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Rosa Chang
*Executive Director and
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June 28, 2018

By Electronic Mail (rule-comments@sec.gov)

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **Amendments No. 1 to File No. SR-NSCC-2017-018 and File No. SR-NSCC-2017-806**

Dear Mr. Errett:

National Securities Clearing Corporation filed Amendments No. 1 to File Nos. SR-NSCC-2017-018 and SR-NSCC-2017-806 on June 28, 2018, copies of which are enclosed.

Sincerely,



Rosa Chang
Executive Director and
Associate General Counsel

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 197 **SECURITIES AND EXCHANGE COMMISSION** File No.* SR 2017 * 018
 WASHINGTON, D.C. 20549 Form 19b 4 Amendment No. (req. for Amendments *) 1

Filing by National Securities Clearing Corporation
 Pursuant to Rule 19b 4 under the Securities Exchange Act of 1934

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

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
	Section 3C(b)(2) * <input type="checkbox"/>

Exhibit 2 Sent As Paper Document Exhibit 3 Sent As Paper Document

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Contact Information

Provide the name, telephone number, and e mail address of the person on the staff of the self regulatory organization prepared to respond to questions and comments on the action.

First Name * Rosa Last Name * Chang
 Title * Executive Director and Associate General Counsel
 E mail *
 Telephone * Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date 06/28/2018
 By Nikki Poulos
 (Name *)
 Managing Director and Deputy General Counsel

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

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information *

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

Exhibit 1 - Notice of Proposed Rule Change *

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

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

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

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

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

Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

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

Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

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

Exhibit 5 - Proposed Rule Text

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

Partial Amendment

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

1. Text of Proposed Rule Change

(a) The proposed rule change of National Securities Clearing Corporation (“NSCC”) is attached hereto as Exhibit 5. The proposed rule change would amend provisions in NSCC’s Rules and Procedures (“Rules”)¹ regarding loss allocation as well as make other changes, as described in greater detail below.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by NSCC’s Board of Directors on October 18, 2017.

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Description of Amendment No. 1

This filing constitutes Amendment No. 1 (“Amendment”) to rule filing SR-NSCC-2017-018 (“Rule Filing”) previously filed by NSCC on December 18, 2017.² This Amendment amends and replaces the Rule Filing in its entirety. NSCC submits this Amendment in order to further clarify the operation of the proposed rule changes on loss allocation by providing additional information and examples. In particular, this Amendment would:

- (i) Clarify which Members would be subject to loss allocation with respect to Defaulting Member Events (as defined below and in the proposed rule change) and Declared Non-Default Loss Events (as defined below and in the proposed rule change) occurring during an Event Period (as defined below and in the proposed rule change). Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member (as defined below and in the proposed rule change)) and each Declared Non-Default Loss Event occurring during the Event Period. Proposed Section 4 of Rule 4 would also make it clear that any Member for which NSCC ceases to act on a

¹ Capitalized terms not defined herein are defined in the Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf.

² See Securities Exchange Act Release No. 82428 (January 2, 2018), 83 FR 897 (January 8, 2018) (SR-NSCC-2017-018).

non-business day, triggering an Event Period that commences on the next business day, would be deemed to be a Member on the first day of that Event Period.

- (ii) Clarify the obligations and Loss Allocation Cap (as defined below and in the proposed rule change) of a Member that withdraws from membership in respect of a loss allocation round. Specifically, pursuant to the Amendment, proposed Section 6 of Rule 4 would provide that the Member would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap as fixed in the round for which it withdrew.
- (iii) Clarify that a Member would be obligated to NSCC for all losses and liabilities incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to the Member. Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member.
- (iv) Clarify that, although a Defaulting Member would not be allocated a ratable share of losses and liabilities arising out of or relating to its own Defaulting Member Event, it would remain obligated to NSCC for all such losses and liabilities. Specifically, pursuant to the Amendment, proposed Section 10 of Rule 4 would provide that no loss allocation under Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any loss or liability to which the Member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under Rule 4.

In addition, pursuant to the Amendment, NSCC is making other clarifying and technical changes to the proposed rule change, as proposed herein.

Nature of the Proposed Change

The primary purpose of this proposed rule change is to amend NSCC's loss allocation rules in order to enhance the resiliency of NSCC's loss allocation process so that NSCC can take timely action to address multiple loss events that occur in succession during a short period of time (defined and explained in detail below). In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of The Depository Trust & Clearing Corporation ("DTCC"), namely The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC") (including the Government Securities Division ("FICC/GSD") and the Mortgage-Backed Securities Division ("FICC/MBSD")), and NSCC (collectively, the "DTCC Clearing Agencies"), so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the loss allocation rules by enhancing their readability and clarity, (iii) reduce the time within which NSCC is required to

return a former Member's Clearing Fund deposit, (iv) increase clarity of the voluntary termination provisions, and (v) make conforming and technical changes.

(i) Background

Central counterparties ("CCPs") play a key role in financial markets by mitigating counterparty credit risk on transactions between market participants. CCPs achieve this by providing guaranties to participants and, as a consequence, are typically exposed to credit risks that could lead to default losses. In addition, in performing its critical functions, a CCP could be exposed to non-default losses that are otherwise incident to the CCP's clearance and settlement business.

A CCP's rulebook should provide a complete description of how losses would be allocated to participants if the size of the losses exceeded the CCP's pre-funded resources. Doing so provides for an orderly allocation of losses, and potentially allows the CCP to continue providing critical services to the market and thereby results in significant financial stability benefits. In addition, a clear description of the loss allocation process offers transparency and accessibility to the CCP's participants.

Current NSCC Loss Allocation Process

As a CCP, NSCC's loss allocation process is a key component of its risk management process. Risk management is the foundation of NSCC's ability to guarantee settlement, as well as the means by which NSCC protects itself and its Members from the risks inherent in the clearance and settlement process. NSCC's risk management process must account for the fact that, in certain extreme circumstances, the collateral and other financial resources that secure NSCC's risk exposures may not be sufficient to fully cover losses resulting from the liquidation of the portfolio of a Member for whom NSCC has ceased to act.³

The Rules currently provide for a loss allocation process through which both NSCC (by applying no less than 25% of its retained earnings in accordance with Addendum E) and its Members would share in the allocation of a loss resulting from the default of a Member for whom NSCC has ceased to act pursuant to the Rules. The Rules also recognize that NSCC may incur losses outside the context of a defaulting Member that are otherwise incident to NSCC's clearance and settlement business.

NSCC's loss allocation rules currently provide that in the event NSCC ceases to act for a Member, the amounts on deposit to the Clearing Fund from the defaulting Member, along with any other resources of, or attributable to, the defaulting Member that NSCC may access under the Rules (e.g., payments from Clearing Agency Cross-Guaranty Agreements), are the first source of funds NSCC would use to cover any losses that may result from the closeout of the

³ When NSCC restricts a Member's access to services generally, NSCC is said to have "ceased to act" for the Member. Rule 46 (Restrictions on Access to Services) sets out the circumstances under which NSCC may cease to act for a Member, and Rule 18 (Procedures for When the Corporation Declines or Ceases to Act) sets out the types of actions NSCC may take when it ceases to act for a Member. Supra note 1.

defaulting Member's guaranteed positions. If these amounts are not sufficient to cover all losses incurred, then NSCC will apply the following available resources, in the following loss allocation waterfall order:

First, as provided in Addendum E, NSCC's corporate contribution of at least 25 percent of NSCC's retained earnings existing at the time of a Member impairment, or such greater amount as the Board of Directors may determine; and

Second, if a loss still remains, as and in the manner provided in Rule 4, the required Clearing Fund deposits of Members who are non-defaulting Members on the date of default.

Pursuant to current Section 5 of Rule 4, if, as a result of applying the Clearing Fund deposit of a Member, the Member's actual Clearing Fund deposit is less than its Required Deposit, it will be required to eliminate such deficiency in order to satisfy its Required Deposit amount. Pursuant to current Section 4 of Rule 4, Members can also be assessed for non-default losses incident to the operation of the clearance and settlement business of NSCC. Pursuant to current Section 8 of Rule 4, Members may withdraw from membership within specified timeframes after a loss allocation charge to limit their obligation for future assessments.

Overview of the Proposed Rule Changes

A. Changes to Enhance Resiliency of NSCC's Loss Allocation Process

In order to enhance the resiliency of NSCC's loss allocation process, NSCC proposes to change the manner in which each of the aspects of the loss allocation waterfall described above would be employed. NSCC would retain the current core loss allocation process following the application of the defaulting Member's resources, i.e., first, by applying NSCC's corporate contribution, and second, by pro rata allocations to Members. However, NSCC would clarify or adjust certain elements and introduce certain new loss allocation concepts, as further discussed below. In addition, the proposed rule change would address the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time, also as described below.

Accordingly, NSCC is proposing five (5) key changes to enhance NSCC's loss allocation process:

- (1) Changing the calculation and application of NSCC's corporate contribution.

As stated above, Addendum E currently provides that NSCC will contribute no less than 25% of its retained earnings (or such higher amount as the Board of Directors shall determine) to a loss or liability that is not satisfied by the impaired Member's Clearing Fund deposit. Under the proposal, NSCC would amend the calculation of its corporate contribution from a percentage of its retained earnings to a mandatory amount equal to 50% of the NSCC General Business Risk

Capital Requirement.⁴ NSCC's General Business Risk Capital Requirement, as defined in NSCC's Clearing Agency Policy on Capital Requirements,⁵ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended (the "Act").⁶ The proposed Corporate Contribution (as defined in the proposed rule change) would be held in addition to NSCC's General Business Risk Capital Requirement.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than those from Member impairments. Under the proposal, NSCC would apply its corporate contribution to non-default losses as well. The proposed Corporate Contribution would apply to losses arising from Defaulting Member Events and Declared Non-Default Loss Events (as such terms are defined below and in the proposed rule change), and would be a mandatory contribution by NSCC prior to any allocation of the loss among NSCC's Members.⁷ As proposed, if the Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following two hundred fifty (250) business days⁸ in order to permit NSCC to replenish the Corporate Contribution.⁹ To ensure transparency, Members would receive notice of any such reduction to the Corporate Contribution.

⁴ NSCC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of NSCC's critical operations, and (iii) an amount determined based on an analysis of NSCC's estimated operating expenses for a six (6) month period.

⁵ See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-NSCC-2017-004).

⁶ 17 CFR 240.17Ad-22(e)(15).

⁷ The proposed rule change would not require a Corporate Contribution with respect to the use of the Clearing Fund as a liquidity resource; however, if NSCC uses the Clearing Fund as a liquidity resource for more than 30 calendar days, as set forth in proposed Section 2 of Rule 4, then NSCC would have to consider the amount used as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and allocate the loss pursuant to proposed Section 4 of Rule 4, which would then require the application of a Corporate Contribution.

⁸ Rule 1 defines "business day" as "any day on which the Corporation is open for business. However, on any business day that banks or transfer agencies in New York State are closed or a Qualified Securities Depository is closed, no deliveries of securities and no payments of money shall be made through the facilities of the Corporation." Supra note 1.

⁹ NSCC believes that two hundred and fifty (250) business days would be a reasonable estimate of the time frame that NSCC would require to replenish the Corporate Contribution by equity in accordance with NSCC's Clearing Agency Policy on Capital

As compared to the current approach of applying “no less than” a percentage of retained earnings to defaulting Member losses, the proposed Corporate Contribution would be a fixed percentage of NSCC’s General Business Risk Capital Requirement, which would provide greater transparency and accessibility to Members. The proposed Corporate Contribution would apply not only towards losses and liabilities arising out of or relating to Defaulting Member Events but also those arising out of or relating to Declared Non-Default Loss Events, which is consistent with the current industry guidance that “a CCP should identify the amount of its own resources to be applied towards losses arising from custody and investment risk, to bolster confidence that participants’ assets are prudently safeguarded.”¹⁰

Under the current Addendum E, NSCC has the discretion to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as result of a Member’s impairment. This option would be retained and expanded under the proposal so that it would be clear that NSCC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of NSCC, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

The proposed rule changes relating to the calculation and application of the Corporate Contribution are set forth in proposed Sections 4 and 5 of Rule 4, as further described below.

(2) Introducing an Event Period.

In order to clearly define the obligations of NSCC and its Members regarding loss allocation and to balance the need to manage the risk of sequential loss events against Members’ need for certainty concerning their maximum loss allocation exposures, NSCC is proposing to introduce the concept of an “Event Period” to the Rules to address the losses and liabilities that may arise from or relate to multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Specifically, the proposal would group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days (“Event Period”) for purposes of allocating losses to Members in one or more rounds (as described below), subject to the limitations of loss allocation set forth in the proposed rule change and as explained below.¹¹ In the case of a loss or liability arising from or relating to

Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

¹⁰ See Resilience of central counterparties (CCPs): Further guidance on the PFMI, issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, at 42 (July 2017), available at www.bis.org/cpmi/publ/d163.pdf.

¹¹ NSCC believes that having a ten (10) business day Event Period would provide a reasonable period of time to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate

a Defaulting Member Event, an Event Period would begin on the day NSCC notifies Members that it has ceased to act¹² for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a loss or liability arising from or relating to a Declared Non-Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Defaulting Member Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for Defaulting Member Events or Declared Non-Default Loss Events occurring during overlapping ten (10) business day periods.

The amount of losses that may be allocated by NSCC, subject to the required Corporate Contribution, and to which a Loss Allocation Cap would apply for any Member that elects to withdraw from membership in respect of a loss allocation round, would include any and all losses from any Defaulting Member Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.¹³

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 4 of Rule 4, as further described below.

(3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

¹² Supra note 3.

¹³ As discussed below, each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period.

Each loss allocation would be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.¹⁴ The “Loss Allocation Cap” of a Member would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

The amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if NSCC has a \$5 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Members subject to the loss allocation is \$4 billion, the first round would begin when NSCC issues the first Loss Allocation Notice for that Event Period. NSCC could issue one or more Loss Allocation Notices for the first round until the sum of losses allocated equals \$4 billion. Once the \$4 billion is allocated, the first round would end and NSCC would need a second round in order to allocate the remaining \$1 billion of loss. NSCC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss

¹⁴ Pursuant to the current Section 8 of Rule 4, the time period for a participant to give notice of its election to terminate its business with NSCC in respect of a pro rata charge is ten (10) business days after receiving notice of a pro rata charge. Supra note 1.

NSCC believes that it is appropriate to shorten such time period from ten (10) business days to five (5) business days because NSCC needs timely notice of which Members would remain in its membership for purposes of calculating the loss allocation for any subsequent round. NSCC believes that five (5) business days would provide Members with sufficient time to decide whether to cap their loss allocation obligations by withdrawing from their membership in NSCC.

Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Members the option to limit their loss allocation exposure at the beginning of each round. As proposed and as described further below, a Member could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to withdraw from membership within five (5) business days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 4 of Rule 4, as further described below.

- (4) Implementing a “look-back” period to calculate a Member’s loss allocation pro rata share and its Loss Allocation Cap.

Currently, the Rules calculate a Member’s pro rata share for purposes of loss allocation based on the Member’s “allocation for a System,” which in turn is based on settlement dollar amounts. Therefore, a Member’s loss allocation obligations are currently based on the Member’s activity in each of the various services or “Systems” offered by NSCC.¹⁵ The Rules do not anticipate the possibility of more than one Defaulting Member Event or Declared Non-Default Loss Event in quick succession.

Given NSCC’s risk-based margining methodology, NSCC believes that it would be more appropriate to determine a Member’s pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC, which is represented by the Member’s Required Deposit (NSCC is proposing that “Required Deposits” be renamed “Required Fund Deposits,” as described below). Accordingly, NSCC is proposing to calculate each Member’s pro rata share of losses and liabilities to be allocated in any round (as described above and in the proposed rule change) to be equal to (i) the Member’s Average RFD divided by (ii) the sum of Average RFD amounts for all Members that are subject to loss allocation in such round.

Additionally, as described above and in the proposed rule change, if a Member withdraws from membership pursuant to proposed Section 6 of Rule 4, NSCC is proposing that the Member’s Loss Allocation Cap be equal to the greater of (i) its Required Fund Deposit on the first day of the applicable Event Period or (ii) its Average RFD.

NSCC believes that employing a backward-looking average to calculate a Member’s loss allocation pro rata share and Loss Allocation Cap would disincentivize Member behavior that could heighten volatility or reduce liquidity in markets in the midst of a financial crisis. Specifically, the proposed look-back period would discourage a Member from reducing its settlement activity during a time of stress primarily to limit its loss allocation pro rata share, which, as proposed, would now be based on the Member’s average settlement activity over the look-back period rather than its settlement activity at a point in time that the Member may not be

¹⁵ NSCC’s current loss allocation rules pre-date NSCC’s move to a risk-based margining methodology.

able to estimate. Similarly, NSCC believes that taking a backward-looking average into consideration when determining a Member's Loss Allocation Cap would also deter a Member from reducing its settlement activity during a time of stress primarily to limit its Loss Allocation Cap.

NSCC believes that having a look-back period of seventy (70) business days is appropriate, because it would be long enough to enable NSCC to capture a full calendar quarter of a Member's activities, including quarterly option expirations, and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred, but not too long that the Member's business strategy and outlook could have shifted significantly, resulting in material changes to the size of its portfolios.

The proposed rule changes relating to the implementation of a look-back period are set forth in proposed Section 4 of Rule 4, as further described below.

(5) Capping withdrawing Members' loss allocation exposure and related changes.

NSCC's current loss allocation rules allow a Member to withdraw if the Member notifies NSCC, within ten (10) business days after receipt of notice of a pro rata charge, of its election to terminate its membership and thereby avail itself of a cap on loss allocation, which is its Required Deposit as fixed immediately prior to the time of the pro rata charge. As discussed above, the proposed rule change would continue providing Members the opportunity to limit their loss allocation exposure by offering withdrawal options; however, the cap on loss allocation would be calculated differently and the associated withdrawal process would also be modified as it relates to withdrawals associated with the loss allocation process. In particular, the proposed rule change would shorten the withdrawal notification period from ten (10) business days to five (5) business days, and would also change the beginning of such notification period from the receipt of the notice of a pro rata charge to the issuance of the notice, as further described below.

As proposed, if a Member timely provides notice of its withdrawal from membership in respect of a loss allocation round, the maximum amount of losses it would be responsible for would be its Loss Allocation Cap,¹⁶ provided that the Member complies with the requirements of the withdrawal process in proposed Section 6 of Rule 4.¹⁷

Currently, NSCC's loss allocation provisions provide that if a pro rata charge is made against a Member's actual Clearing Fund deposit, and as result thereof the Member's deposit is less than its Required Deposit, the Member will, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. To

¹⁶ If a Member's Loss Allocation Cap exceeds the Member's then-current Required Fund Deposit, it must still cover the excess amount.

¹⁷ For the avoidance of doubt, pursuant to Section 13(d) of Rule 4(A) (Supplemental Liquidity Deposits), a Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any pro rata charge pursuant to Section 4 of Rule 4. Supra note 1.

increase transparency of the timeframe under which NSCC would require funds from Members to satisfy their loss allocation obligations, NSCC is proposing that Members would receive two (2) business days' notice of a loss allocation, and Members would be required to pay the requisite amount no later than the second business day following issuance of such notice.¹⁸ Members would have five (5) business days¹⁹ from the issuance of the first Loss Allocation Notice in any round of an Event Period to decide whether to withdraw from membership.²⁰

Each round would allow a Member the opportunity to notify NSCC of its election to withdraw from membership after satisfaction of the losses allocated in such round. Multiple Loss Allocation Notices may be issued with respect to each round to allocate losses up to the round cap.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Members included in the round. If a Member provides notice of its election to withdraw from membership, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover NSCC's losses, a second round will be noticed to those Members that did not elect to withdraw from membership in the previous round; however, as noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, a Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member must: (i) specify in its Loss Allocation Withdrawal Notice (as defined below and in the proposed rule change) an effective date of withdrawal, which date shall be no later than ten (10) business days following the last day of the applicable Loss Allocation Withdrawal Notification Period (as defined below and in the proposed rule change) (i.e., no later than ten (10) business days after the 5th business day following the first Loss Allocation Notice in that round of loss allocation),²¹ (ii) cease all activity that would result in transactions being

¹⁸ NSCC believes that allowing Members two (2) business days to satisfy their loss allocation obligations would provide Members sufficient notice to arrange funding, if necessary, while allowing NSCC to address losses in a timely manner.

