that maintain a Required Fund Deposit of less than \$250,000, and approximately 88% of the deficiencies of those Members would have been eliminated during the Impact Study Period if the Required Fund Deposit were \$250,000 or higher. By raising the minimum Required Fund Deposit amount to \$250,000, the Commission believes the proposal could enable NSCC to decrease the number of backtesting deficiencies by Members, and thus decrease NSCC's exposure to such Members in the event of a Member default.

Additionally, based on the Commission's review and analysis of the Impact Study Results, the proposed \$250,000 minimum Required Fund Deposit amount would have decreased the number of repeat backtesting deficiencies during the study period, which would have decreased the number of Members whose margin levels during the study

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<sup>65</sup> 17 CFR 240.17Ad-22(e)(6)(iii).

<sup>66</sup> See supra text accompanying note 49.

<sup>67</sup> See supra text accompanying notes 16-18.

period fell below the 99% confidence target.<sup>68</sup> Therefore, by raising the minimum Required Fund Deposit amount to \$250,000, the Commission concludes that the increase in margin for NSCC Members that currently maintain a Required Fund Deposit of less than \$250,000 would improve the probabilities that the margin maintained by these Members is sufficient to cover NSCC's potential future exposure to Members in the interval between the last margin collection and the close out of positions following a Member default.

One commenter states the increase in margin is unwarranted because NSCC's Clearing Fund backtesting results from the Impact Study Results show that NSCC's current minimum Required Fund Deposit amount is sufficient to cover the risks presented by smaller Members.<sup>69</sup> As summarized in Section II.B above, the Impact Study Results show that the proposed \$250,000 minimum requirement would have increased NSCC's twelve-month rolling Clearing Fund coverage by 0.14% to 99.41% resulting from decreased backtesting deficiencies, which the commenter argues does not warrant the proposed increase in the minimum Required Fund Deposit amount. However, as discussed above and based on the Commission's review, the Impact Study Results show that certain Members who maintained Required Fund Deposits of less than \$250,000 experienced repeat backtesting deficiencies that resulted in those Members' individual margin levels falling below the 99% confidence level. In other words, these Members' individual margin levels were not sufficient 99% of the time during the study period. For

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<sup>68</sup> See supra text accompanying notes 29-31. See also, supra text accompanying notes 17-19.

<sup>69</sup> See Alpine Letter, supra note 4, at 5-6.

that reason, the Commission is not persuaded by the commenter's argument.

Therefore, the Commission concludes NSCC's Proposed Rule Change should better ensure NSCC maintains sufficient margin to cover its potential future exposure to its Members in the interval between the last margin collection and the close out of positions following a Member default, thereby reducing the likelihood NSCC or non-defaulting Members would incur losses as a result. Accordingly, the Commission finds that NSCC's proposed increase to its minimum Required Fund Deposit would be consistent with Rule 17Ad-22(e)(6)(iii).<sup>70</sup>

#### **IV. SOLICITATION OF COMMENTS**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as modified by Partial Amendment No. 1, is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2021-005 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-NSCC-2021-005. This file

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<sup>70</sup> 17 CFR 240.17Ad-22(e)(6)(iii).

number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSCC-2021-005 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

**V. ACCELERATED APPROVAL OF THE PROPOSED RULE CHANGE, AS MODIFIED BY PARTIAL AMENDMENT NO. 1**

The Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act,<sup>71</sup> to approve the proposed rule change prior to the 30th day after the date of

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<sup>71</sup> 15 U.S.C. 78s(b)(2).

publication of Partial Amendment No. 1 in the Federal Register. As discussed above, in Partial Amendment No. 1, NSCC updates its proposed rule text to include a legend to indicate a delayed implementation date, specifically that the rule change would be implemented no later than 20 business days after Commission approval of the Proposed Rule Change. Partial Amendment No. 1 improves the efficiency of the filing process by obviating the need for NSCC to propose another change to its rules to resolve the omitted legend in the future, while not changing the purpose of or basis for the Proposed Rule Change.

For similar reasons as discussed above, the Commission finds that Partial Amendment No. 1 is consistent with the requirement that NSCC's rules be designed, in part, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible under Section 17A(b)(3)(F) of the Exchange Act.<sup>72</sup> Accordingly, the Commission finds good cause for approving the Proposed Rule Change, as modified by Partial Amendment No. 1, on an accelerated basis, pursuant to Section 19(b)(2) of the Exchange Act.<sup>73</sup>

## **VI. 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 Act<sup>74</sup> and the rules and regulations promulgated thereunder.

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<sup>72</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>73</sup> 15 U.S.C. 78s(b)(2).

<sup>74</sup> 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>75</sup> that Proposed Rule Change SR-NSCC-2021-005, as modified by Partial Amendment No. 1, be, and hereby is, APPROVED.<sup>76</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>77</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>75</sup> 15 U.S.C. 78s(b)(2).

<sup>76</sup> In approving the Proposed Rule Change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f). See discussion supra Section III.B.

<sup>77</sup> 17 CFR 200.30-3(a)(12).