

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-96088; File No. SR-NSCC-2022-009)

October 14, 2022

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt Intraday Volatility Charge and Eliminate Intraday Backtesting Charge

I. Introduction

On July 7, 2022, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NSCC-2022-009 (the “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 July 20, 2022,³ and the Commission has received comments regarding the changes proposed in the Proposed Rule Change.⁴

On September 1, 2022, pursuant to Section 19(b)(2) of the Act,⁵ the Commission designated a longer period within which to approve, disapprove, or institute proceedings

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 95286 (July 14, 2022), 87 FR 43355 (July 20, 2022) (File No. SR-NSCC-2022-009) (“Notice”).

⁴ Comments are available at <https://www.sec.gov/comments/sr-nscc-2022-009/srnsc2022009.htm>.

⁵ 15 U.S.C. 78s(b)(2).

to determine whether to approve or disapprove the Proposed Rule Change.⁶ This order institutes proceedings, pursuant to Section 19(b)(2)(B) of the Act,⁷ to determine whether to approve or disapprove the Proposed Rule Change.

II. Summary of the Proposed Rule Change

A key tool that NSCC uses to manage its respective credit exposures to its members is the daily collection of margin from each member, which is referred to as each member's Required Fund Deposit.⁸ The aggregated amount of all members' margin constitutes the Clearing Fund, which NSCC would access should a member default and the defaulted member's own margin be insufficient to satisfy losses to NSCC caused by the liquidation of that member's portfolio.

A. Intraday Volatility Charge

The volatility component of each member's Required Fund Deposit is designed to measure market price volatility of the start of day portfolio and is calculated for members' Net Unsettled Positions. The volatility component is designed to capture the market price risk⁹ associated with each member's portfolio at a 99th percentile level of confidence. NSCC has two methodologies for calculating the volatility component – a

⁶ Securities Exchange Act Release No. 95650 (Sept. 1, 2022), 87 FR 55054 (Sept. 8, 2022) (SR-NSCC-2022-009).

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ The description of the Proposed Rule Change is based on the statements prepared by NSCC in the Notice. See Notice, supra note 3. Capitalized terms used herein and not otherwise defined herein are defined in the Rules, available at https://www.dtcc.com/-/media/Files/Downloads/legal/rules/nscc_rules.pdf.

⁹ Market price risk refers to the risk that volatility in the market causes the price of a security to change between the execution of a trade and settlement of that trade. This risk is also referred to herein as market risk and volatility risk.

“VaR Charge” and a haircut-based calculation. The VaR Charge applies to the majority of Net Unsettled Positions and is calculated as the greater of (1) the larger of two separate calculations that utilize a parametric Value at Risk (“VaR”) model, (2) a gap risk measure calculation based on the concentration threshold of the largest non-index position in a portfolio, and (3) a portfolio margin floor calculation based on the market values of the long and short positions in the portfolio.¹⁰ The VaR Charge usually comprises the largest portion of a Member’s Required Fund Deposit.

In the Proposed Rule Change, NSCC is proposing to implement an intraday volatility charge, which it may collect on an intraday basis, to better address the volatility risks presented by Members’ adjusted intraday Net Unsettled Positions between start of day collections of Required Fund Deposits. More specifically, NSCC is proposing to utilize its existing intraday monitoring to determine when the difference between a Member’s (1) start of day volatility charge, collected on that Business Day as part of the Member’s start of day Required Fund Deposit based on that Member’s prior end-of-day Net Unsettled Positions, and (2) a calculation of the volatility charge based on that Member’s adjusted intraday Net Unsettled Positions as of a point intraday between the collection of the start of day Required Fund Deposit and end of day settlement, exceeds 100 percent and the amount that would be collected as an intraday volatility charge, calculated as described below, would be greater than \$250,000. The amount of the intraday volatility charge would be reduced by the amount collected from that Member at the start of that Business Day as the volatility portion of the Margin Requirement Differential charge, as discussed in more detail in the Notice.

¹⁰ Procedure XV, Sections I(A)(1)(a)(i) and (2)(a)(i) of the Rules, supra note 8.

NSCC is also proposing that it would not collect an intraday volatility charge when the quantitative thresholds are met, if (a) trades submitted later in the day would offset trades submitted earlier in the day, such that the quantitative thresholds would not have been met if such activity had been submitted earlier in the day, or (b) the threshold was met due to the submission of an erroneous trade that can be corrected. NSCC would continue to monitor intraday volatility in 15-minute increments throughout the day, and the calculation of the intraday volatility charge would be done at those intervals. While collections may occur multiple times throughout the day, intraday volatility charges are more likely to be collected later in the day, after additional, and potentially offsetting, activity has been submitted.