¹⁹ Supra note 14.

²⁰ NSCC believes that setting the start date of the withdrawal notification period to the date of issuance of a notice would provide a single withdrawal timeframe that would be consistent across the Members.

²¹ NSCC believes that having an effective date of withdrawal that is not later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period would provide Members with a reasonable period of time to wind down their activities at NSCC while minimizing any uncertainty typically associated with a longer withdrawal period.

submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member's withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully and finally settled by the effective date of the Member's withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

As proposed, a Member that withdraws in compliance with proposed Section 6 of Rule 4 would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

The proposed rule changes are designed to enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated. To the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

The proposed rule changes relating to capping withdrawing Members' loss allocation exposure and related changes to the withdrawal process are set forth in proposed Sections 4 and 6 of Rule 4, as further described below.

B. Changes to Align Loss Allocation Rules

The proposed rule changes would align the loss allocation rules, to the extent practicable and appropriate, of the three DTCC Clearing Agencies so as to provide consistent treatment, especially for firms that are participants of two or more DTCC Clearing Agencies. As proposed, the loss allocation waterfall and certain related provisions, e.g., returning a former Member's Clearing Fund, would be consistent across the DTCC Clearing Agencies to the extent practicable and appropriate. The proposed rule changes of NSCC that would align loss allocation rules of the DTCC Clearing Agencies are set forth in proposed Sections 1, 2, 7, and 12 of Rule 4, as further described below.

C. Clarifying Changes Relating to Loss Allocation

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to Members. In particular, NSCC is proposing the following changes relating to loss allocation to clarify Members' obligations for Declared Non-Default Loss Events.

Aside from losses that NSCC might face as a result of a Defaulting Member Event, NSCC could incur non-default losses incident to its clearance and settlement business.²² The Rules currently permit NSCC to apply Clearing Fund to non-default losses. Specifically,

²² Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

pursuant to Section 2(b) of Rule 4,²³ NSCC can use the Clearing Fund to satisfy losses or liabilities of NSCC incident to the operation of the clearance and settlement business of NSCC. Section II of Addendum K provides additional details regarding the application of the Clearing Fund to losses outside of a System.

If there is a failure of NSCC following a non-default loss, such occurrence would affect Members in much the same way as a failure of NSCC following a Defaulting Member Event. Accordingly, NSCC is proposing rule changes to enhance the provisions relating to non-default losses by clarifying Members' obligations for such losses.

Specifically, NSCC is proposing enhancement of the governance around non-default losses that would trigger loss allocation to Members by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that NSCC would then be required to promptly notify Members of this determination, which is referred to in the proposed rule as a Declared Non-Default Loss Event. In addition, NSCC is proposing to better align the interests of NSCC with those of its Members by stipulating a mandatory Corporate Contribution apply to a Declared Non-Default Loss Event prior to any allocation of the loss among Members, as described above. Additionally, NSCC is proposing language to clarify Members' obligations for Declared Non-Default Loss Events.

The proposed rule changes relating to Declared Non-Default Loss Events and Members' obligations for such events are set forth in proposed Section 4 of Rule 4, as further described below.

D. Reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit

The proposed rule change would reduce the time period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.

NSCC believes that shortening the time period for the return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they could have use of the

²³ Section 2(b) of Rule 4 provides that "the use of the Clearing Fund...shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses and liabilities of a System." Supra note 1.

deposits sooner than under the current Rules while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied, which would include both matured as well as contingent obligations.

The proposed rule changes relating to the reduced time period in which NSCC is required to return the Clearing Fund deposit of a former Member are set forth in proposed Section 7 of Rule 4, as further described below.

The foregoing changes as well as other changes (including a number of conforming and technical changes) that NSCC is proposing in order to improve the transparency and accessibility of the Rules are described in detail below.

E. Loss Allocation Waterfall Comparison

The following example²⁴ illustrates the differences between the current and proposed loss allocation provisions:

Assumptions:

- (i) Member A defaults on a business day (Day 1). On the same day, NSCC ceases to act for Member A and notifies Members of the cease to act. After liquidating Member A's portfolio and applying Member A's Clearing Fund deposit, NSCC has a loss of \$350 million.
- (ii) Member X voluntarily retires from membership five (5) business days after NSCC ceases to act for Member A (Day 6).
- (iii) Member B defaults seven (7) business days after NSCC ceases to act for Member A (Day 8). On the same day, NSCC ceases to act for Member B and notifies Members of the cease to act. After liquidating Member B's portfolio and applying Member B's Clearing Fund deposit, NSCC has a loss of \$350 million.
- (iv) The current NSCC loss provisions require NSCC to contribute no less than 25% of its retained earnings as a corporate contribution. For the purposes of this example, it is assumed that NSCC will contribute 25% of its retained earnings. The amount of NSCC's retained earnings is \$416 million.
- (v) NSCC's General Business Risk Capital Requirement is \$154 million.

Current Loss Allocation:

²⁴ For purposes of this example, NSCC has assumed that the losses occurred with guaranteed CNS activity of Members, and NSCC allocated all such Members' deposits to the Clearing Fund to CNS activity (which is typically more than 99% of the NSCC daily gross settlement amount).

Under the current loss allocation provisions, with respect to the losses arising out of Member A's default, NSCC will contribute \$104 million ($\$416 \text{ million} * 25\%$) from retained earnings and then allocate the remaining loss of \$246 million ($\$350 \text{ million} - \104 million) to Members.

With respect to losses arising out of Member B's default, NSCC will contribute \$78 million ($(\$416 \text{ million} - \$104 \text{ million}) * 25\%$) from retained earnings and then allocate the remaining loss of \$272 million ($\$350 \text{ million} - \78 million) to Members. Because Member X voluntarily retired before NSCC ceased to act for Member B, Member X is not subject to loss allocation with respect to losses arising out of Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC will contribute \$182 million of retained earnings and will allocate losses of \$518 million to Members.

Proposed Loss Allocation:

Under the proposed loss allocation provisions, a Defaulting Member Event with respect to Member A's default would have occurred on Day One, and a Defaulting Member Event with respect to Member B's default would have occurred on Day 8. Because the Defaulting Member Events occurred during a 10-business day period, they would be grouped together into an Event Period for purposes of allocating losses to Members. The Event Period would begin on the 1st business day and end on the 10th business day.

With respect to losses arising out of Member A's default, NSCC would apply a Corporate Contribution of \$77 million ($\$154 \text{ million} * 50\%$) and then allocate the remaining loss of \$273 million ($\$350 \text{ million} - \77 million) to Members. With respect to losses arising out of Member B's default, NSCC would not apply a Corporate Contribution since it would have already contributed the maximum Corporate Contribution of 50% of its General Business Risk Capital Requirement. NSCC would allocate the losses of \$350 million arising out of Member B's default to Members. Because Member X was a Member on the first day of the Event Period, Member X would be subject to loss allocation with respect to all events occurring during the Event Period, even if the event occurred after its retirement. Therefore, Member X would be subject to loss allocation with respect to Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC would apply a Corporate Contribution of \$77 million and would allocate losses of \$623 million to Members. The principal differences in the above example are due to (i) the proposed changes to the calculation and application of the Corporate Contribution and (ii) the proposed introduction of an Event Period.

(ii) Detailed Description of the Proposed Rule Changes Related to Loss Allocation

A. Proposed Changes to Rule 4 (Clearing Fund)

Overview of Rule 4 (Clearing Fund)

Rule 4 currently addresses Clearing Fund requirements and loss allocation obligations. While Procedure XV addresses the various Clearing Fund calculations, Rule 4 sets forth rights, obligations and other aspects associated with the Clearing Fund, as well as the loss allocation process. Rule 4 is currently organized into 12 sections. NSCC is proposing changes to each section, and consolidating provisions in Rule 4 relating to Mutual Fund Services and Insurance and Retirement Processing Services into new sections, as described below.

Section 1

Section 1 of Rule 4 currently sets forth the requirement that each Member and Mutual Fund/Insurance Services Member shall, and each Fund Member and Insurance Carrier/Retirement Services Member may, be required to make a deposit to the Clearing Fund. Section 1 currently provides that each participant's Required Deposit is based on one or more formulas specified by NSCC's Board of Directors. The basis of each such formula is participants' usage of NSCC's facilities. Section 1 also currently sets forth the minimum amount of each participant category's Required Deposit.

Current Section 1 allows a portion of a participant's Clearing Fund deposit to be evidenced by an open account indebtedness secured by Eligible Clearing Fund Securities, subject to certain limitations set forth in Procedure XV, and sets forth the various requirements associated with the deposit of Eligible Clearing Fund Securities. Current Section 1 also permits NSCC to require participants to post a letter of credit where NSCC believes the participants present legal risk.

Current Section 1 also provides that NSCC allocate the Clearing Fund by types of service (e.g., Mutual Fund Services) as well as by Systems (e.g., CNS), and divide the Clearing Fund into separate "Allocations" for each such service and separate "Funds" for each such System.

Under the proposed rule change, NSCC is proposing to add a subheading of "Required Fund Deposits" to Section 1 and restructure Section 1 so that it applies to Members only and delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Section 1.²⁵ Provisions of Rule 4 regarding Mutual Fund/Insurance Services Members and Fund Members would be covered in a new proposed Section 13 to Rule 4, discussed below. Provisions of Rule 4 regarding Insurance Carrier/Retirement Services Members would be covered in a new proposed Section 14 to Rule 4, discussed below.

²⁵ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Sections 2, 3, 4, 5, 6, 7, 8, 9, and 12 of Rule 4.

Under the proposed rule change, Section 1 would continue to have the same provisions as they relate to Members except for the following: (i) the language throughout the section would be reorganized, streamlined and clarified, (ii) “Required Deposits” would be renamed “Required Fund Deposits,”²⁶ which is a more descriptive term to refer to Members’ deposits required for the Clearing Fund, and would harmonize with the rules of FICC/GSD and FICC/MBSD²⁷ and the term used in such rules,²⁸ (iii) a sentence would be added regarding additional deposits maintained by the Members at NSCC, (iv) the provision regarding the Clearing Fund being allocated by Systems and services would be deleted,²⁹ and (v) change “Rules” to “Rules and Procedures” to better reflect the name of NSCC’s rulebook.³⁰

The proposed sentence regarding additional deposits to the Clearing Fund would permit Members to post such additional deposits at their discretion and would make clear that such additional deposits would be deemed to be part of the Clearing Fund and the Member’s Actual Deposit (as discussed below and as defined in the proposed rule change) but would not be deemed to be part of the Member’s Required Fund Deposit.

NSCC proposes to add language in Section 1 to make it clear that each Member would grant NSCC a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure the Member’s open account indebtedness or placed by the Member in NSCC’s possession (or its agents acting on its behalf) to secure all such Member’s obligations to NSCC, and that NSCC would be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The additional language would further harmonize the Rules with language used in the FICC/GSD Rules and FICC/MBSD Rules,³¹ thus providing consistent treatment of pledged resources for firms that are members of both NSCC and FICC.

²⁶ In addition to Section 1 of Rule 4, NSCC is proposing to rename “Required Deposits” to “Required Fund Deposits” in Sections 2, 3, 4, 8, 9, and 11 of Rule 4.

²⁷ FICC/GSD Rulebook (“FICC/GSD Rules”), [available at](http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf) http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf and FICC/MBSD Clearing Rules (“FICC/MBSD Rules”), [available at](http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf) http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf.

²⁸ See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 27.

²⁹ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to the Clearing Fund being allocated by Systems and services from Sections 2, 3, and 4 of Rule 4.

³⁰ In addition to Section 1 of Rule 4, NSCC is proposing to change “Rules” to “Rules and Procedures” in Sections 9 and 12 of Rule 4.

³¹ See Section 4 of FICC/GSD Rule 4 and Section 4 of FICC/MBSD Rule 4, supra note 27.

NSCC proposes to clarify the language in footnote 2 of Section 1. In addition, NSCC proposes to add “Eligible Letter of Credit” as a defined term to refer to letters of credit posted by participants if required by NSCC,³² which would harmonize the term with the term used in the FICC/GSD Rules and FICC/MBSD Rules,³³ thus providing consistent terminology for firms that are members of both NSCC and FICC.

Similarly, NSCC proposes to add “Actual Deposit” as a defined term in Section 1 to refer to Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure a Member’s open account indebtedness or placed by a Member in the possession of NSCC (or its agents acting on its behalf) and any Eligible Letters of Credit issued on behalf of a Member in favor of NSCC.

Instead of requiring participants to pledge Eligible Clearing Fund Securities to NSCC’s account at a Qualified Securities Depository designated by the participants, NSCC proposes to clarify and streamline Section 1 of proposed Rule 4 to provide that Eligible Clearing Fund Securities pledged to secure a Member’s open account indebtedness would be delivered to NSCC’s account at DTC.

NSCC would delete the provision regarding allocation of the Clearing Fund by Systems and services, as this provision is no longer relevant under the proposed rule change. Provisions relating to Mutual Fund Services and Insurance and Retirement Processing Services in Section 1 (as well as other sections in Rule 4) would be consolidated in the proposed new Sections 13 and 14, entitled “Mutual Fund Deposits” and “Insurance Deposits,” respectively.

To consolidate provisions regarding the maintenance, investment and permitted use of Clearing Fund, NSCC would move the last paragraph of Section 1 about segregation and maintenance of Clearing Fund (again, in terms of “Fund,” “System,” and “Allocation,” as discussed above) to Section 2.

In addition, NSCC proposes to correct a typographical error in the reference to a footnote in Section 1 of Rule 4. Specifically, there is an incorrect reference to footnote 22 in the second paragraph of Section 1 in current Rule 4. NSCC is proposing to change this reference to reflect the correct footnote, which is footnote 2.

Section 2

Section 2 of Rule 4 currently covers the permitted uses of the Clearing Fund (again by “Fund” and “Allocation,” as set forth in current Section 1), including the investment of Clearing Fund Cash and Cash Receipts, as well as participants’ rights to any interest earned or paid on pledged Eligible Clearing Fund Securities or cash deposits.

³² In addition to Section 1 of Rule 4, NSCC is also proposing to rename “Letter of Credit” to “Eligible Letter of Credit” in Sections 2 and 12 of Rule 4.

³³ See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 27.

NSCC is proposing to add a subheading of “Permitted Use, Investment, and Maintenance of Clearing Fund Assets” to Section 2 and restructure Section 2 so that it applies to Members only. NSCC is also proposing to restructure Section 2 so that the permitted use of Clearing Fund appears first, then the investment of Clearing Fund, followed by maintenance of Clearing Fund.

Under the proposed rule change, the permitted use of Clearing Fund paragraph would continue to have the same provisions as they relate to how the Clearing Fund can be used by NSCC, except the provisions would be streamlined and clarified. Specifically, in order to be consistent with the proposed change in Section 4 (as described below) regarding NSCC requiring Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact), NSCC is proposing to modify the permitted use of Clearing Fund to make it clear that the Clearing Fund can be used by NSCC to secure each Member’s performance of obligations to NSCC, including each Member’s obligations with respect to any loss allocations as set forth in Section 4 of Rule 4. NSCC is also proposing to delete the defined term of Cash Receipts and related provisions from Rule 4 because, unlike the Clearing Fund, Cash Receipts are money payments received from participants and payable to others; therefore, NSCC believes that continuing to include Cash Receipts in Rule 4 is no longer necessary and may cause confusion among Members.

NSCC is proposing to add a paragraph that provides that each time NSCC uses any part of the Clearing Fund to provide liquidity to NSCC to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity for more than thirty (30) calendar days, NSCC, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, would consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with proposed Section 4 of Rule 4. NSCC believes that this proposed change would increase transparency and accessibility of the Rules for Members by specifying a point in time by which NSCC would need to replenish the Clearing Fund through loss allocation if NSCC uses the Clearing Fund to provide or secure liquidity to NSCC to meet its settlement obligations. NSCC believes that a period of thirty (30) calendar days would be appropriate because it would provide sufficient time for NSCC to determine whether it would be able to obtain the necessary funds from liquidation of the portfolio of the Defaulting Member to repay the used Clearing Fund amount. In addition, this proposed change would also harmonize this section with the comparable section in the FICC/GSD Rules and FICC/MBSD Rules,³⁴ so as to provide consistent treatment for firms that are members of both NSCC and FICC.

Proposed Section 2 would continue to have the same provisions concerning the investment and maintenance of the Clearing Fund, except these provisions would also be streamlined and clarified. Specifically, NSCC is proposing language to make it clear that it may invest cash in the Clearing Fund in accordance with the Clearing Agency Investment Policy

³⁴ See Section 5 of FICC/GSD Rule 4 and Section 5 of FICC/MBSD Rule 4, supra note 27.

adopted by NSCC.³⁵ NSCC would revise the relocated sentence from Section 1 which provides that NSCC shall not be required to segregate any Clearing Fund (again, in terms of “Fund,” “System,” and “Allocation,” as discussed above) in order to (i) conform to the proposed deletions in Section 1 and use the newly defined term of “Actual Deposit” as set forth in Section 1 and (ii) make clear that NSCC would not be required to segregate a Member’s Actual Deposit but that NSCC would maintain books and records concerning the assets that constitute each Member’s Actual Deposit.

Under the proposed rule change, Members would continue to be entitled to any interest earned or paid on Clearing Fund cash deposits and pledged Eligible Clearing Fund Securities; however, NSCC is proposing additional language to make it clear that interest on pledged Eligible Clearing Fund Securities that is received by NSCC would be credited to a Member’s cash deposits to the Clearing Fund, except in the event of a default by such Member on any obligations to NSCC, in which case NSCC may exercise its rights under proposed Section 3 of Rule 4.

Section 3

Section 3 of Rule 4 currently provides that NSCC may apply a participant’s actual deposit to any obligation the participant has to NSCC that the participant has failed to satisfy and to any Cross-Guaranty Obligation. Participants are required to eliminate any resulting deficiencies in their Required Deposits within such time as NSCC requires. Section 3 also currently provides for the manner in which loss allocation would apply with respect to Off-the-Market Transactions.

Under the proposed rule change, NSCC is proposing to add a subheading of “Application of Clearing Fund Deposits and Other Amounts to Members’ Obligations” and to delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into Funds/Allocations by Systems and services. Under the proposed rule change, NSCC would retain the provisions in Section 3 regarding applying the Member’s Actual Deposit to satisfy an obligation to NSCC that a Member fails to satisfy and the requirement to replenish the Required

³⁵ See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-NSCC-2016-003). The Clearing Agency Investment Policy (the “Policy”) governs the management, custody, and investment of cash deposited to the Clearing Fund, the proprietary liquid net assets (cash and cash equivalents) of NSCC and other funds held by NSCC. The Policy sets forth guiding principles for the investment of those funds, which include adherence to a conservative investment philosophy that places the highest priority on maximizing liquidity and avoiding risk, as well as mandating the segregation and separation of funds. The Policy also addresses the process for evaluating credit ratings of counterparties and identifies permitted investments within specified parameters. In general, assets are required to be held by regulated and creditworthy financial institution counterparties and invested in financial instruments that, with respect to the Clearing Fund, may include deposits with banks, including the Federal Reserve Bank of New York, collateralized reverse-repurchase agreements, direct obligations of the U.S. government and money-market mutual funds.

Fund Deposit as necessary, but NSCC proposes to add clarifying language that, in addition to a Member's Actual Deposit, NSCC will also apply any amounts available under a Clearing Agency Cross-Guaranty Agreement and any proceeds therefrom to satisfy the obligation. NSCC also proposes to add language making it clear that NSCC may take any and all actions with respect to the assets and amounts referenced in the prior sentence, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that NSCC determines is appropriate.

Under the proposed rule change, NSCC would move the provision regarding allocation of losses from Off-the-Market Transactions to proposed Section 4 of Rule 4, which addresses allocation of losses to Members. NSCC would streamline and clarify the remaining provisions for transparency and accessibility.

Section 4 and Section 5

Current Section 4 of Rule 4 contains NSCC's current loss allocation waterfall, which would be initiated if NSCC incurs a loss or liability in a System that is not satisfied pursuant to current Section 3. Section 4 currently provides for the following loss allocation waterfall:

- (i) Application of NSCC's existing retained earnings or such lesser part³⁶ of the existing retained earnings unless the Board of Directors elects to apply the Fund/Allocation for a particular System or service.
- (ii) If a loss or liability remains after the application of the retained earnings, NSCC would apply the Clearing Fund (this application is subject to the current structure where the Rules provide that the Clearing Fund is allocated to different Systems/services).
 - a. NSCC is required to provide participants and the Commission with 5 business days' prior notice before applying the Clearing Fund.
 - b. Participants (other than those responsible for causing the loss or liability) would be charged pro rata based upon their allocation to the applicable Fund, less any amounts that participants were required to deposit pursuant to Rule 15.

Section 5 of Rule 4 currently states that if a pro rata charge is made pursuant to Rule 4 against a participant's actual Clearing Fund deposit, and as a consequence thereof the participant's remaining deposit is less than its Required Deposit, the participant would, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. Current Section 5 further provides that if the participant does not take this required action, NSCC may take disciplinary action against the participant, and any disciplinary action taken against the participant or the voluntary or involuntary termination of the

³⁶ Addendum E provides that NSCC "will apply no less than twenty-five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability." Supra note 1.

participant's membership will not affect the obligations of the participant to NSCC or any remedy to which NSCC may be entitled under applicable law.

Under the proposed rule change, NSCC is proposing to add a subheading of "Loss Allocation Waterfall, Off-the-Market Transactions" to Section 4 and delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into Funds/Allocations by System or service. In addition, NSCC is proposing to restructure its loss allocation waterfall as described below.

Under the proposal, Section 4 would make clear that the loss allocation waterfall applies to any loss and liability incurred by NSCC arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event.

As proposed, Section 4 would provide that, for the purposes of Rule 4, the term "Defaulting Member" would mean a Member for which NSCC has ceased to act pursuant to Rule 46,³⁷ the term "Defaulting Member Event" would mean the determination by NSCC to cease to act for a Member pursuant to Rule 46, and the term "Declared Non-Default Loss Event" would mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of NSCC may be a significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner. Proposed Section 4 would establish the concept of an "Event Period" to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) business days, which would be grouped into an Event Period.³⁸ As stated above, both Defaulting Member Events or Declared Non-Default Loss Events could occur within the same Event Period.

Under the proposal, an Event Period with respect to a Defaulting Member Event would begin on the day NSCC notifies participants that it has ceased to act for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a Declared Non-Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

As proposed, each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member. Under the proposal, to the extent that such loss or liability is not

³⁷ NSCC may cease to act for a Member pursuant to any of the circumstances set forth under Rule 46 (Restrictions on Access to Services), including, but not limited to, in the event the Member is in default of any delivery of funds or securities to NSCC. Supra note 1.

³⁸ Supra note 11.

satisfied pursuant to proposed Section 3 of Rule 4, NSCC would apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as provided in proposed Section 4.

Under proposed Section 4, the loss allocation waterfall would begin with a corporate contribution from NSCC (“Corporate Contribution”), as is the case under the current Rules, but in a different form than under the current Section 4 of Rule 4. Today, pursuant to Addendum E, in the event of a Member impairment, NSCC is required to apply at least 25% of its retained earnings existing at the time of a Member impairment; however, no corporate contribution from NSCC is currently required for losses resulting other than those from Member impairments. Under the proposal, NSCC would amend Section 5 to add a subheading of “Corporate Contribution” and define NSCC’s Corporate Contribution with respect to any loss allocation pursuant to proposed Section 4 of Rule 4, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, as an amount that is equal to fifty (50) percent of the amount calculated by NSCC in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.³⁹ The proposed rule change would specify that NSCC’s General Business Risk Capital Requirement, as defined in NSCC’s Clearing Agency Policy on Capital Requirements,⁴⁰ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.⁴¹

As proposed, if NSCC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Defaulting Member Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the two hundred fifty (250) business days thereafter,⁴² the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period. Proposed Section 5 would require NSCC to notify Members of any such reduction to the Corporate Contribution.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than from Member impairments. Under the proposal, NSCC would expand the application of its corporate contribution beyond losses and liabilities from Member impairments. The proposed Corporate Contribution would apply to losses or liabilities relating to or arising out of Defaulting Member Events and Declared Non-Default Loss Events, and would be a mandatory loss contribution by NSCC prior to any allocation of the loss among Members.

Addendum E currently provides NSCC the option to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as the result of a Member’s impairment. This option would be

³⁹ Supra note 4.

⁴⁰ Supra note 5.

⁴¹ Supra note 6.

⁴² Supra note 9.

retained and expanded under the proposal to also cover non-default losses. Proposed Section 5 would provide that nothing in the Rules would prevent NSCC from voluntarily applying amounts greater than the Corporate Contribution against any NSCC loss or liability, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Proposed Section 4 of Rule 4 would provide that NSCC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, NSCC would allocate such losses and liabilities to Members, as described below.

Proposed Section 4 of Rule 4 would also retain the requirement of loss allocation among Members if a loss or liability remains after the application of the Corporate Contribution, as described above. In contrast to the current Section 4 where NSCC would apply Members' Required Deposits to the mutualized loss allocation amounts, under the proposal, NSCC would require Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact).⁴³ Loss allocation obligations would continue to be calculated based upon a Member's pro rata share of losses and liabilities (although the pro rata share would be calculated differently than it is today), and Members would still retain the ability to voluntarily withdraw from membership and cap their loss allocation obligation (although the loss allocation obligation would also be calculated differently than it is today).

The proposed rule change to Section 4 of Rule 4 would clarify that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. The proposal would make it clear

⁴³ NSCC believes that shifting from the two-step methodology of applying the Clearing Fund and then requiring Members to immediately replenish it, to requiring direct payment would increase efficiency while preserving the right to charge a Member's Clearing Fund deposits in the event the Member does not timely pay. Such a failure to pay would trigger recourse to the Clearing Fund deposits of the Member under proposed Section 3 of Rule 4. In addition, this change would provide greater stability for NSCC in times of stress by allowing NSCC to retain the Clearing Fund, its critical prefunded resource, while charging loss allocations. NSCC believes doing so would allow NSCC to cover its current credit exposures to Members at all times. By retaining the Clearing Fund as proposed, NSCC could use the Clearing Fund to secure the performance obligations of Members to NSCC, including their payment obligation for any loss allocation, while maintaining access to prefunded resources. By being able to manage its current credit exposures throughout the loss allocation process, NSCC would be able to continue to provide its critical operations and services during what would be expected to be a stressful period.

that any Member for which NSCC ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

Under the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the round cap. When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

As proposed, each loss allocation would be communicated to Members by the issuance of a Loss Allocation Notice. Under the proposal, each Member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the Member’s Average RFD divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Withdrawal Notification Period”) to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.⁴⁴ As proposed, the “Loss Allocation Cap” of a Member would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

NSCC is proposing to clarify that after a first round of loss allocation with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

As proposed, Members would have two (2) business days after NSCC issues a first round Loss Allocation Notice to pay the amount specified in any such notice.⁴⁵ On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because NSCC was only able to allocate up to the round cap), Members would also have two (2) business days after notice by NSCC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless Members have notified (or will timely notify) NSCC of their election to withdraw from membership with respect to a prior loss allocation round pursuant to proposed Section 6 of Rule 4.

⁴⁴ Supra note 14.

⁴⁵ Supra note 18.

As proposed, Section 4 would also provide that, to the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

Under the proposal, if a Member fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, NSCC would have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with proposed Section 3 of Rule 4 described above. Members who wish to withdraw would be required to comply with the requirements in proposed Section 6 of Rule 4, described further below. Specifically, proposed Section 4 of Rule 4 would provide that if, after notifying NSCC of its election to withdraw from membership pursuant to proposed Section 6 of Rule 4, the Member fails to comply with the provisions of proposed Section 6 of Rule 4, its notice of withdrawal would be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

Under the proposal, NSCC would delete the provision in current Section 4 of Rule 4 that requires NSCC to provide Members and the Commission with 5 business days' prior notice before applying the Clearing Fund to a loss or liability because such requirement would no longer be relevant under the proposed rule change. Under the proposed rule change, NSCC would notify Members subject to loss allocation of the amounts being allocated to them in one or more Loss Allocation Notices. As proposed, instead of applying the Clearing Fund, NSCC would require Members to pay their loss allocation amounts (leaving their Clearing Fund deposits intact). In order to conform to these proposed rule changes, NSCC is proposing to eliminate the required notification to Members regarding the application of Clearing Fund in current Section 4 of Rule 4. NSCC is also proposing to delete the required notification to the Commission regarding the application of Clearing Fund in the same section. While as a practical matter, NSCC would notify the Commission of a decision to loss allocate, NSCC does not believe such notification needs to be specified in the Rules.

Under the proposed rule change, NSCC would move the provision related to Off-the-Market Transactions from current Section 3 of Rule 4 to proposed Section 4 of Rule 4 and clarify that (i) a loss or liability of NSCC in connection with the close-out or liquidation of an Off-the-Market Transaction would be allocated to the Member that was the counterparty to such transaction and (ii) no allocation would be made if the Defaulting Member satisfied all applicable intraday mark-to-market margin charges assessed by NSCC with respect to the Off-the-Market Transaction prior to its default.⁴⁶

⁴⁶ See Securities Exchange Act Release No. 79598 (December 19, 2016), 81 FR 94462 (December 23, 2016) (SR-NSCC-2016-005), at 94465, and Securities Exchange Act Release No. 79592 (December 19, 2016), 81 FR 94448 (December 23, 2016) (SR-NSCC-2016-803), at 94452.

Section 6

Proposed Section 6 of Rule 4 would include the provisions regarding withdrawal from membership currently covered by Section 8 of Rule 4. NSCC believes that relocating the provisions on withdrawal from membership as it pertains to loss allocation, so that it comes right after the section on the loss allocation waterfall, would provide for the better organization of Rule 4. As proposed, the subheading for Section 6 would read “Withdrawal Following Loss Allocation.”

Currently, Section 8 of Rule 4 provides that participants may notify NSCC within ten (10) business days after receipt of notice of a pro rata charge that they have elected to terminate their membership and thereby avail themselves of a cap on loss allocation, which is currently their Required Deposit as fixed immediately prior to the time of the pro rata charge.

As stated above, under the proposed rule change, a Member who wishes to withdraw from membership in respect of a loss allocation round must provide notice of its election to withdraw (“Loss Allocation Withdrawal Notice”) within five (5) business days from the issuance of the first Loss Allocation Notice in any round.⁴⁷ In order to avail itself of its Loss Allocation Cap, the Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member must: (i) specify in its Loss Allocation Withdrawal Notice an effective date for withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period (i.e., no later than ten (10) business days after the 5th business day following the first Loss Allocation Notice in that round of loss allocation),⁴⁸ (ii) cease all activity that would result in transactions being submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member’s withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully and finally settled by the effective date of the Member’s withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

Proposed Section 6 of Rule 4 would provide that a Member that withdraws in compliance with the requirements of proposed Section 6 of Rule 4 would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under proposed Rule 4; however, the Member’s aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

NSCC is proposing to include a sentence in proposed Section 6 of Rule 4 to make it clear that if the Member fails to comply with the requirements set forth in that section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to proposed Section 4 of Rule 4 as if it had not given such notice.

⁴⁷ Supra note 14.

⁴⁸ Supra note 21.

Currently, Section 8 also contains provisions regarding additional pro rata charges that may be made by NSCC for the same loss or liability under the existing loss allocation process and the applicable caps that participants wishing to voluntarily terminate their membership after such additional pro rata charges are noticed may avail themselves of. These provisions would be replaced by the loss allocation process contained in proposed Section 4 described above.

Section 7

As proposed, Section 7 would cover the provisions on the return of a Member's Clearing Fund deposit that are currently covered by Section 6 of Rule 4. Proposed Section 7's subheading would be "Return of Members' Clearing Fund Deposits" and would apply only to Members.

Currently, with respect to the return of Clearing Fund deposits, Section 6 of Rule 4 states that NSCC will return a participant's Clearing Fund deposit 90 days after 3 conditions are met: (i) the participant ceases to be a participant, (ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund have been closed, and (iii) all obligations of the participant to NSCC have been satisfied or have been deducted from the participant's Clearing Fund deposit by NSCC, provided that the participant has provided NSCC with satisfactory indemnities or guarantees or another participant has been substituted on all transactions and obligations of the participant.

Current Section 6 provides further that in the absence of an acceptable guarantee, indemnity or substitution, NSCC will retain the entire Clearing Fund deposit of a participant if such deposit is less than \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after conditions described in (i), (ii) and (iii) of the paragraph above have occurred. If the participant's Clearing Fund deposit is equal to or greater than \$100,000, NSCC will retain the greater of twenty-five (25) percent of a participant's average Clearing Fund requirement over the twelve (12) months immediately prior to the date the participant ceased to be a participant, or \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after conditions described in (i), (ii) and (iii) of the paragraph above have occurred.

Current Section 6 states that if a participant made a deposit with respect to the Mutual Fund Services or Insurance and Retirement Processing Services, the participant will be entitled to the return of this deposit ninety (90) days after all associated transactions in these services have been satisfied.

Finally, Section 6 currently provides that any obligation of a participant to NSCC unsatisfied at the time the participant ceases to be a participant will not be affected by such cessation of membership.

Proposed Section 7 would reduce the period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a

Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC. NSCC believes that shortening the time periods for the return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they could have use of the deposits sooner than under the current Rules, while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. Proposed Section 7 would also harmonize the retention period for a Member's deposits to the Clearing Fund with the FICC/GSD Rules,⁴⁹ thus providing consistent treatment for firms that are members of both NSCC and FICC. Similarly, the Clearing Fund deposit retention for Members who have Sponsored Accounts at DTC would be reduced in order to stay consistent with the proposed retention period in the rules of DTC.⁵⁰ In addition, NSCC proposes to make it clear that a Member's obligations to NSCC would include both matured as well as contingent obligations.

Section 8

Proposed Section 8 of Rule 4 would cover the subject matter currently covered in Section 7 of Rule 4. Proposed Section 8's subheading would be "Changes in Members' Required Fund Deposits" and would apply only to Members.

Currently, Section 7 of Rule 4 requires participants to satisfy any increase in their Required Deposit within such time as NSCC requires. At the time the increase becomes effective, the participant's obligations to NSCC will be determined in accordance with the increased Required Deposit whether or not the Member has so increased its deposit. NSCC is not proposing any substantive changes to this provision, which will be renumbered as Section 8 of Rule 4 under the proposed rule change, except for streamlining the provision and limiting its application to Members as stated above.

Section 9

Currently, Section 9 of Rule 4 addresses situations where a participant has excess deposits in the Clearing Fund (i.e., amounts above its Required Deposit). The current provision

⁴⁹ Section 10 of FICC/GSD Rule 4, in relevant part, states that "If a Netting Member gives notice to the Corporation pursuant to Rule 3 of its election to terminate its membership in the Netting System, the Member's deposits to the Clearing Fund in the form of cash or securities shall be returned to it within 30 calendar days thereafter ... provided that all amounts owing to the Corporation by the Member have been paid to the Corporation prior to such return and the Member has no remaining open Net Settlement Position, Fail Net Settlement Position, or Forward Net Settlement Position." Supra note 27.

⁵⁰ On December 18, 2017, DTC submitted a proposed rule change and an advance notice to enhance its rules regarding allocation of losses. See Securities Exchange Act Release Nos. 82426 (January 2, 2018), 83 FR 913 (January 8, 2018) (SR-DTC-2017-022) and 82582 (January 24, 2018), 83 FR 4297 (January 30, 2018) (SR-DTC-2017-804). On June 28, 2018, DTC submitted amendments to the proposed rule change and advance notice. Copies of the amendments to the proposed rule change and the advance notice are available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

provides that NSCC will, on any day that NSCC has determined and provided notification that an excess deposit exists with respect to a participant, return an excess amount requested by a participant that follows the formats and timeframe established by NSCC for such request. The current provision makes clear that NSCC will not return the requested excess amount (i) until any amount required to be charged against the participant's Required Deposit is paid by the participant to NSCC and/or (ii) if NSCC determines that the participant's current month's use of one or more services is materially different than the previous month's use upon which such excess is based. Section 9 currently makes clear that, notwithstanding any of the foregoing, NSCC may, in its discretion, withhold any or all of a participant's excess deposit if the participant has been placed on the Watch List.⁵¹ Current Section 9 also makes clear that nothing in this section limits NSCC's rights under Rule 15.⁵²

Proposed Section 9 would add a subheading "Excess Clearing Fund Deposits" and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except for streamlining the provisions in this section and eliminating the condition described in clause (i) of the paragraph above that limits participants' ability to request the return of excess amounts on deposit in the Clearing Fund and replacing clause (ii) of the paragraph above with a clause that provides NSCC may, in its discretion, withhold any or all of a participant's excess deposit if NSCC determines that the Member's anticipated activities in NSCC in the near future may reasonably be expected to be materially different than its activities of the recent past. NSCC believes that the proposed additional clause would protect NSCC and its participants because the clause would allow NSCC to retain excess deposits to cover an expected near-term increase in a Member's Required Fund Deposit amount due to the anticipated change in the Member's activities. The proposed additional clause would also align NSCC's Rules with that of FICC/GSD and FICC/MBSD,⁵³ thus providing consistent treatment for firms that are members of both NSCC and FICC.

Section 10

Current Section 10 of Rule 4 provides for crediting persons against whom losses are charged pursuant to Rule 4 if there is a subsequent recovery of such losses by NSCC. NSCC is not proposing any changes to this section other than (i) making it clear that no loss allocation under proposed Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any losses or liabilities to which the Member is subject under the Rules, including,

⁵¹ Pursuant to Section 4 of Rule 2B, a Member could be placed on the Watch List either based on its credit rating of 5, 6 or 7, which can either be generated by the Credit Risk Rating Matrix or from a manual downgrade, or when NSCC deems such placement as necessary to protect NSCC and its Members. Supra note 1.

⁵² Rule 15 permits NSCC to require a Member, Limited Member or any applicant to become either to furnish NSCC adequate assurances of the entity's financial responsibility and operational capability as NSCC may deem necessary. Supra note 1.