The proposed methodology would allow NSCC to measure the change in the volatility charge to determine if such change presents NSCC with exposures that are not adequately addressed by the start of day volatility charge on deposit in the Clearing Fund. By collecting an amount that is measured as the difference between the two volatility charge calculations, NSCC would be able to supplement the volatility charge already on deposit in its Clearing Fund with an amount that measures the change in volatility that has occurred since the Required Fund Deposit was collected at the start of the day.

B. Intraday Backtesting Charge

The Backtesting Charge is an additional component of a member's Required Fund Deposit that NSCC may assess at either the start of the day as the Regular Backtesting Charge, or on an intraday basis as the Intraday Backtesting Charge. More specifically, NSCC may assess a Backtesting Charge against any member that has a 12-month trailing backtesting coverage below the 99 percent backtesting coverage target. When calculating

a member's backtesting coverage, NSCC excludes amounts already collected as a Backtesting Charge in calculating any applicable Backtesting Charge.¹¹

If assessed, a member's Backtesting Charge is generally equal to the member's third largest deficiency, when calculating the Regular Backtesting Charge, and fifth largest deficiency, when calculating the Intraday Backtesting Charge, that occurred during the previous 12 months. NSCC may adjust the Backtesting Charge if it determines that circumstances particular to a member's settlement activity and/or market price volatility warrant a different approach to determining or applying such charge in a manner consistent with achieving NSCC's backtesting coverage target.

In the Proposed Rule Change, NSCC is proposing to eliminate the Intraday Backtesting Charge for several reasons, as set forth in more detail in the Notice. First, in connection with recent regulatory feedback, NSCC has determined that the current methodology for calculating the Intraday Backtesting Charge makes an unreasonable assumption that NSCC would cease to act for a member that has paid all of its intraday margin requirements. As a result, this calculation methodology may underestimate a member's backtesting losses and undercount potential backtesting deficiencies. Second, NSCC believes it will continue to be able to adequately address both its intraday market risk exposures and its backtesting coverage metrics if it eliminates the Intraday Backtesting Charge. Additionally, NSCC would maintain the Regular Backtesting Charge, which is collected at the start of the day, to support its backtesting coverage. Studies reviewing the impact of removing the Intraday Backtesting Charge on NSCC's

¹¹ Procedure XV, Sections I(B)(3) of the Rules, supra note 8.

backtesting coverage metrics indicate that this proposal would not have a significant impact on NSCC's ability to maintain its backtesting coverage target.

III. Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act¹² to determine whether the Proposed Rule Change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the Proposed Rule Change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the Proposed Rule Change, providing the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Change.

Pursuant to Section 19(b)(2)(B) of the Act,¹³ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the Proposed Rule Change's consistency with Section 17A of the Act,¹⁴ and the rules thereunder, including the following provisions:

- Section 17A(b)(3)(F) of the Act,¹⁵ which requires, among other things, that the

¹² 15 U.S.C. 78s(b)(2)(B).

¹³ Id.

¹⁴ 15 U.S.C. 78q-1.

¹⁵ 15 U.S.C. 78q-1(b)(3)(F).

rules of a clearing agency must be 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, and to protect investors and the public interest; and

- Rule 17Ad-22(e)(4)(i) of the Act,¹⁶ which requires that a covered clearing agency 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.
- Rule 17Ad-22(e)(6)(i) of the Act,¹⁷ which requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to cover, if the covered clearing agency provides central counterparty services, its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.
- Rule 17Ad-22(e)(23)(ii) of the Act¹⁸ which requires that a covered clearing

¹⁶ 17 CFR 240.17Ad-22(e)(4)(i).

¹⁷ 17 CFR 240.17Ad-22(e)(6)(i).

¹⁸ 17 CFR 240.17Ad-22(e)(23)(ii).

agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to 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.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the Proposed Rule Change. In particular, the Commission invites the written views of interested persons concerning whether the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act,¹⁹ and Rules 17Ad-22(e)(4)(i), (e)(6)(i) and (e)(23)(ii) of the Act,²⁰ or any other provision of the Act, or the rules and regulations thereunder.

Interested persons are invited to submit written data, views, and arguments regarding whether the Proposed Rule Change should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

The Commission asks that commenters address the sufficiency of NSCC's statements in support of the Proposed Rule Change, which are set forth in the Notice,²¹ in

¹⁹ 15 U.S.C. 78q-1(b)(3)(F).

²⁰ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i) and (e)(23)(ii).

²¹ See Notice, supra note 3.

addition to any other comments they may wish to submit about the Proposed Rule Change.

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. Please include File Number SR-NSCC-2022-005 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NSCC-2022-009. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the 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 the filing also will be available for inspection and copying at the

principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSCC-2022-009 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

J. Matthew DeLesDernier,
Deputy Secretary.

²² 17 CFR 200.30-3(a)(31).