⁵³ See Section 9 of FICC/GSD Rule 4 (Clearing Fund and Loss Allocation) and Section 9 of FICC/MBSD Rule 4 (Clearing Fund and Loss Allocation). Supra note 27.

without limitation, any loss or liability to which it may be subject under proposed Rule 4, and (ii) adding a subheading “No Waiver; Subsequent Recovery Against Loss Amounts” and replacing “persons” with “Persons,” which is currently defined in Rule 1 (Definitions and Descriptions) to mean “a partnership, corporation, limited liability corporation or other organization, entity or an individual.” NSCC is proposing the change in (i) above to preserve its legal rights and to make it clear to Members that loss allocation under proposed Rule 4 would not be deemed as NSCC waiving any claims it may have against a Member for any losses or liabilities to which the Member is subject under the Rules. With respect to the proposed change in (ii) above, given that NSCC is a corporation, NSCC believes that the term “Person” already includes NSCC; however, for increased clarity, NSCC is proposing to add “including the Corporation” to make it clear to Members that if there is a subsequent recovery of losses charged pursuant to Rule 4, the net amount of the recovery would be credited to Persons, including NSCC, against whom the loss was charged in proportion to the amounts charged against them.

Section 11

Current Section 11 of Rule 4 provides that a participant may withdraw Eligible Clearing Fund Securities from pledge, provided that the participant has deposited cash with, or pledged additional Eligible Clearing Fund Securities to, NSCC that, in the aggregate, secure the open account indebtedness of the participant and/or satisfy the participant’s Required Deposit. Proposed Section 11 would add a subheading “Substitution or Withdrawal of Pledged Securities” and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except for changes to improve the transparency and accessibility of this section.

Section 12

Current Section 12 of Rule 4 makes it clear that NSCC has certain rights with respect to the Clearing Fund. Proposed Section 12 would add a subheading “Authority of Corporation” and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except to clarify that a reference to 30 days in current Section 12 would mean 30 calendar days.

Section 13

NSCC is proposing to add a new Section 13 to Rule 4 that would be entitled “Mutual Fund Deposits.” Under the proposal, NSCC would consolidate provisions from various sections in the current Rule 4 concerning Mutual Fund/Insurance Services Members and Fund Members and group them into proposed Section 13. Aside from the consolidation, NSCC is not proposing any substantive changes to these provisions, except for changes to (i) reduce NSCC’s retention period of Mutual Fund Deposits when a Mutual Fund Participant (as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with the proposed change in Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

Proposed Section 13 would provide that each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member would, and each Fund

Member (collectively with such Members and Mutual Fund/Insurance Services Members, “Mutual Fund Participants”) may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its “Mutual Fund Deposit” and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit would be a separate and additional component of such Member’s deposit to the Clearing Fund but not part of the Member’s Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to proposed Section 4 of Rule 4.

As in the current Rules, proposed Section 13 would also provide that if any Mutual Fund Participant fails to satisfy any obligation to NSCC relating to Mutual Fund Services, notwithstanding NSCC’s right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, NSCC would first apply such Mutual Fund Participant’s Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated to NSCC, NSCC would apply such Member’s Actual Deposit in accordance with proposed Section 3 of Rule 4. NSCC would next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants, and after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Mutual Fund Participants are Members. If any loss or liability remains thereafter and there are no continuing Mutual Fund Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 13 would reduce NSCC’s retention period of Mutual Fund Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that a Mutual Fund Participant that elects to withdraw from membership would be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Mutual Fund Participant was responsible while a Mutual Fund Participant. NSCC is proposing this change in order to harmonize the retention period of Mutual Fund Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 13 would make it clear that NSCC’s rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Mutual Fund Deposits.

Section 14

NSCC is proposing to add a new Section 14 to Rule 4 that would be entitled “Insurance Deposits.” Under the proposal, NSCC would consolidate provisions from various sections in current Rule 4 concerning Insurance Carrier/Retirement Services Members and group them into proposed Section 14. Aside from the consolidation, NSCC is not proposing any substantive

changes to these provisions, except for changes to (i) reduce NSCC's retention period of Insurance Deposits when an Insurance Participant (as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with proposed Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

As in the current Rules, proposed Section 14 would provide that each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, "Insurance Participants") may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its "Insurance Deposit" and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Insurance Deposits). Proposed Section 14 would also provide that if any Insurance Participant fails to satisfy any obligation to NSCC relating to the Insurance and Retirement Processing Services, NSCC would first apply such Insurance Participant's Insurance Deposit. If after such application any loss or liability remains, NSCC would allocate the remaining loss or liability to the other Insurance Participants in successive rounds of loss allocations in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants, and after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 14 would reduce NSCC's retention period of Insurance Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that an Insurance Participant that elects to withdraw from membership would be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Insurance Participant was responsible while an Insurance Participant. NSCC is proposing this change in order to harmonize the retention period of Insurance Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 14 would make it clear that NSCC's rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Insurance Deposits.

B. Proposed Changes to Addendum E (Statement of Policy Application of Retained Earnings Member Impairments) and Addendum K (Interpretation of the Board of Directors Application of Clearing Fund)

Addendum E is a statement of policy that currently provides that NSCC will apply no less than twenty-five (25) percent of its retained earnings to cover losses or liabilities from a Member's impairment that is not otherwise satisfied by the impaired Member's Clearing Fund

deposit. NSCC is proposing to delete Addendum E in its entirety because it would no longer be relevant given the proposed rule change relating to the Corporate Contribution discussed above.

NSCC is proposing to modify Addendum K to delete all provisions associated with loss allocation and application of the Clearing Fund in connection with a loss or liability incurred by NSCC, including modifying the title of Addendum K. These provisions would no longer be necessary under the proposed rule change because the loss allocation process in its entirety would be governed by Rule 4. In addition, the current language in Addendum K regarding allocation by System would no longer be applicable under the proposed rule change as described above. NSCC would retain the provisions in Addendum K that pertain to NSCC's guaranty and rename Addendum K "The Corporation's Guaranty." NSCC is also proposing to replace "Rules" with "Rules and Procedures" to better reflect the name of NSCC's rulebook.

(iii) Other Proposed Rule Changes

NSCC is proposing changes to Rule 1 (Definitions and Descriptions), Rule 2B (Ongoing Membership Requirements and Monitoring), Rule 4(A) (Supplemental Liquidity Deposits), Rule 13 (Exception Processing), Rule 15 (Assurances of Financial Responsibility and Operational Capability), Rule 42 (Wind-Down of a Member, Fund Member or Insurance Carrier/Retirement Services Member), Procedure III (Trade Recording Service (Interface with Qualified Clearing Agencies)), Procedure XV (Clearing Fund Formula and Other Matters), and Addendum O (Admission of Non-US Entities as Direct NSCC Members). NSCC is proposing changes to these Rules in order to conform them with the proposed changes to Rule 4 as well as to make certain technical changes to these Rules.

Specifically, NSCC is proposing to add the following defined terms to Rule 1, in alphabetical order: Actual Deposit, Average RFD, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member, Defaulting Member Event, Eligible Letter of Credit, Event Period, Insurance Deposit, Insurance Participant, Issuer, Lender, Loss Allocation Cap, Loss Allocation Notice, Loss Allocation Withdrawal Notice, Loss Allocation Withdrawal Notification Period, Mutual Fund Deposit, Mutual Fund Participant, Required Fund Deposit, Termination Date, and Voluntary Termination Notice.

NSCC is proposing to delete the defined term "The Corporation" in Rule 1 and replace it with "Corporation" in Rule 1. NSCC is proposing to replace "Required Deposits" with "Required Fund Deposits" in Rule 2B, Rule 4(A), Rule 15, Rule 42, Procedure III, and Procedure XV. NSCC is proposing to replace "Rules" with "Rules and Procedures" in Rule 1, Rule 2B, Rule 13, Rule 15, and Procedure III. NSCC is also proposing to replace "Letter of Credit" with "Eligible Letter of Credit" in Rule 42 and Addendum O.

In addition, in Section 5 of Rule 2B, NSCC proposes to change the reference to Section 8 of Rule 4 to reflect the updated section number, which would be to Section 4 of Rule 4. NSCC is also proposing conforming changes to this section to ensure that termination provisions in the Rules, whether voluntary or in response to a loss allocation, are consistent with one another to the extent appropriate.

Currently, Section 5 of Rule 2B provides that participants may elect to voluntarily retire their membership by providing NSCC with written notice of such termination. Such termination will not be effective until accepted by NSCC, which shall be evidenced by a notice to NSCC's participants announcing the participant's retirement and the effective date of the retirement, which is defined as the "Retirement Date." This section also provides that a participant's voluntary termination of membership shall not affect its obligations to NSCC.

Where appropriate, NSCC is proposing changes to align Section 5 of Rule 2B with the proposed new Section 6 of Rule 4, both of which address termination of membership. Specifically, NSCC is proposing to rename the subheading of Section 5 of Rule 2B to "Voluntary Termination" and to change "retirement" to "termination" and "Retirement Date" to "Termination Date" throughout Section 5 of Rule 2B. NSCC is also proposing to provide that when a participant elects to voluntarily terminate its membership by providing NSCC a written notice of such termination ("Voluntary Termination Notice"), the participant must specify in its Voluntary Termination Notice a desired date for its withdrawal, provided such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to NSCC as of the time such Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC. NSCC is retaining the provision that makes it clear that the termination will not be effective until accepted by NSCC.⁵⁴ NSCC is also retaining the provision that describes NSCC's acceptance of the termination; however, NSCC is proposing to make it clear that such acceptance, as evidenced by a notice to NSCC's participants, would (i) be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from the participant and (ii) announce the last trade date for the participant instead of the Termination Date. In addition, NSCC is proposing to make it clear that the Termination Date would be the final settlement date of all transactions of the participant. NSCC is proposing these clarifying changes so that the Rules would align more closely with NSCC's current practice.

As an example, Member A submits a Voluntary Termination Notice to NSCC on April 1st indicating its desired termination date is June 15th. NSCC would accept such termination request by issuing a notice to Members within 10 business days from April 1st; such notice would provide that the last trade date for Member A is June 12th, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A. In contrast, if Member A submits a Voluntary Termination Notice on April 1st and indicates its desired termination date is April 5th, NSCC would either (i) accept such termination notice by issuing a notice to Members on or before April 5th; such notice would provide that the last trade date for Member A is April 2nd, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A, or (ii) if NSCC requires additional time to process the termination, NSCC would accept such

⁵⁴ Unlike the Voluntary Termination Notice, the Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4 does not require explicit acceptance by NSCC to be effective. NSCC believes that requiring explicit acceptance of the Loss Allocation Withdrawal Notice could complicate the loss allocation process and potentially result in membership withdrawal being delayed as well as detract from the objective to have NSCC know on a timely basis which Members would remain subject to the subsequent rounds of loss allocation.

termination notice by issuing notice to Members after April 5th but still within 10 business days from April 1st; such notice would provide that the last trade date for Member A is a date after April 2nd, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A.

NSCC is also proposing to clarify that after the close of business on the Termination Date,⁵⁵ a participant that terminates its membership shall no longer be eligible or required to submit transactions to NSCC for clearance and settlement, unless the Board of Directors determines otherwise in order to ensure an orderly liquidation of the participant's open obligations. If any transaction is submitted to NSCC by such participant that is scheduled to settle after the Termination Date, the participant's Voluntary Termination Notice would be deemed void and the participant would remain subject to the Rules as if it had not given such notice. Furthermore, NSCC is proposing to add a sentence to Section 5 of Rule 2B to refer participants to Sections 7, 13 and 14 of Rule 4, as applicable, regarding provisions on the return of a participant's Clearing Fund deposit and to specify that if an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, would supersede and void any pending Voluntary Termination Notice previously submitted by the participant. As an example, if an Event Period occurs after submission of the Voluntary Termination Notice by a Member but on or prior to the Termination Date, and the Member does not subsequently submit a Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4, then the Member would not benefit from its Loss Allocation Cap, i.e., the Member would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period that commenced on or prior to the Termination Date.

In Rule 4(A), NSCC proposes to amend Section 11 to update a cross-reference to the time period for the refund of deposits to the Clearing Fund when a Member ceases to be a participant in order to align it with proposed Section 7 of Rule 4, which would reduce the time period from 90 days to 30 calendar days. NSCC is also proposing to add a reference to Section 13 of Rule 4 in clause (c) of Section 13 of Rule 4(A) in order to specify that a Special Activity Supplemental Deposit of a Member may be used to satisfy a loss or liability as provided in such new proposed Section 13. NSCC is also proposing technical changes in Sections 2 and 13 of Rule 4(A) to reflect new proposed defined terms in the Rules.

In Rule 13, NSCC would replace "System" with "system" to reflect the proposed deletion of "System" as a defined term from Rule 4 and Addendum K. In Procedure XV, NSCC would replace "Qualified Securities Depository" with "DTC" to be consistent with the proposed change in Section 1 of Rule 4.

⁵⁵ Account(s) of a terminating participant are generally deactivated after the close of business on the Termination Date.

Member Outreach

Beginning in August 2017, NSCC conducted outreach to Members in order to provide them with advance notice of the proposed changes. As of the date of this filing, no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

Implementation Timeframe

Pending Commission approval, NSCC expects to implement this proposal within two (2) business days after approval. Members would be advised of the implementation date of this proposal through issuance of an NSCC Important Notice.

(b) Statutory Basis

NSCC believes that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to a registered clearing agency. Specifically, NSCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act⁵⁶ and Rules 17Ad-22(e)(13) and 17Ad-22(e)(23)(i),⁵⁷ each as promulgated under the Act, for the reasons described below.

Section 17A(b)(3)(F) of the Act requires that the Rules be designed to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible.⁵⁸ The proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken together, are intended to enhance the overall resiliency of NSCC's loss allocation process.

By modifying the calculation of NSCC's corporate contribution, NSCC would apply a mandatory fixed percentage of its General Business Risk Capital Requirement (as compared to the current Rules which provide for "no less than" a percentage of retained earnings), which would provide greater transparency and accessibility to Members as to how much NSCC would contribute in the event of a loss or liability. By modifying the application of NSCC's corporate contribution to apply to Declared Non-Default Loss Events, in addition to Defaulting Member Events, on a mandatory basis, NSCC would expand the application of its corporate contribution

⁵⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁵⁷ 17 CFR 240.17Ad-22(e)(13) and (e)(23)(i).

⁵⁸ 15 U.S.C. 78q-1(b)(3)(F).

beyond losses and liabilities from Member impairments, which would better align the interests of NSCC with those of its Members by stipulating a mandatory application of the Corporate Contribution to a Declared Non-Default Loss Event prior to any allocation of the loss among Members. Taken together, these proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process by enhancing the calculation and application of NSCC's Corporate Contribution, which is one of the key elements of NSCC's loss allocation process. Moreover, by providing greater transparency and accessibility to Members, as stated above, the proposed rule changes regarding the Corporate Contribution, including the proposed replenishment period, would allow Members to better assess the adequacy of NSCC's loss allocation process.

By introducing the concept of an Event Period, NSCC would be able to group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days for purposes of allocating losses to Members. NSCC believes that the Event Period would provide a defined structure for the loss allocation process to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or market dislocation episode. Having this structure would enhance the overall resiliency of NSCC's loss allocation process because NSCC would be better equipped to address losses that may arise from multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would provide certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

By introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, NSCC would (i) set forth a defined amount that it would allocate to Members during each round (i.e., the round cap), (ii) advise Members of loss allocation obligation information as well as round information through the issuance of Loss Allocation Notices, and (iii) provide Members with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process because they would enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated and enable NSCC to identify continuing Members for purposes of calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for Members a clear manner and process in which they could cap their loss allocation exposure to NSCC.

By implementing a "look-back" period to calculate a Member's loss allocation obligations and its Loss Allocation Cap, NSCC would discourage Members from reducing their settlement activity during a time of stress primarily to limit their loss allocation obligations. By determining a Member's loss allocation obligations based on the average of its Required Fund Deposit over a look-back period and its Loss Allocation Cap based on the greater of its Required Fund Deposit or the average thereof over a look-back period, NSCC would be able to calculate a Member's pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC. These proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process because they would deter Members from reducing their settlement activity during a time of stress primarily to limit their Loss Allocation Caps.

Taken together, the foregoing proposed rule changes would establish a stronger (for all the reasons discussed above) and clearer loss allocation process for NSCC, which NSCC believes would allow it to take timely action to address losses. The ability to timely address losses would allow NSCC to continue to meet its clearance and settlement obligations, especially in circumstances that may involve a series of substantially contemporaneous loss events. Therefore, NSCC believes that these proposed rule changes would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

By reducing the time within which NSCC is required to return a former Member's Clearing Fund deposit, NSCC would enable firms that have exited NSCC to have access to their funds sooner than under the current Rules while at the same time protecting NSCC and its provision of clearance and settlement services because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. As such, NSCC would maintain the requisite level of Clearing Fund deposit to ensure that it can continue to meet its clearance and settlement obligations. Therefore, NSCC believes that this proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

The proposed rule changes to NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Having clear voluntary termination provisions would enable Members to better understand NSCC's voluntary termination process and provide Members with increased predictability and certainty regarding their rights and obligations with respect to such process. Enabling Members to readily understand NSCC's voluntary termination process and their rights and obligations in connection therewith would help the withdrawing Member and the membership at large to know when a Member is no longer a Member of NSCC for clearance and settlement and would thereby promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

Rule 17Ad-22(e)(13) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure NSCC has the authority and operational capacity to take timely action to contain losses and continue to meet its obligations.⁵⁹ As described above, the proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken together, are designed to enhance the resiliency of NSCC's loss allocation process. Having a resilient loss allocation process would help ensure that NSCC can effectively and timely address losses relating to or arising out of either the default of one or more Members or one or more non-default

⁵⁹ 17 CFR 240.17Ad-22(e)(13).

loss events, which in turn would help NSCC contain losses and continue to meet its clearance and settlement obligations. Therefore, NSCC believes that the proposed rule changes to enhance the resiliency of NSCC's loss allocation process are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of NSCC's default rules and procedures.⁶⁰ The proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) improve the overall transparency and accessibility of the provisions in the Rules governing loss allocation, and (iii) make conforming and technical changes, would not only ensure that NSCC's loss allocation rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of other DTCC Clearing Agencies, but also would help to ensure that NSCC's loss allocation rules are transparent and clear to Members. Aligning the loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable Members to better understand the key aspects of NSCC's default rules and procedures and provide Members with increased predictability and certainty regarding their exposures and obligations. As such, NSCC believes that the proposed rule changes to align the loss allocation rules of the DTCC Clearing Agencies as well as to improve the overall transparency and accessibility of NSCC's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

Similarly, the proposed rule changes to NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Having clear voluntary termination provisions would enable Members to better understand NSCC's voluntary termination process and provide Members with increased predictability and certainty regarding their rights and obligations with respect to such process. As such, NSCC believes that the proposed rule changes to the voluntary termination provision are also consistent with Rule 17Ad-22(e)(23)(i) under the Act.

4. Self-Regulatory Organization's Statement on Burden on Competition

NSCC does not believe that the proposed rule changes to enhance the resiliency of NSCC's loss allocation process would impact competition.⁶¹ As described above, the proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken

⁶⁰ 17 CFR 240.17Ad-22(e)(23)(i).

⁶¹ 15 U.S.C. 78q-1(b)(3)(I).

together, are intended to enhance the overall resiliency of NSCC's loss allocation process, and would apply equally to all Members. While the proposed rule changes would amend the manner in which NSCC's corporate contribution and loss allocation are calculated and applied, such proposed rule changes would maintain NSCC's current core loss allocation waterfall in the case of a loss relating to or arising out of the default of a Member for whom NSCC has ceased to act following application of the defaulting Member's resources, i.e., NSCC's corporate contribution and loss allocation among Members. With respect to a loss or liability arising from a non-default loss event, the proposed rule changes clarify NSCC's contribution to such loss and liability, but, as with losses and liabilities arising from a Member default event, the proposed rule changes would maintain the loss mutualization requirement under the current Rule 4. While the calculation of the loss obligations associated with non-default losses would change under the proposal, NSCC would maintain this aspect of the loss allocation waterfall (i.e., loss mutualization among Members for non-default losses). Based on the foregoing, NSCC believes that these proposed rule changes to enhance the resiliency of NSCC's loss allocation process would not have any impact on competition.

NSCC does not believe the proposed rule change to reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit would impact competition.⁶² This proposed rule change is intended to enable firms who have exited NSCC to have use of their Clearing Fund deposit sooner, while at the same time protecting NSCC because such return would only occur if all obligations of the terminated Member to NSCC have been satisfied. While the proposed rule change would reduce the applicable timeframe, it does not change the requirement that the return occur after all obligations to NSCC have been satisfied and the proposed rule change would apply equally to all Members. Based on the foregoing, NSCC believes that the proposed rule change to reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit would not have any impact on competition.

NSCC also does not believe that the proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) increase the transparency and accessibility of provisions in the Rules governing loss allocation, (iii) clarify NSCC's voluntary termination provisions, and (iv) make conforming and technical changes, would impact competition.⁶³ These changes would apply equally to all Members. Alignment of the loss allocation rules of the DTCC Clearing Agencies are intended to increase the consistency of the Rules with the rules of other DTCC Clearing Agencies in order to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and accessible provisions in the Rules governing loss allocation are intended to improve the readability and clarity of the Rules regarding the loss allocation process. Clarifying NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Making conforming and technical changes to ensure the Rules remain clear and accurate would facilitate Members' understanding of the Rules and their obligations thereunder.

⁶² Id.

⁶³ Id.

As such, NSCC believes that these proposed rule changes would not have any impact on competition.

5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments relating to this proposed rule change have not been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

6. Extension of Time Period for Commission Action

NSCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Act⁶⁴ for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

- (a) Not applicable.
- (b) Not applicable.
- (c) Not applicable.
- (d) Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule changes in proposed Section 1 of Rule 4 relating to (x) the renaming of “Required Deposits” to “Required Fund Deposits,” (y) the renaming of “Letter of Credit” to “Eligible Letter of Credit,” and (z) the additional language regarding Members’ granting of security interest to NSCC, are similar to the respective FICC/GSD Rules and FICC/MBSD Rules,⁶⁵ and the proposed rule changes in proposed Section 7 of Rule 4 relating to the retention period for Members’ Clearing Fund deposits are similar to the FICC/GSD Rules.⁶⁶ The remaining proposed rule changes are not based on the rules of another self-regulatory organization or the Commission.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

⁶⁴ 15 U.S.C. 78s(b)(2).

⁶⁵ See FICC/GSD Rule 1 (Definitions) and Section 4 of FICC/GSD Rule 4 (Clearing Fund and Loss Allocation), and FICC/MBSD Rule 1 (Definitions) and Section 4 of FICC/MBSD Rule 4 (Clearing Fund and Loss Allocation), supra note 27.

⁶⁶ See Section 10 of FICC/GSD Rule 4 (Clearing Fund and Loss Allocation), supra note 27.

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

Not applicable.

11. Exhibits

Exhibit 1 Not applicable.

Exhibit 1A Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 Not applicable.

Exhibit 3 Not applicable.

Exhibit 4 Changes to the Rules proposed by this Amendment.

Exhibit 5 Proposed changes to the Rules.

SR-NSCC-2017-018 Amendment No. 1

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[____]; File No. SR-NSCC-2017-018)

[DATE]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Amendment No. 1 to Proposed Rule Change to Amend the Loss Allocation Rules and Make Other Changes

On December 18, 2017, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change SR-NSCC-2017-018 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 January 8, 2018.³ Notice is hereby given that on June __, 2018, NSCC filed with the Commission Amendment No. 1 to the proposed rule change, as described in Items I, II and III below, which Items have been prepared by the clearing agency.⁴ Amendment No. 1 supersedes and replaces the proposed rule change in its

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 82428 (January 2, 2018), 83 FR 897 (January 8, 2018) (SR-NSCC-2017-018).

⁴ On December 18, 2017, NSCC filed the proposed rule change as an advance notice (SR-NSCC-2017-806) with the Commission pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010, 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) of the Act, 17 CFR 240.19b-4(n)(1)(i). The advance notice was published in the Federal Register January 30, 2018. See Securities Exchange Act Release No. 82584 (January 24, 2018), 83 FR 4377 (January 30, 2018) (SR-NSCC-2017-806). On June __, 2018, NSCC filed with the Commission Amendment No. 1 to the advance notice, which supersedes and

entirety. The Commission is publishing this notice to solicit comments on Amendment No. 1 to the proposed rule change from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of modifications to NSCC's Rules and Procedures ("Rules") in order to amend provisions in the Rules regarding loss allocation as well as make other changes, as described in greater detail below.⁵

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

replaces the advance notice in its entirety. A copy of Amendment No. 1 to the advance notice is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

⁵ Capitalized terms not defined herein are defined in the Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Description of Amendment No. 1

This filing constitutes Amendment No. 1 ("Amendment") to rule filing SR-NSCC-2017-018 ("Rule Filing") previously filed by NSCC on December 18, 2017.⁶

This Amendment amends and replaces the Rule Filing in its entirety. NSCC submits this Amendment in order to further clarify the operation of the proposed rule changes on loss allocation by providing additional information and examples. In particular, this

Amendment would:

- (i) Clarify which Members would be subject to loss allocation with respect to Defaulting Member Events (as defined below and in the proposed rule change) and Declared Non-Default Loss Events (as defined below and in the proposed rule change) occurring during an Event Period (as defined below and in the proposed rule change). Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member (as defined below and in the proposed rule change)) and each Declared Non-Default Loss Event occurring during the Event Period. Proposed Section

⁶ See Securities Exchange Act Release No. 82428 (January 2, 2018), 83 FR 897 (January 8, 2018) (SR-NSCC-2017-018).

4 of Rule 4 would also make it clear that any Member for which NSCC ceases to act on a non-business day, triggering an Event Period that commences on the next business day, would be deemed to be a Member on the first day of that Event Period.

- (ii) Clarify the obligations and Loss Allocation Cap (as defined below and in the proposed rule change) of a Member that withdraws from membership in respect of a loss allocation round. Specifically, pursuant to the Amendment, proposed Section 6 of Rule 4 would provide that the Member would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap as fixed in the round for which it withdrew.
- (iii) Clarify that a Member would be obligated to NSCC for all losses and liabilities incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to the Member. Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member.
- (iv) Clarify that, although a Defaulting Member would not be allocated a ratable share of losses and liabilities arising out of or relating to its own

Defaulting Member Event, it would remain obligated to NSCC for all such losses and liabilities. Specifically, pursuant to the Amendment, proposed Section 10 of Rule 4 would provide that no loss allocation under Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any loss or liability to which the Member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under Rule 4.

In addition, pursuant to the Amendment, NSCC is making other clarifying and technical changes to the proposed rule change, as proposed herein.

Nature of the Proposed Change

The primary purpose of this proposed rule change is to amend NSCC's loss allocation rules in order to enhance the resiliency of NSCC's loss allocation process so that NSCC can take timely action to address multiple loss events that occur in succession during a short period of time (defined and explained in detail below). In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of The Depository Trust & Clearing Corporation ("DTCC"), namely The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC") (including the Government Securities Division ("FICC/GSD") and the Mortgage-Backed Securities Division ("FICC/MBSD")), and NSCC (collectively, the "DTCC Clearing Agencies"), so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the loss allocation rules by enhancing their readability and clarity, (iii) reduce the time within which NSCC is

required to return a former Member's Clearing Fund deposit, (iv) increase clarity of the voluntary termination provisions, and (v) make conforming and technical changes.

(i) Background

Central counterparties ("CCPs") play a key role in financial markets by mitigating counterparty credit risk on transactions between market participants. CCPs achieve this by providing guaranties to participants and, as a consequence, are typically exposed to credit risks that could lead to default losses. In addition, in performing its critical functions, a CCP could be exposed to non-default losses that are otherwise incident to the CCP's clearance and settlement business.

A CCP's rulebook should provide a complete description of how losses would be allocated to participants if the size of the losses exceeded the CCP's pre-funded resources. Doing so provides for an orderly allocation of losses, and potentially allows the CCP to continue providing critical services to the market and thereby results in significant financial stability benefits. In addition, a clear description of the loss allocation process offers transparency and accessibility to the CCP's participants.

Current NSCC Loss Allocation Process

As a CCP, NSCC's loss allocation process is a key component of its risk management process. Risk management is the foundation of NSCC's ability to guarantee settlement, as well as the means by which NSCC protects itself and its Members from the risks inherent in the clearance and settlement process. NSCC's risk management process must account for the fact that, in certain extreme circumstances, the collateral and other financial resources that secure NSCC's risk exposures may not be sufficient to fully

cover losses resulting from the liquidation of the portfolio of a Member for whom NSCC has ceased to act.⁷

The Rules currently provide for a loss allocation process through which both NSCC (by applying no less than 25% of its retained earnings in accordance with Addendum E) and its Members would share in the allocation of a loss resulting from the default of a Member for whom NSCC has ceased to act pursuant to the Rules. The Rules also recognize that NSCC may incur losses outside the context of a defaulting Member that are otherwise incident to NSCC's clearance and settlement business.

NSCC's loss allocation rules currently provide that in the event NSCC ceases to act for a Member, the amounts on deposit to the Clearing Fund from the defaulting Member, along with any other resources of, or attributable to, the defaulting Member that NSCC may access under the Rules (e.g., payments from Clearing Agency Cross-Guaranty Agreements), are the first source of funds NSCC would use to cover any losses that may result from the closeout of the defaulting Member's guaranteed positions. If these amounts are not sufficient to cover all losses incurred, then NSCC will apply the following available resources, in the following loss allocation waterfall order:

First, as provided in Addendum E, NSCC's corporate contribution of at least 25 percent of NSCC's retained earnings existing at the time of a Member impairment, or such greater amount as the Board of Directors may determine; and

⁷ When NSCC restricts a Member's access to services generally, NSCC is said to have "ceased to act" for the Member. Rule 46 (Restrictions on Access to Services) sets out the circumstances under which NSCC may cease to act for a Member, and Rule 18 (Procedures for When the Corporation Declines or Ceases to Act) sets out the types of actions NSCC may take when it ceases to act for a Member. Supra note 5.

Second, if a loss still remains, as and in the manner provided in Rule 4, the required Clearing Fund deposits of Members who are non-defaulting Members on the date of default.

Pursuant to current Section 5 of Rule 4, if, as a result of applying the Clearing Fund deposit of a Member, the Member's actual Clearing Fund deposit is less than its Required Deposit, it will be required to eliminate such deficiency in order to satisfy its Required Deposit amount. Pursuant to current Section 4 of Rule 4, Members can also be assessed for non-default losses incident to the operation of the clearance and settlement business of NSCC. Pursuant to current Section 8 of Rule 4, Members may withdraw from membership within specified timeframes after a loss allocation charge to limit their obligation for future assessments.

Overview of the Proposed Rule Changes

A. *Changes to Enhance Resiliency of NSCC's Loss Allocation Process*

In order to enhance the resiliency of NSCC's loss allocation process, NSCC proposes to change the manner in which each of the aspects of the loss allocation waterfall described above would be employed. NSCC would retain the current core loss allocation process following the application of the defaulting Member's resources, i.e., first, by applying NSCC's corporate contribution, and second, by pro rata allocations to Members. However, NSCC would clarify or adjust certain elements and introduce certain new loss allocation concepts, as further discussed below. In addition, the proposed rule change would address the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time, also as described below.

Accordingly, NSCC is proposing five (5) key changes to enhance NSCC's loss allocation process:

- (1) Changing the calculation and application of NSCC's corporate contribution.

As stated above, Addendum E currently provides that NSCC will contribute no less than 25% of its retained earnings (or such higher amount as the Board of Directors shall determine) to a loss or liability that is not satisfied by the impaired Member's Clearing Fund deposit. Under the proposal, NSCC would amend the calculation of its corporate contribution from a percentage of its retained earnings to a mandatory amount equal to 50% of the NSCC General Business Risk Capital Requirement.⁸ NSCC's General Business Risk Capital Requirement, as defined in NSCC's Clearing Agency Policy on Capital Requirements,⁹ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.¹⁰ The proposed Corporate Contribution (as defined in the proposed rule change) would be held in addition to NSCC's General Business Risk Capital Requirement.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than those from Member impairments. Under the proposal, NSCC would apply its corporate contribution to non-default losses as well. The proposed

⁸ NSCC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of NSCC's critical operations, and (iii) an amount determined based on an analysis of NSCC's estimated operating expenses for a six (6) month period.

⁹ See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-NSCC-2017-004).

¹⁰ 17 CFR 240.17Ad-22(e)(15).

Corporate Contribution would apply to losses arising from Defaulting Member Events and Declared Non-Default Loss Events (as such terms are defined below and in the proposed rule change), and would be a mandatory contribution by NSCC prior to any allocation of the loss among NSCC's Members.¹¹ As proposed, if the Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following two hundred fifty (250) business days¹² in order to permit NSCC to replenish the Corporate Contribution.¹³ To ensure transparency, Members would receive notice of any such reduction to the Corporate Contribution.

As compared to the current approach of applying “no less than” a percentage of retained earnings to defaulting Member losses, the proposed Corporate Contribution would be a fixed percentage of NSCC's General Business Risk Capital Requirement, which would provide greater transparency and accessibility to Members. The proposed

¹¹ The proposed rule change would not require a Corporate Contribution with respect to the use of the Clearing Fund as a liquidity resource; however, if NSCC uses the Clearing Fund as a liquidity resource for more than 30 calendar days, as set forth in proposed Section 2 of Rule 4, then NSCC would have to consider the amount used as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and allocate the loss pursuant to proposed Section 4 of Rule 4, which would then require the application of a Corporate Contribution.

¹² Rule 1 defines “business day” as “any day on which the Corporation is open for business. However, on any business day that banks or transfer agencies in New York State are closed or a Qualified Securities Depository is closed, no deliveries of securities and no payments of money shall be made through the facilities of the Corporation.” Supra note 5.

¹³ NSCC believes that two hundred and fifty (250) business days would be a reasonable estimate of the time frame that NSCC would require to replenish the Corporate Contribution by equity in accordance with NSCC's Clearing Agency Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

Corporate Contribution would apply not only towards losses and liabilities arising out of or relating to Defaulting Member Events but also those arising out of or relating to Declared Non-Default Loss Events, which is consistent with the current industry guidance that “a CCP should identify the amount of its own resources to be applied towards losses arising from custody and investment risk, to bolster confidence that participants’ assets are prudently safeguarded.”¹⁴

Under the current Addendum E, NSCC has the discretion to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as result of a Member’s impairment. This option would be retained and expanded under the proposal so that it would be clear that NSCC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of NSCC, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

The proposed rule changes relating to the calculation and application of the Corporate Contribution are set forth in proposed Sections 4 and 5 of Rule 4, as further described below.

(2) Introducing an Event Period.

In order to clearly define the obligations of NSCC and its Members regarding loss allocation and to balance the need to manage the risk of sequential loss events against Members’ need for certainty concerning their maximum loss allocation exposures, NSCC

¹⁴ See Resilience of central counterparties (CCPs): Further guidance on the PFMI, issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, at 42 (July 2017), available at www.bis.org/cpmi/publ/d163.pdf.

is proposing to introduce the concept of an “Event Period” to the Rules to address the losses and liabilities that may arise from or relate to multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Specifically, the proposal would group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days (“Event Period”) for purposes of allocating losses to Members in one or more rounds (as described below), subject to the limitations of loss allocation set forth in the proposed rule change and as explained below.¹⁵ In the case of a loss or liability arising from or relating to a Defaulting Member Event, an Event Period would begin on the day NSCC notifies Members that it has ceased to act¹⁶ for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a loss or liability arising from or relating to a Declared Non-Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Defaulting Member Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for Defaulting Member

¹⁵ NSCC believes that having a ten (10) business day Event Period would provide a reasonable period of time to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

¹⁶ Supra note 7.

Events or Declared Non-Default Loss Events occurring during overlapping ten (10) business day periods.

The amount of losses that may be allocated by NSCC, subject to the required Corporate Contribution, and to which a Loss Allocation Cap would apply for any Member that elects to withdraw from membership in respect of a loss allocation round, would include any and all losses from any Defaulting Member Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.¹⁷

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 4 of Rule 4, as further described below.

(3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event

¹⁷ As discussed below, each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period.

Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

Each loss allocation would be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.¹⁸ The “Loss Allocation Cap” of a Member would be equal

¹⁸ Pursuant to the current Section 8 of Rule 4, the time period for a participant to give notice of its election to terminate its business with NSCC in respect of a pro rata charge is ten (10) business days after receiving notice of a pro rata charge. Supra note 5.

NSCC believes that it is appropriate to shorten such time period from ten (10) business days to five (5) business days because NSCC needs timely notice of which Members would remain in its membership for purposes of calculating the loss allocation for any subsequent round. NSCC believes that five (5) business

to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

The amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if NSCC has a \$5 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Members subject to the loss allocation is \$4 billion, the first round would begin when NSCC issues the first Loss Allocation Notice for that Event Period. NSCC could issue one or more Loss Allocation Notices for the first round until the sum of losses allocated equals \$4 billion. Once the \$4 billion is allocated, the first round would end and NSCC would need a second round in order to allocate the remaining \$1 billion of loss. NSCC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

days would provide Members with sufficient time to decide whether to cap their loss allocation obligations by withdrawing from their membership in NSCC.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Members the option to limit their loss allocation exposure at the beginning of each round. As proposed and as described further below, a Member could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to withdraw from membership within five (5) business days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 4 of Rule 4, as further described below.

- (4) Implementing a “look-back” period to calculate a Member’s loss allocation pro rata share and its Loss Allocation Cap.

Currently, the Rules calculate a Member’s pro rata share for purposes of loss allocation based on the Member’s “allocation for a System,” which in turn is based on settlement dollar amounts. Therefore, a Member’s loss allocation obligations are currently based on the Member’s activity in each of the various services or “Systems” offered by NSCC.¹⁹ The Rules do not anticipate the possibility of more than one Defaulting Member Event or Declared Non-Default Loss Event in quick succession.

Given NSCC’s risk-based margining methodology, NSCC believes that it would be more appropriate to determine a Member’s pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC, which is represented by the Member’s Required Deposit (NSCC is proposing that “Required Deposits” be renamed “Required Fund Deposits,” as described below). Accordingly, NSCC is proposing to

¹⁹ NSCC’s current loss allocation rules pre-date NSCC’s move to a risk-based margining methodology.

calculate each Member's pro rata share of losses and liabilities to be allocated in any round (as described above and in the proposed rule change) to be equal to (i) the Member's Average RFD divided by (ii) the sum of Average RFD amounts for all Members that are subject to loss allocation in such round.

Additionally, as described above and in the proposed rule change, if a Member withdraws from membership pursuant to proposed Section 6 of Rule 4, NSCC is proposing that the Member's Loss Allocation Cap be equal to the greater of (i) its Required Fund Deposit on the first day of the applicable Event Period or (ii) its Average RFD.

NSCC believes that employing a backward-looking average to calculate a Member's loss allocation pro rata share and Loss Allocation Cap would disincentivize Member behavior that could heighten volatility or reduce liquidity in markets in the midst of a financial crisis. Specifically, the proposed look-back period would discourage a Member from reducing its settlement activity during a time of stress primarily to limit its loss allocation pro rata share, which, as proposed, would now be based on the Member's average settlement activity over the look-back period rather than its settlement activity at a point in time that the Member may not be able to estimate. Similarly, NSCC believes that taking a backward-looking average into consideration when determining a Member's Loss Allocation Cap would also deter a Member from reducing its settlement activity during a time of stress primarily to limit its Loss Allocation Cap.

NSCC believes that having a look-back period of seventy (70) business days is appropriate, because it would be long enough to enable NSCC to capture a full calendar quarter of a Member's activities, including quarterly option expirations, and smooth out

the impact from any abnormalities and/or arbitrariness that may have occurred, but not too long that the Member's business strategy and outlook could have shifted significantly, resulting in material changes to the size of its portfolios.

The proposed rule changes relating to the implementation of a look-back period are set forth in proposed Section 4 of Rule 4, as further described below.

(5) Capping withdrawing Members' loss allocation exposure and related changes.

NSCC's current loss allocation rules allow a Member to withdraw if the Member notifies NSCC, within ten (10) business days after receipt of notice of a pro rata charge, of its election to terminate its membership and thereby avail itself of a cap on loss allocation, which is its Required Deposit as fixed immediately prior to the time of the pro rata charge. As discussed above, the proposed rule change would continue providing Members the opportunity to limit their loss allocation exposure by offering withdrawal options; however, the cap on loss allocation would be calculated differently and the associated withdrawal process would also be modified as it relates to withdrawals associated with the loss allocation process. In particular, the proposed rule change would shorten the withdrawal notification period from ten (10) business days to five (5) business days, and would also change the beginning of such notification period from the receipt of the notice of a pro rata charge to the issuance of the notice, as further described below.

As proposed, if a Member timely provides notice of its withdrawal from membership in respect of a loss allocation round, the maximum amount of losses it would

be responsible for would be its Loss Allocation Cap,²⁰ provided that the Member complies with the requirements of the withdrawal process in proposed Section 6 of Rule 4.²¹

Currently, NSCC's loss allocation provisions provide that if a pro rata charge is made against a Member's actual Clearing Fund deposit, and as result thereof the Member's deposit is less than its Required Deposit, the Member will, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. To increase transparency of the timeframe under which NSCC would require funds from Members to satisfy their loss allocation obligations, NSCC is proposing that Members would receive two (2) business days' notice of a loss allocation, and Members would be required to pay the requisite amount no later than the second business day following issuance of such notice.²² Members would have five (5) business days²³ from the issuance of the first Loss Allocation Notice in any round of an Event Period to decide whether to withdraw from membership.²⁴

²⁰ If a Member's Loss Allocation Cap exceeds the Member's then-current Required Fund Deposit, it must still cover the excess amount.

²¹ For the avoidance of doubt, pursuant to Section 13(d) of Rule 4(A) (Supplemental Liquidity Deposits), a Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any pro rata charge pursuant to Section 4 of Rule 4. Supra note 5.

²² NSCC believes that allowing Members two (2) business days to satisfy their loss allocation obligations would provide Members sufficient notice to arrange funding, if necessary, while allowing NSCC to address losses in a timely manner.

²³ Supra note 18.

²⁴ NSCC believes that setting the start date of the withdrawal notification period to the date of issuance of a notice would provide a single withdrawal timeframe that would be consistent across the Members.

Each round would allow a Member the opportunity to notify NSCC of its election to withdraw from membership after satisfaction of the losses allocated in such round. Multiple Loss Allocation Notices may be issued with respect to each round to allocate losses up to the round cap.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Members included in the round. If a Member provides notice of its election to withdraw from membership, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover NSCC's losses, a second round will be noticed to those Members that did not elect to withdraw from membership in the previous round; however, as noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, a Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member must: (i) specify in its Loss Allocation Withdrawal Notice (as defined below and in the proposed rule change) an effective date of withdrawal, which date shall be no later than ten (10) business days following the last day of the applicable Loss Allocation Withdrawal Notification Period (as defined below and in the proposed rule change) (i.e., no later than ten (10) business days after the 5th

business day following the first Loss Allocation Notice in that round of loss allocation),²⁵ (ii) cease all activity that would result in transactions being submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member's withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully and finally settled by the effective date of the Member's withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

As proposed, a Member that withdraws in compliance with proposed Section 6 of Rule 4 would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

The proposed rule changes are designed to enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated. To the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

²⁵ NSCC believes that having an effective date of withdrawal that is not later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period would provide Members with a reasonable period of time to wind down their activities at NSCC while minimizing any uncertainty typically associated with a longer withdrawal period.

The proposed rule changes relating to capping withdrawing Members' loss allocation exposure and related changes to the withdrawal process are set forth in proposed Sections 4 and 6 of Rule 4, as further described below.

B. Changes to Align Loss Allocation Rules

The proposed rule changes would align the loss allocation rules, to the extent practicable and appropriate, of the three DTCC Clearing Agencies so as to provide consistent treatment, especially for firms that are participants of two or more DTCC Clearing Agencies. As proposed, the loss allocation waterfall and certain related provisions, e.g., returning a former Member's Clearing Fund, would be consistent across the DTCC Clearing Agencies to the extent practicable and appropriate. The proposed rule changes of NSCC that would align loss allocation rules of the DTCC Clearing Agencies are set forth in proposed Sections 1, 2, 7, and 12 of Rule 4, as further described below.

C. Clarifying Changes Relating to Loss Allocation

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to Members. In particular, NSCC is proposing the following changes relating to loss allocation to clarify Members' obligations for Declared Non-Default Loss Events.

Aside from losses that NSCC might face as a result of a Defaulting Member Event, NSCC could incur non-default losses incident to its clearance and settlement business.²⁶ The Rules currently permit NSCC to apply Clearing Fund to non-default

²⁶ Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

losses. Specifically, pursuant to Section 2(b) of Rule 4,²⁷ NSCC can use the Clearing Fund to satisfy losses or liabilities of NSCC incident to the operation of the clearance and settlement business of NSCC. Section II of Addendum K provides additional details regarding the application of the Clearing Fund to losses outside of a System.

If there is a failure of NSCC following a non-default loss, such occurrence would affect Members in much the same way as a failure of NSCC following a Defaulting Member Event. Accordingly, NSCC is proposing rule changes to enhance the provisions relating to non-default losses by clarifying Members' obligations for such losses.

Specifically, NSCC is proposing enhancement of the governance around non-default losses that would trigger loss allocation to Members by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that NSCC would then be required to promptly notify Members of this determination, which is referred to in the proposed rule as a Declared Non-Default Loss Event. In addition, NSCC is proposing to better align the interests of NSCC with those of its Members by stipulating a mandatory Corporate Contribution apply to a Declared Non-Default Loss Event prior to any allocation of the loss among

²⁷ Section 2(b) of Rule 4 provides that “the use of the Clearing Fund...shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses and liabilities of a System.” Supra note 5.

Members, as described above. Additionally, NSCC is proposing language to clarify Members' obligations for Declared Non-Default Loss Events.

The proposed rule changes relating to Declared Non-Default Loss Events and Members' obligations for such events are set forth in proposed Section 4 of Rule 4, as further described below.

D. Reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit

The proposed rule change would reduce the time period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.

NSCC believes that shortening the time period for the return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they could have use of the deposits sooner than under the current Rules while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied, which would include both matured as well as contingent obligations.

The proposed rule changes relating to the reduced time period in which NSCC is required to return the Clearing Fund deposit of a former Member are set forth in proposed Section 7 of Rule 4, as further described below.

The foregoing changes as well as other changes (including a number of conforming and technical changes) that NSCC is proposing in order to improve the transparency and accessibility of the Rules are described in detail below.

E. Loss Allocation Waterfall Comparison

The following example²⁸ illustrates the differences between the current and proposed loss allocation provisions:

Assumptions:

- (i) Member A defaults on a business day (Day 1). On the same day, NSCC ceases to act for Member A and notifies Members of the cease to act. After liquidating Member A's portfolio and applying Member A's Clearing Fund deposit, NSCC has a loss of \$350 million.
- (ii) Member X voluntarily retires from membership five (5) business days after NSCC ceases to act for Member A (Day 6).
- (iii) Member B defaults seven (7) business days after NSCC ceases to act for Member A (Day 8). On the same day, NSCC ceases to act for Member B and notifies Members of the cease to act. After

²⁸ For purposes of this example, NSCC has assumed that the losses occurred with guaranteed CNS activity of Members, and NSCC allocated all such Members' deposits to the Clearing Fund to CNS activity (which is typically more than 99% of the NSCC daily gross settlement amount).

liquidating Member B's portfolio and applying Member B's Clearing Fund deposit, NSCC has a loss of \$350 million.

- (iv) The current NSCC loss provisions require NSCC to contribute no less than 25% of its retained earnings as a corporate contribution. For the purposes of this example, it is assumed that NSCC will contribute 25% of its retained earnings. The amount of NSCC's retained earnings is \$416 million.
- (v) NSCC's General Business Risk Capital Requirement is \$154 million.

Current Loss Allocation:

Under the current loss allocation provisions, with respect to the losses arising out of Member A's default, NSCC will contribute \$104 million ($\$416 \text{ million} * 25\%$) from retained earnings and then allocate the remaining loss of \$246 million ($\$350 \text{ million} - \104 million) to Members.

With respect to losses arising out of Member B's default, NSCC will contribute \$78 million ($(\$416 \text{ million} - \$104 \text{ million}) * 25\%$) from retained earnings and then allocate the remaining loss of \$272 million ($\$350 \text{ million} - \78 million) to Members. Because Member X voluntarily retired before NSCC ceased to act for Member B, Member X is not subject to loss allocation with respect to losses arising out of Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC will contribute \$182 million of retained earnings and will allocate losses of \$518 million to Members.

Proposed Loss Allocation:

Under the proposed loss allocation provisions, a Defaulting Member Event with respect to Member A's default would have occurred on Day One, and a Defaulting Member Event with respect to Member B's default would have occurred on Day 8. Because the Defaulting Member Events occurred during a 10-business day period, they would be grouped together into an Event Period for purposes of allocating losses to Members. The Event Period would begin on the 1st business day and end on the 10th business day.

With respect to losses arising out of Member A's default, NSCC would apply a Corporate Contribution of \$77 million ($\$154 \text{ million} * 50\%$) and then allocate the remaining loss of \$273 million ($\$350 \text{ million} - \77 million) to Members. With respect to losses arising out of Member B's default, NSCC would not apply a Corporate Contribution since it would have already contributed the maximum Corporate Contribution of 50% of its General Business Risk Capital Requirement. NSCC would allocate the losses of \$350 million arising out of Member B's default to Members. Because Member X was a Member on the first day of the Event Period, Member X would be subject to loss allocation with respect to all events occurring during the Event Period, even if the event occurred after its retirement. Therefore, Member X would be subject to loss allocation with respect to Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC would apply a Corporate Contribution of \$77 million and would allocate losses of \$623 million to Members. The principal differences in the above example are due to (i) the proposed changes to the calculation and application of the Corporate Contribution and (ii) the proposed introduction of an Event Period.

(ii) Detailed Description of the Proposed Rule Changes Related to Loss Allocation

A. Proposed Changes to Rule 4 (Clearing Fund)

Overview of Rule 4 (Clearing Fund)

Rule 4 currently addresses Clearing Fund requirements and loss allocation obligations. While Procedure XV addresses the various Clearing Fund calculations, Rule 4 sets forth rights, obligations and other aspects associated with the Clearing Fund, as well as the loss allocation process. Rule 4 is currently organized into 12 sections. NSCC is proposing changes to each section, and consolidating provisions in Rule 4 relating to Mutual Fund Services and Insurance and Retirement Processing Services into new sections, as described below.

Section 1

Section 1 of Rule 4 currently sets forth the requirement that each Member and Mutual Fund/Insurance Services Member shall, and each Fund Member and Insurance Carrier/Retirement Services Member may, be required to make a deposit to the Clearing Fund. Section 1 currently provides that each participant's Required Deposit is based on one or more formulas specified by NSCC's Board of Directors. The basis of each such formula is participants' usage of NSCC's facilities. Section 1 also currently sets forth the minimum amount of each participant category's Required Deposit.

Current Section 1 allows a portion of a participant's Clearing Fund deposit to be evidenced by an open account indebtedness secured by Eligible Clearing Fund Securities, subject to certain limitations set forth in Procedure XV, and sets forth the various requirements associated with the deposit of Eligible Clearing Fund Securities. Current Section 1 also permits NSCC to require participants to post a letter of credit where NSCC believes the participants present legal risk.

Current Section 1 also provides that NSCC allocate the Clearing Fund by types of service (e.g., Mutual Fund Services) as well as by Systems (e.g., CNS), and divide the Clearing Fund into separate "Allocations" for each such service and separate "Funds" for each such System.

Under the proposed rule change, NSCC is proposing to add a subheading of "Required Fund Deposits" to Section 1 and restructure Section 1 so that it applies to Members only and delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Section 1.²⁹ Provisions of Rule 4 regarding Mutual Fund/Insurance Services Members and Fund Members would be covered in a new proposed Section 13 to Rule 4, discussed below. Provisions of Rule 4 regarding Insurance Carrier/Retirement Services Members would be covered in a new proposed Section 14 to Rule 4, discussed below.

Under the proposed rule change, Section 1 would continue to have the same provisions as they relate to Members except for the following: (i) the language throughout the section would be reorganized, streamlined and clarified, (ii) "Required

²⁹ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Sections 2, 3, 4, 5, 6, 7, 8, 9, and 12 of Rule 4.

Deposits” would be renamed “Required Fund Deposits,”³⁰ which is a more descriptive term to refer to Members’ deposits required for the Clearing Fund, and would harmonize with the rules of FICC/GSD and FICC/MBSD³¹ and the term used in such rules,³² (iii) a sentence would be added regarding additional deposits maintained by the Members at NSCC, (iv) the provision regarding the Clearing Fund being allocated by Systems and services would be deleted,³³ and (v) change “Rules” to “Rules and Procedures” to better reflect the name of NSCC’s rulebook.³⁴

The proposed sentence regarding additional deposits to the Clearing Fund would permit Members to post such additional deposits at their discretion and would make clear that such additional deposits would be deemed to be part of the Clearing Fund and the Member’s Actual Deposit (as discussed below and as defined in the proposed rule change) but would not be deemed to be part of the Member’s Required Fund Deposit.

NSCC proposes to add language in Section 1 to make it clear that each Member would grant NSCC a first priority perfected security interest in its right, title and interest

³⁰ In addition to Section 1 of Rule 4, NSCC is proposing to rename “Required Deposits” to “Required Fund Deposits” in Sections 2, 3, 4, 8, 9, and 11 of Rule 4.

³¹ FICC/GSD Rulebook (“FICC/GSD Rules”), available at http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf and FICC/MBSD Clearing Rules (“FICC/MBSD Rules”), available at http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf.

³² See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 31.

³³ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to the Clearing Fund being allocated by Systems and services from Sections 2, 3, and 4 of Rule 4.

³⁴ In addition to Section 1 of Rule 4, NSCC is proposing to change “Rules” to “Rules and Procedures” in Sections 9 and 12 of Rule 4.

in and to any Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure the Member's open account indebtedness or placed by the Member in NSCC's possession (or its agents acting on its behalf) to secure all such Member's obligations to NSCC, and that NSCC would be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The additional language would further harmonize the Rules with language used in the FICC/GSD Rules and FICC/MBSD Rules,³⁵ thus providing consistent treatment of pledged resources for firms that are members of both NSCC and FICC.

NSCC proposes to clarify the language in footnote 2 of Section 1. In addition, NSCC proposes to add "Eligible Letter of Credit" as a defined term to refer to letters of credit posted by participants if required by NSCC,³⁶ which would harmonize the term with the term used in the FICC/GSD Rules and FICC/MBSD Rules,³⁷ thus providing consistent terminology for firms that are members of both NSCC and FICC.

Similarly, NSCC proposes to add "Actual Deposit" as a defined term in Section 1 to refer to Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure a Member's open account indebtedness or placed by a Member in the possession of NSCC (or its agents acting on its behalf) and any Eligible Letters of Credit issued on behalf of a Member in favor of NSCC.

³⁵ See Section 4 of FICC/GSD Rule 4 and Section 4 of FICC/MBSD Rule 4, supra note 31.

³⁶ In addition to Section 1 of Rule 4, NSCC is also proposing to rename "Letter of Credit" to "Eligible Letter of Credit" in Sections 2 and 12 of Rule 4.

³⁷ See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 31.

Instead of requiring participants to pledge Eligible Clearing Fund Securities to NSCC's account at a Qualified Securities Depository designated by the participants, NSCC proposes to clarify and streamline Section 1 of proposed Rule 4 to provide that Eligible Clearing Fund Securities pledged to secure a Member's open account indebtedness would be delivered to NSCC's account at DTC.

NSCC would delete the provision regarding allocation of the Clearing Fund by Systems and services, as this provision is no longer relevant under the proposed rule change. Provisions relating to Mutual Fund Services and Insurance and Retirement Processing Services in Section 1 (as well as other sections in Rule 4) would be consolidated in the proposed new Sections 13 and 14, entitled "Mutual Fund Deposits" and "Insurance Deposits," respectively.

To consolidate provisions regarding the maintenance, investment and permitted use of Clearing Fund, NSCC would move the last paragraph of Section 1 about segregation and maintenance of Clearing Fund (again, in terms of "Fund," "System," and "Allocation," as discussed above) to Section 2.

In addition, NSCC proposes to correct a typographical error in the reference to a footnote in Section 1 of Rule 4. Specifically, there is an incorrect reference to footnote 22 in the second paragraph of Section 1 in current Rule 4. NSCC is proposing to change this reference to reflect the correct footnote, which is footnote 2.

Section 2

Section 2 of Rule 4 currently covers the permitted uses of the Clearing Fund (again by "Fund" and "Allocation," as set forth in current Section 1), including the investment of Clearing Fund Cash and Cash Receipts, as well as participants' rights to any interest earned or paid on pledged Eligible Clearing Fund Securities or cash deposits.

NSCC is proposing to add a subheading of “Permitted Use, Investment, and Maintenance of Clearing Fund Assets” to Section 2 and restructure Section 2 so that it applies to Members only. NSCC is also proposing to restructure Section 2 so that the permitted use of Clearing Fund appears first, then the investment of Clearing Fund, followed by maintenance of Clearing Fund.

Under the proposed rule change, the permitted use of Clearing Fund paragraph would continue to have the same provisions as they relate to how the Clearing Fund can be used by NSCC, except the provisions would be streamlined and clarified. Specifically, in order to be consistent with the proposed change in Section 4 (as described below) regarding NSCC requiring Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact), NSCC is proposing to modify the permitted use of Clearing Fund to make it clear that the Clearing Fund can be used by NSCC to secure each Member’s performance of obligations to NSCC, including each Member’s obligations with respect to any loss allocations as set forth in Section 4 of Rule 4. NSCC is also proposing to delete the defined term of Cash Receipts and related provisions from Rule 4 because, unlike the Clearing Fund, Cash Receipts are money payments received from participants and payable to others; therefore, NSCC believes that continuing to include Cash Receipts in Rule 4 is no longer necessary and may cause confusion among Members.

NSCC is proposing to add a paragraph that provides that each time NSCC uses any part of the Clearing Fund to provide liquidity to NSCC to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund

Securities in order to secure liquidity for more than thirty (30) calendar days, NSCC, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, would consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with proposed Section 4 of Rule 4. NSCC believes that this proposed change would increase transparency and accessibility of the Rules for Members by specifying a point in time by which NSCC would need to replenish the Clearing Fund through loss allocation if NSCC uses the Clearing Fund to provide or secure liquidity to NSCC to meet its settlement obligations. NSCC believes that a period of thirty (30) calendar days would be appropriate because it would provide sufficient time for NSCC to determine whether it would be able to obtain the necessary funds from liquidation of the portfolio of the Defaulting Member to repay the used Clearing Fund amount. In addition, this proposed change would also harmonize this section with the comparable section in the FICC/GSD Rules and FICC/MBSD Rules,³⁸ so as to provide consistent treatment for firms that are members of both NSCC and FICC.

Proposed Section 2 would continue to have the same provisions concerning the investment and maintenance of the Clearing Fund, except these provisions would also be streamlined and clarified. Specifically, NSCC is proposing language to make it clear that it may invest cash in the Clearing Fund in accordance with the Clearing Agency Investment Policy adopted by NSCC.³⁹ NSCC would revise the relocated sentence from

³⁸ See Section 5 of FICC/GSD Rule 4 and Section 5 of FICC/MBSD Rule 4, supra note 31.

³⁹ See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-NSCC-2016-003). The Clearing Agency Investment Policy (the “Policy”) governs the management, custody, and

Section 1 which provides that NSCC shall not be required to segregate any Clearing Fund (again, in terms of “Fund,” “System,” and “Allocation,” as discussed above) in order to (i) conform to the proposed deletions in Section 1 and use the newly defined term of “Actual Deposit” as set forth in Section 1 and (ii) make clear that NSCC would not be required to segregate a Member’s Actual Deposit but that NSCC would maintain books and records concerning the assets that constitute each Member’s Actual Deposit.

Under the proposed rule change, Members would continue to be entitled to any interest earned or paid on Clearing Fund cash deposits and pledged Eligible Clearing Fund Securities; however, NSCC is proposing additional language to make it clear that interest on pledged Eligible Clearing Fund Securities that is received by NSCC would be credited to a Member’s cash deposits to the Clearing Fund, except in the event of a default by such Member on any obligations to NSCC, in which case NSCC may exercise its rights under proposed Section 3 of Rule 4.

Section 3

Section 3 of Rule 4 currently provides that NSCC may apply a participant’s actual deposit to any obligation the participant has to NSCC that the participant has failed to

investment of cash deposited to the Clearing Fund, the proprietary liquid net assets (cash and cash equivalents) of NSCC and other funds held by NSCC. The Policy sets forth guiding principles for the investment of those funds, which include adherence to a conservative investment philosophy that places the highest priority on maximizing liquidity and avoiding risk, as well as mandating the segregation and separation of funds. The Policy also addresses the process for evaluating credit ratings of counterparties and identifies permitted investments within specified parameters. In general, assets are required to be held by regulated and creditworthy financial institution counterparties and invested in financial instruments that, with respect to the Clearing Fund, may include deposits with banks, including the Federal Reserve Bank of New York, collateralized reverse-repurchase agreements, direct obligations of the U.S. government and money-market mutual funds.

satisfy and to any Cross-Guaranty Obligation. Participants are required to eliminate any resulting deficiencies in their Required Deposits within such time as NSCC requires. Section 3 also currently provides for the manner in which loss allocation would apply with respect to Off-the-Market Transactions.

Under the proposed rule change, NSCC is proposing to add a subheading of “Application of Clearing Fund Deposits and Other Amounts to Members’ Obligations” and to delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into Funds/Allocations by Systems and services. Under the proposed rule change, NSCC would retain the provisions in Section 3 regarding applying the Member’s Actual Deposit to satisfy an obligation to NSCC that a Member fails to satisfy and the requirement to replenish the Required Fund Deposit as necessary, but NSCC proposes to add clarifying language that, in addition to a Member’s Actual Deposit, NSCC will also apply any amounts available under a Clearing Agency Cross-Guaranty Agreement and any proceeds therefrom to satisfy the obligation. NSCC also proposes to add language making it clear that NSCC may take any and all actions with respect to the assets and amounts referenced in the prior sentence, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that NSCC determines is appropriate.

Under the proposed rule change, NSCC would move the provision regarding allocation of losses from Off-the-Market Transactions to proposed Section 4 of Rule 4, which addresses allocation of losses to Members. NSCC would streamline and clarify the remaining provisions for transparency and accessibility.

Section 4 and Section 5

Current Section 4 of Rule 4 contains NSCC's current loss allocation waterfall, which would be initiated if NSCC incurs a loss or liability in a System that is not satisfied pursuant to current Section 3. Section 4 currently provides for the following loss allocation waterfall:

- (i) Application of NSCC's existing retained earnings or such lesser part⁴⁰ of the existing retained earnings unless the Board of Directors elects to apply the Fund/Allocation for a particular System or service.
- (ii) If a loss or liability remains after the application of the retained earnings, NSCC would apply the Clearing Fund (this application is subject to the current structure where the Rules provide that the Clearing Fund is allocated to different Systems/services).
 - a. NSCC is required to provide participants and the Commission with 5 business days' prior notice before applying the Clearing Fund.
 - b. Participants (other than those responsible for causing the loss or liability) would be charged pro rata based upon their allocation to the applicable Fund, less any amounts that participants were required to deposit pursuant to Rule 15.

Section 5 of Rule 4 currently states that if a pro rata charge is made pursuant to Rule 4 against a participant's actual Clearing Fund deposit, and as a consequence thereof the participant's remaining deposit is less than its Required Deposit, the participant

⁴⁰ Addendum E provides that NSCC "will apply no less than twenty-five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability." Supra note 5.

would, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. Current Section 5 further provides that if the participant does not take this required action, NSCC may take disciplinary action against the participant, and any disciplinary action taken against the participant or the voluntary or involuntary termination of the participant's membership will not affect the obligations of the participant to NSCC or any remedy to which NSCC may be entitled under applicable law.

Under the proposed rule change, NSCC is proposing to add a subheading of "Loss Allocation Waterfall, Off-the-Market Transactions" to Section 4 and delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into Funds/Allocations by System or service. In addition, NSCC is proposing to restructure its loss allocation waterfall as described below.

Under the proposal, Section 4 would make clear that the loss allocation waterfall applies to any loss and liability incurred by NSCC arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event.

As proposed, Section 4 would provide that, for the purposes of Rule 4, the term "Defaulting Member" would mean a Member for which NSCC has ceased to act pursuant to Rule 46,⁴¹ the term "Defaulting Member Event" would mean the determination by NSCC to cease to act for a Member pursuant to Rule 46, and the term "Declared Non-Default Loss Event" would mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of NSCC may be a

⁴¹ NSCC may cease to act for a Member pursuant to any of the circumstances set forth under Rule 46 (Restrictions on Access to Services), including, but not limited to, in the event the Member is in default of any delivery of funds or securities to NSCC. Supra note 5.

significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner. Proposed Section 4 would establish the concept of an “Event Period” to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) business days, which would be grouped into an Event Period.⁴² As stated above, both Defaulting Member Events or Declared Non-Default Loss Events could occur within the same Event Period.

Under the proposal, an Event Period with respect to a Defaulting Member Event would begin on the day NSCC notifies participants that it has ceased to act for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a Declared Non-Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

As proposed, each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member. Under the proposal, to the extent that such

⁴² Supra note 15.

loss or liability is not satisfied pursuant to proposed Section 3 of Rule 4, NSCC would apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as provided in proposed Section 4.

Under proposed Section 4, the loss allocation waterfall would begin with a corporate contribution from NSCC (“Corporate Contribution”), as is the case under the current Rules, but in a different form than under the current Section 4 of Rule 4. Today, pursuant to Addendum E, in the event of a Member impairment, NSCC is required to apply at least 25% of its retained earnings existing at the time of a Member impairment; however, no corporate contribution from NSCC is currently required for losses resulting other than those from Member impairments. Under the proposal, NSCC would amend Section 5 to add a subheading of “Corporate Contribution” and define NSCC’s Corporate Contribution with respect to any loss allocation pursuant to proposed Section 4 of Rule 4, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, as an amount that is equal to fifty (50) percent of the amount calculated by NSCC in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.⁴³ The proposed rule change would specify that NSCC’s General Business Risk Capital Requirement, as defined in NSCC’s Clearing Agency Policy on Capital Requirements,⁴⁴ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.⁴⁵

⁴³ Supra note 8.

⁴⁴ Supra note 9.

⁴⁵ Supra note 10.

As proposed, if NSCC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Defaulting Member Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the two hundred fifty (250) business days thereafter,⁴⁶ the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period. Proposed Section 5 would require NSCC to notify Members of any such reduction to the Corporate Contribution.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than from Member impairments. Under the proposal, NSCC would expand the application of its corporate contribution beyond losses and liabilities from Member impairments. The proposed Corporate Contribution would apply to losses or liabilities relating to or arising out of Defaulting Member Events and Declared Non-Default Loss Events, and would be a mandatory loss contribution by NSCC prior to any allocation of the loss among Members.

Addendum E currently provides NSCC the option to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as the result of a Member's impairment. This option would be retained and expanded under the proposal to also cover non-default losses. Proposed Section 5 would provide that nothing in the Rules would prevent NSCC from voluntarily applying amounts greater than the Corporate Contribution against any NSCC loss or liability, whether arising out of or relating to a

⁴⁶ Supra note 13.

Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Proposed Section 4 of Rule 4 would provide that NSCC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, NSCC would allocate such losses and liabilities to Members, as described below.

Proposed Section 4 of Rule 4 would also retain the requirement of loss allocation among Members if a loss or liability remains after the application of the Corporate Contribution, as described above. In contrast to the current Section 4 where NSCC would apply Members' Required Deposits to the mutualized loss allocation amounts, under the proposal, NSCC would require Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact).⁴⁷ Loss allocation obligations would

⁴⁷ NSCC believes that shifting from the two-step methodology of applying the Clearing Fund and then requiring Members to immediately replenish it, to requiring direct payment would increase efficiency while preserving the right to charge a Member's Clearing Fund deposits in the event the Member does not timely pay. Such a failure to pay would trigger recourse to the Clearing Fund deposits of the Member under proposed Section 3 of Rule 4. In addition, this change would provide greater stability for NSCC in times of stress by allowing NSCC to retain the Clearing Fund, its critical prefunded resource, while charging loss allocations. NSCC believes doing so would allow NSCC to cover its current credit exposures to Members at all times. By retaining the Clearing Fund as proposed, NSCC could use the Clearing Fund to secure the performance obligations of Members to NSCC, including their payment obligation for any loss allocation, while maintaining access to prefunded resources. By being able to

continue to be calculated based upon a Member's pro rata share of losses and liabilities (although the pro rata share would be calculated differently than it is today), and Members would still retain the ability to voluntarily withdraw from membership and cap their loss allocation obligation (although the loss allocation obligation would also be calculated differently than it is today).

The proposed rule change to Section 4 of Rule 4 would clarify that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. The proposal would make it clear that any Member for which NSCC ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

Under the proposed rule change, a loss allocation "round" would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the round cap. When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

manage its current credit exposures throughout the loss allocation process, NSCC would be able to continue to provide its critical operations and services during what would be expected to be a stressful period.

As proposed, each loss allocation would be communicated to Members by the issuance of a Loss Allocation Notice. Under the proposal, each Member's pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the Member's Average RFD divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a "Loss Allocation Withdrawal Notification Period") to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.⁴⁸ As proposed, the "Loss Allocation Cap" of a Member would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

NSCC is proposing to clarify that after a first round of loss allocation with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

⁴⁸ Supra note 18.

As proposed, Members would have two (2) business days after NSCC issues a first round Loss Allocation Notice to pay the amount specified in any such notice.⁴⁹ On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because NSCC was only able to allocate up to the round cap), Members would also have two (2) business days after notice by NSCC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless Members have notified (or will timely notify) NSCC of their election to withdraw from membership with respect to a prior loss allocation round pursuant to proposed Section 6 of Rule 4.

As proposed, Section 4 would also provide that, to the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

Under the proposal, if a Member fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, NSCC would have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with proposed Section 3 of Rule 4 described above. Members who wish to withdraw would be required to comply with the requirements in proposed Section 6 of Rule 4, described further below. Specifically, proposed Section 4 of Rule 4 would provide that if, after notifying NSCC of its election to withdraw from membership pursuant to proposed Section 6 of Rule 4, the Member fails to comply with the provisions of proposed Section 6 of Rule 4, its notice of withdrawal would be deemed void and any

⁴⁹ Supra note 22.

further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

Under the proposal, NSCC would delete the provision in current Section 4 of Rule 4 that requires NSCC to provide Members and the Commission with 5 business days' prior notice before applying the Clearing Fund to a loss or liability because such requirement would no longer be relevant under the proposed rule change. Under the proposed rule change, NSCC would notify Members subject to loss allocation of the amounts being allocated to them in one or more Loss Allocation Notices. As proposed, instead of applying the Clearing Fund, NSCC would require Members to pay their loss allocation amounts (leaving their Clearing Fund deposits intact). In order to conform to these proposed rule changes, NSCC is proposing to eliminate the required notification to Members regarding the application of Clearing Fund in current Section 4 of Rule 4. NSCC is also proposing to delete the required notification to the Commission regarding the application of Clearing Fund in the same section. While as a practical matter, NSCC would notify the Commission of a decision to loss allocate, NSCC does not believe such notification needs to be specified in the Rules.

Under the proposed rule change, NSCC would move the provision related to Off-the-Market Transactions from current Section 3 of Rule 4 to proposed Section 4 of Rule 4 and clarify that (i) a loss or liability of NSCC in connection with the close-out or liquidation of an Off-the-Market Transaction would be allocated to the Member that was the counterparty to such transaction and (ii) no allocation would be made if the

Defaulting Member satisfied all applicable intraday mark-to-market margin charges assessed by NSCC with respect to the Off-the-Market Transaction prior to its default.⁵⁰

Section 6

Proposed Section 6 of Rule 4 would include the provisions regarding withdrawal from membership currently covered by Section 8 of Rule 4. NSCC believes that relocating the provisions on withdrawal from membership as it pertains to loss allocation, so that it comes right after the section on the loss allocation waterfall, would provide for the better organization of Rule 4. As proposed, the subheading for Section 6 would read “Withdrawal Following Loss Allocation.”

Currently, Section 8 of Rule 4 provides that participants may notify NSCC within ten (10) business days after receipt of notice of a pro rata charge that they have elected to terminate their membership and thereby avail themselves of a cap on loss allocation, which is currently their Required Deposit as fixed immediately prior to the time of the pro rata charge.

As stated above, under the proposed rule change, a Member who wishes to withdraw from membership in respect of a loss allocation round must provide notice of its election to withdraw (“Loss Allocation Withdrawal Notice”) within five (5) business days from the issuance of the first Loss Allocation Notice in any round.⁵¹ In order to avail itself of its Loss Allocation Cap, the Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member

⁵⁰ See Securities Exchange Act Release No. 79598 (December 19, 2016), 81 FR 94462 (December 23, 2016) (SR-NSCC-2016-005), at 94465, and Securities Exchange Act Release No. 79592 (December 19, 2016), 81 FR 94448 (December 23, 2016) (SR-NSCC-2016-803), at 94452.

⁵¹ Supra note 18.

must: (i) specify in its Loss Allocation Withdrawal Notice an effective date for withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period (i.e., no later than ten (10) business days after the 5th business day following the first Loss Allocation Notice in that round of loss allocation),⁵² (ii) cease all activity that would result in transactions being submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member's withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully and finally settled by the effective date of the Member's withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

Proposed Section 6 of Rule 4 would provide that a Member that withdraws in compliance with the requirements of proposed Section 6 of Rule 4 would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under proposed Rule 4; however, the Member's aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

NSCC is proposing to include a sentence in proposed Section 6 of Rule 4 to make it clear that if the Member fails to comply with the requirements set forth in that section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to proposed Section 4 of Rule 4 as if it had not given such notice.

⁵² Supra note 25.

Currently, Section 8 also contains provisions regarding additional pro rata charges that may be made by NSCC for the same loss or liability under the existing loss allocation process and the applicable caps that participants wishing to voluntarily terminate their membership after such additional pro rata charges are noticed may avail themselves of. These provisions would be replaced by the loss allocation process contained in proposed Section 4 described above.

Section 7

As proposed, Section 7 would cover the provisions on the return of a Member's Clearing Fund deposit that are currently covered by Section 6 of Rule 4. Proposed Section 7's subheading would be "Return of Members' Clearing Fund Deposits" and would apply only to Members.

Currently, with respect to the return of Clearing Fund deposits, Section 6 of Rule 4 states that NSCC will return a participant's Clearing Fund deposit 90 days after 3 conditions are met: (i) the participant ceases to be a participant, (ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund have been closed, and (iii) all obligations of the participant to NSCC have been satisfied or have been deducted from the participant's Clearing Fund deposit by NSCC, provided that the participant has provided NSCC with satisfactory indemnities or guarantees or another participant has been substituted on all transactions and obligations of the participant.

Current Section 6 provides further that in the absence of an acceptable guarantee, indemnity or substitution, NSCC will retain the entire Clearing Fund deposit of a participant if such deposit is less than \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after

conditions described in (i), (ii) and (iii) of the paragraph above have occurred. If the participant's Clearing Fund deposit is equal to or greater than \$100,000, NSCC will retain the greater of twenty-five (25) percent of a participant's average Clearing Fund requirement over the twelve (12) months immediately prior to the date the participant ceased to be a participant, or \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after conditions described in (i), (ii) and (iii) of the paragraph above have occurred.

Current Section 6 states that if a participant made a deposit with respect to the Mutual Fund Services or Insurance and Retirement Processing Services, the participant will be entitled to the return of this deposit ninety (90) days after all associated transactions in these services have been satisfied.

Finally, Section 6 currently provides that any obligation of a participant to NSCC unsatisfied at the time the participant ceases to be a participant will not be affected by such cessation of membership.

Proposed Section 7 would reduce the period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC. NSCC believes that shortening the time periods for the

return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they could have use of the deposits sooner than under the current Rules, while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. Proposed Section 7 would also harmonize the retention period for a Member's deposits to the Clearing Fund with the FICC/GSD Rules,⁵³ thus providing consistent treatment for firms that are members of both NSCC and FICC. Similarly, the Clearing Fund deposit retention for Members who have Sponsored Accounts at DTC would be reduced in order to stay consistent with the proposed retention period in the rules of DTC.⁵⁴ In addition, NSCC proposes to make it clear that a Member's obligations to NSCC would include both matured as well as contingent obligations.

⁵³ Section 10 of FICC/GSD Rule 4, in relevant part, states that "If a Netting Member gives notice to the Corporation pursuant to Rule 3 of its election to terminate its membership in the Netting System, the Member's deposits to the Clearing Fund in the form of cash or securities shall be returned to it within 30 calendar days thereafter ... provided that all amounts owing to the Corporation by the Member have been paid to the Corporation prior to such return and the Member has no remaining open Net Settlement Position, Fail Net Settlement Position, or Forward Net Settlement Position." Supra note 31.

⁵⁴ On December 18, 2017, DTC submitted a proposed rule change and an advance notice to enhance its rules regarding allocation of losses. See Securities Exchange Act Release Nos. 82426 (January 2, 2018), 83 FR 913 (January 8, 2018) (SR-DTC-2017-022) and 82582 (January 24, 2018), 83 FR 4297 (January 30, 2018) (SR-DTC-2017-804). On June 28, 2018, DTC submitted amendments to the proposed rule change and advance notice. Copies of the amendments to the proposed rule change and the advance notice are available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

Section 8

Proposed Section 8 of Rule 4 would cover the subject matter currently covered in Section 7 of Rule 4. Proposed Section 8's subheading would be "Changes in Members' Required Fund Deposits" and would apply only to Members.

Currently, Section 7 of Rule 4 requires participants to satisfy any increase in their Required Deposit within such time as NSCC requires. At the time the increase becomes effective, the participant's obligations to NSCC will be determined in accordance with the increased Required Deposit whether or not the Member has so increased its deposit. NSCC is not proposing any substantive changes to this provision, which will be renumbered as Section 8 of Rule 4 under the proposed rule change, except for streamlining the provision and limiting its application to Members as stated above.

Section 9

Currently, Section 9 of Rule 4 addresses situations where a participant has excess deposits in the Clearing Fund (i.e., amounts above its Required Deposit). The current provision provides that NSCC will, on any day that NSCC has determined and provided notification that an excess deposit exists with respect to a participant, return an excess amount requested by a participant that follows the formats and timeframe established by NSCC for such request. The current provision makes clear that NSCC will not return the requested excess amount (i) until any amount required to be charged against the participant's Required Deposit is paid by the participant to NSCC and/or (ii) if NSCC determines that the participant's current month's use of one or more services is materially different than the previous month's use upon which such excess is based. Section 9 currently makes clear that, notwithstanding any of the foregoing, NSCC may, in its discretion, withhold any or all of a participant's excess deposit if the participant has been

placed on the Watch List.⁵⁵ Current Section 9 also makes clear that nothing in this section limits NSCC's rights under Rule 15.⁵⁶

Proposed Section 9 would add a subheading "Excess Clearing Fund Deposits" and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except for streamlining the provisions in this section and eliminating the condition described in clause (i) of the paragraph above that limits participants' ability to request the return of excess amounts on deposit in the Clearing Fund and replacing clause (ii) of the paragraph above with a clause that provides NSCC may, in its discretion, withhold any or all of a participant's excess deposit if NSCC determines that the Member's anticipated activities in NSCC in the near future may reasonably be expected to be materially different than its activities of the recent past. NSCC believes that the proposed additional clause would protect NSCC and its participants because the clause would allow NSCC to retain excess deposits to cover an expected near-term increase in a Member's Required Fund Deposit amount due to the anticipated change in the Member's activities. The proposed additional clause would also align NSCC's Rules with that of

⁵⁵ Pursuant to Section 4 of Rule 2B, a Member could be placed on the Watch List either based on its credit rating of 5, 6 or 7, which can either be generated by the Credit Risk Rating Matrix or from a manual downgrade, or when NSCC deems such placement as necessary to protect NSCC and its Members. Supra note 5.

⁵⁶ Rule 15 permits NSCC to require a Member, Limited Member or any applicant to become either to furnish NSCC adequate assurances of the entity's financial responsibility and operational capability as NSCC may deem necessary. Supra note 5.

FICC/GSD and FICC/MBSD,⁵⁷ thus providing consistent treatment for firms that are members of both NSCC and FICC.

Section 10

Current Section 10 of Rule 4 provides for crediting persons against whom losses are charged pursuant to Rule 4 if there is a subsequent recovery of such losses by NSCC. NSCC is not proposing any changes to this section other than (i) making it clear that no loss allocation under proposed Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any losses or liabilities to which the Member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under proposed Rule 4, and (ii) adding a subheading “No Waiver; Subsequent Recovery Against Loss Amounts” and replacing “persons” with “Persons,” which is currently defined in Rule 1 (Definitions and Descriptions) to mean “a partnership, corporation, limited liability corporation or other organization, entity or an individual.” NSCC is proposing the change in (i) above to preserve its legal rights and to make it clear to Members that loss allocation under proposed Rule 4 would not be deemed as NSCC waiving any claims it may have against a Member for any losses or liabilities to which the Member is subject under the Rules. With respect to the proposed change in (ii) above, given that NSCC is a corporation, NSCC believes that the term “Person” already includes NSCC; however, for increased clarity, NSCC is proposing to add “including the Corporation” to make it clear to Members that if there is a subsequent recovery of losses charged pursuant to Rule 4, the net amount of the recovery would be credited to Persons,

⁵⁷ See Section 9 of FICC/GSD Rule 4 (Clearing Fund and Loss Allocation) and Section 9 of FICC/MBSD Rule 4 (Clearing Fund and Loss Allocation). Supra note 31.

including NSCC, against whom the loss was charged in proportion to the amounts charged against them.

Section 11

Current Section 11 of Rule 4 provides that a participant may withdraw Eligible Clearing Fund Securities from pledge, provided that the participant has deposited cash with, or pledged additional Eligible Clearing Fund Securities to, NSCC that, in the aggregate, secure the open account indebtedness of the participant and/or satisfy the participant's Required Deposit. Proposed Section 11 would add a subheading "Substitution or Withdrawal of Pledged Securities" and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except for changes to improve the transparency and accessibility of this section.

Section 12

Current Section 12 of Rule 4 makes it clear that NSCC has certain rights with respect to the Clearing Fund. Proposed Section 12 would add a subheading "Authority of Corporation" and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except to clarify that a reference to 30 days in current Section 12 would mean 30 calendar days.

Section 13

NSCC is proposing to add a new Section 13 to Rule 4 that would be entitled "Mutual Fund Deposits." Under the proposal, NSCC would consolidate provisions from various sections in the current Rule 4 concerning Mutual Fund/Insurance Services Members and Fund Members and group them into proposed Section 13. Aside from the consolidation, NSCC is not proposing any substantive changes to these provisions, except for changes to (i) reduce NSCC's retention period of Mutual Fund Deposits when a

Mutual Fund Participant (as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with the proposed change in Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

Proposed Section 13 would provide that each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member would, and each Fund Member (collectively with such Members and Mutual Fund/Insurance Services Members, “Mutual Fund Participants”) may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its “Mutual Fund Deposit” and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit would be a separate and additional component of such Member’s deposit to the Clearing Fund but not part of the Member’s Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to proposed Section 4 of Rule 4.

As in the current Rules, proposed Section 13 would also provide that if any Mutual Fund Participant fails to satisfy any obligation to NSCC relating to Mutual Fund Services, notwithstanding NSCC’s right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, NSCC would first apply such Mutual Fund Participant’s Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated

to NSCC, NSCC would apply such Member's Actual Deposit in accordance with proposed Section 3 of Rule 4. NSCC would next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants, and after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Mutual Fund Participants are Members. If any loss or liability remains thereafter and there are no continuing Mutual Fund Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 13 would reduce NSCC's retention period of Mutual Fund Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that a Mutual Fund Participant that elects to withdraw from membership would be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Mutual Fund Participant was responsible while a Mutual Fund Participant. NSCC is proposing this change in order to harmonize the retention period of Mutual Fund Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 13 would make it clear that NSCC's rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Mutual Fund Deposits.

Section 14

NSCC is proposing to add a new Section 14 to Rule 4 that would be entitled "Insurance Deposits." Under the proposal, NSCC would consolidate provisions from various sections in current Rule 4 concerning Insurance Carrier/Retirement Services Members and group them into proposed Section 14. Aside from the consolidation, NSCC is not proposing any substantive changes to these provisions, except for changes to (i) reduce NSCC's retention period of Insurance Deposits when an Insurance Participant (as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with proposed Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

As in the current Rules, proposed Section 14 would provide that each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, "Insurance Participants") may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its "Insurance Deposit" and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Insurance Deposits). Proposed Section 14 would also provide that if any Insurance Participant fails to satisfy any obligation to NSCC relating to the Insurance and Retirement Processing Services, NSCC would first apply such Insurance Participant's Insurance Deposit. If after such application any loss or liability remains, NSCC would allocate the remaining loss or liability to the other

Insurance Participants in successive rounds of loss allocations in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants, and after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 14 would reduce NSCC's retention period of Insurance Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that an Insurance Participant that elects to withdraw from membership would be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Insurance Participant was responsible while an Insurance Participant. NSCC is proposing this change in order to harmonize the retention period of Insurance Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 14 would make it clear that NSCC's rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Insurance Deposits.

B. Proposed Changes to Addendum E (Statement of Policy Application of Retained Earnings Member Impairments) and Addendum K (Interpretation of the Board of Directors Application of Clearing Fund)

Addendum E is a statement of policy that currently provides that NSCC will apply no less than twenty-five (25) percent of its retained earnings to cover losses or liabilities from a Member's impairment that is not otherwise satisfied by the impaired Member's Clearing Fund deposit. NSCC is proposing to delete Addendum E in its entirety because it would no longer be relevant given the proposed rule change relating to the Corporate Contribution discussed above.

NSCC is proposing to modify Addendum K to delete all provisions associated with loss allocation and application of the Clearing Fund in connection with a loss or liability incurred by NSCC, including modifying the title of Addendum K. These provisions would no longer be necessary under the proposed rule change because the loss allocation process in its entirety would be governed by Rule 4. In addition, the current language in Addendum K regarding allocation by System would no longer be applicable under the proposed rule change as described above. NSCC would retain the provisions in Addendum K that pertain to NSCC's guaranty and rename Addendum K "The Corporation's Guaranty." NSCC is also proposing to replace "Rules" with "Rules and Procedures" to better reflect the name of NSCC's rulebook.

(iii) Other Proposed Rule Changes

NSCC is proposing changes to Rule 1 (Definitions and Descriptions), Rule 2B (Ongoing Membership Requirements and Monitoring), Rule 4(A) (Supplemental Liquidity Deposits), Rule 13 (Exception Processing), Rule 15 (Assurances of Financial Responsibility and Operational Capability), Rule 42 (Wind-Down of a Member, Fund

Member or Insurance Carrier/Retirement Services Member), Procedure III (Trade Recording Service (Interface with Qualified Clearing Agencies)), Procedure XV (Clearing Fund Formula and Other Matters), and Addendum O (Admission of Non-US Entities as Direct NSCC Members). NSCC is proposing changes to these Rules in order to conform them with the proposed changes to Rule 4 as well as to make certain technical changes to these Rules.

Specifically, NSCC is proposing to add the following defined terms to Rule 1, in alphabetical order: Actual Deposit, Average RFD, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member, Defaulting Member Event, Eligible Letter of Credit, Event Period, Insurance Deposit, Insurance Participant, Issuer, Lender, Loss Allocation Cap, Loss Allocation Notice, Loss Allocation Withdrawal Notice, Loss Allocation Withdrawal Notification Period, Mutual Fund Deposit, Mutual Fund Participant, Required Fund Deposit, Termination Date, and Voluntary Termination Notice.

NSCC is proposing to delete the defined term “The Corporation” in Rule 1 and replace it with “Corporation” in Rule 1. NSCC is proposing to replace “Required Deposits” with “Required Fund Deposits” in Rule 2B, Rule 4(A), Rule 15, Rule 42, Procedure III, and Procedure XV. NSCC is proposing to replace “Rules” with “Rules and Procedures” in Rule 1, Rule 2B, Rule 13, Rule 15, and Procedure III. NSCC is also proposing to replace “Letter of Credit” with “Eligible Letter of Credit” in Rule 42 and Addendum O.

In addition, in Section 5 of Rule 2B, NSCC proposes to change the reference to Section 8 of Rule 4 to reflect the updated section number, which would be to Section 4 of

Rule 4. NSCC is also proposing conforming changes to this section to ensure that termination provisions in the Rules, whether voluntary or in response to a loss allocation, are consistent with one another to the extent appropriate.

Currently, Section 5 of Rule 2B provides that participants may elect to voluntarily retire their membership by providing NSCC with written notice of such termination. Such termination will not be effective until accepted by NSCC, which shall be evidenced by a notice to NSCC's participants announcing the participant's retirement and the effective date of the retirement, which is defined as the "Retirement Date." This section also provides that a participant's voluntary termination of membership shall not affect its obligations to NSCC.

Where appropriate, NSCC is proposing changes to align Section 5 of Rule 2B with the proposed new Section 6 of Rule 4, both of which address termination of membership. Specifically, NSCC is proposing to rename the subheading of Section 5 of Rule 2B to "Voluntary Termination" and to change "retirement" to "termination" and "Retirement Date" to "Termination Date" throughout Section 5 of Rule 2B. NSCC is also proposing to provide that when a participant elects to voluntarily terminate its membership by providing NSCC a written notice of such termination ("Voluntary Termination Notice"), the participant must specify in its Voluntary Termination Notice a desired date for its withdrawal, provided such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to NSCC as of the time such Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC. NSCC is retaining the provision that makes it clear that the

termination will not be effective until accepted by NSCC.⁵⁸ NSCC is also retaining the provision that describes NSCC's acceptance of the termination; however, NSCC is proposing to make it clear that such acceptance, as evidenced by a notice to NSCC's participants, would (i) be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from the participant and (ii) announce the last trade date for the participant instead of the Termination Date. In addition, NSCC is proposing to make it clear that the Termination Date would be the final settlement date of all transactions of the participant. NSCC is proposing these clarifying changes so that the Rules would align more closely with NSCC's current practice.

As an example, Member A submits a Voluntary Termination Notice to NSCC on April 1st indicating its desired termination date is June 15th. NSCC would accept such termination request by issuing a notice to Members within 10 business days from April 1st; such notice would provide that the last trade date for Member A is June 12th, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A. In contrast, if Member A submits a Voluntary Termination Notice on April 1st and indicates its desired termination date is April 5th, NSCC would either (i) accept such termination notice by issuing a notice to Members on or before April 5th; such notice would provide that the last trade date for Member A is April 2nd, and the effective date of Member A's NSCC membership

⁵⁸ Unlike the Voluntary Termination Notice, the Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4 does not require explicit acceptance by NSCC to be effective. NSCC believes that requiring explicit acceptance of the Loss Allocation Withdrawal Notice could complicate the loss allocation process and potentially result in membership withdrawal being delayed as well as detract from the objective to have NSCC know on a timely basis which Members would remain subject to the subsequent rounds of loss allocation.

termination would be the final settlement date of all transactions of Member A, or (ii) if NSCC requires additional time to process the termination, NSCC would accept such termination notice by issuing notice to Members after April 5th but still within 10 business days from April 1st; such notice would provide that the last trade date for Member A is a date after April 2nd, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A.

NSCC is also proposing to clarify that after the close of business on the Termination Date,⁵⁹ a participant that terminates its membership shall no longer be eligible or required to submit transactions to NSCC for clearance and settlement, unless the Board of Directors determines otherwise in order to ensure an orderly liquidation of the participant's open obligations. If any transaction is submitted to NSCC by such participant that is scheduled to settle after the Termination Date, the participant's Voluntary Termination Notice would be deemed void and the participant would remain subject to the Rules as if it had not given such notice. Furthermore, NSCC is proposing to add a sentence to Section 5 of Rule 2B to refer participants to Sections 7, 13 and 14 of Rule 4, as applicable, regarding provisions on the return of a participant's Clearing Fund deposit and to specify that if an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, would

⁵⁹ Account(s) of a terminating participant are generally deactivated after the close of business on the Termination Date.

supersede and void any pending Voluntary Termination Notice previously submitted by the participant. As an example, if an Event Period occurs after submission of the Voluntary Termination Notice by a Member but on or prior to the Termination Date, and the Member does not subsequently submit a Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4, then the Member would not benefit from its Loss Allocation Cap, i.e., the Member would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period that commenced on or prior to the Termination Date.

In Rule 4(A), NSCC proposes to amend Section 11 to update a cross-reference to the time period for the refund of deposits to the Clearing Fund when a Member ceases to be a participant in order to align it with proposed Section 7 of Rule 4, which would reduce the time period from 90 days to 30 calendar days. NSCC is also proposing to add a reference to Section 13 of Rule 4 in clause (c) of Section 13 of Rule 4(A) in order to specify that a Special Activity Supplemental Deposit of a Member may be used to satisfy a loss or liability as provided in such new proposed Section 13. NSCC is also proposing technical changes in Sections 2 and 13 of Rule 4(A) to reflect new proposed defined terms in the Rules.

In Rule 13, NSCC would replace “System” with “system” to reflect the proposed deletion of “System” as a defined term from Rule 4 and Addendum K. In Procedure XV, NSCC would replace “Qualified Securities Depository” with “DTC” to be consistent with the proposed change in Section 1 of Rule 4.

Member Outreach

Beginning in August 2017, NSCC conducted outreach to Members in order to provide them with advance notice of the proposed changes. As of the date of this filing,

no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

Implementation Timeframe

Pending Commission approval, NSCC expects to implement this proposal within two (2) business days after approval. Members would be advised of the implementation date of this proposal through issuance of an NSCC Important Notice.

2. Statutory Basis

NSCC believes that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to a registered clearing agency. Specifically, NSCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act⁶⁰ and Rules 17Ad-22(e)(13) and 17Ad-22(e)(23)(i),⁶¹ each as promulgated under the Act, for the reasons described below.

Section 17A(b)(3)(F) of the Act requires that the Rules be designed to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible.⁶² The proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back"

⁶⁰ 15 U.S.C. 78q-1(b)(3)(F).

⁶¹ 17 CFR 240.17Ad-22(e)(13) and (e)(23)(i).

⁶² 15 U.S.C. 78q-1(b)(3)(F).

period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken together, are intended to enhance the overall resiliency of NSCC's loss allocation process.

By modifying the calculation of NSCC's corporate contribution, NSCC would apply a mandatory fixed percentage of its General Business Risk Capital Requirement (as compared to the current Rules which provide for "no less than" a percentage of retained earnings), which would provide greater transparency and accessibility to Members as to how much NSCC would contribute in the event of a loss or liability. By modifying the application of NSCC's corporate contribution to apply to Declared Non-Default Loss Events, in addition to Defaulting Member Events, on a mandatory basis, NSCC would expand the application of its corporate contribution beyond losses and liabilities from Member impairments, which would better align the interests of NSCC with those of its Members by stipulating a mandatory application of the Corporate Contribution to a Declared Non-Default Loss Event prior to any allocation of the loss among Members. Taken together, these proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process by enhancing the calculation and application of NSCC's Corporate Contribution, which is one of the key elements of NSCC's loss allocation process. Moreover, by providing greater transparency and accessibility to Members, as stated above, the proposed rule changes regarding the Corporate Contribution, including the proposed replenishment period, would allow Members to better assess the adequacy of NSCC's loss allocation process.

By introducing the concept of an Event Period, NSCC would be able to group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days for purposes of allocating losses to Members. NSCC believes that the Event Period would provide a defined structure for the loss allocation process to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or market dislocation episode. Having this structure would enhance the overall resiliency of NSCC's loss allocation process because NSCC would be better equipped to address losses that may arise from multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would provide certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

By introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, NSCC would (i) set forth a defined amount that it would allocate to Members during each round (i.e., the round cap), (ii) advise Members of loss allocation obligation information as well as round information through the issuance of Loss Allocation Notices, and (iii) provide Members with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process because they would enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated and enable NSCC to identify continuing Members for purposes of

calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for Members a clear manner and process in which they could cap their loss allocation exposure to NSCC.

By implementing a “look-back” period to calculate a Member’s loss allocation obligations and its Loss Allocation Cap, NSCC would discourage Members from reducing their settlement activity during a time of stress primarily to limit their loss allocation obligations. By determining a Member’s loss allocation obligations based on the average of its Required Fund Deposit over a look-back period and its Loss Allocation Cap based on the greater of its Required Fund Deposit or the average thereof over a look-back period, NSCC would be able to calculate a Member’s pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC. These proposed rule changes would enhance the overall resiliency of NSCC’s loss allocation process because they would deter Members from reducing their settlement activity during a time of stress primarily to limit their Loss Allocation Caps.

Taken together, the foregoing proposed rule changes would establish a stronger (for all the reasons discussed above) and clearer loss allocation process for NSCC, which NSCC believes would allow it to take timely action to address losses. The ability to timely address losses would allow NSCC to continue to meet its clearance and settlement obligations, especially in circumstances that may involve a series of substantially contemporaneous loss events. Therefore, NSCC believes that these proposed rule changes would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

By reducing the time within which NSCC is required to return a former Member's Clearing Fund deposit, NSCC would enable firms that have exited NSCC to have access to their funds sooner than under the current Rules while at the same time protecting NSCC and its provision of clearance and settlement services because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. As such, NSCC would maintain the requisite level of Clearing Fund deposit to ensure that it can continue to meet its clearance and settlement obligations. Therefore, NSCC believes that this proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

The proposed rule changes to NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Having clear voluntary termination provisions would enable Members to better understand NSCC's voluntary termination process and provide Members with increased predictability and certainty regarding their rights and obligations with respect to such process. Enabling Members to readily understand NSCC's voluntary termination process and their rights and obligations in connection therewith would help the withdrawing Member and the membership at large to know when a Member is no longer a Member of NSCC for clearance and settlement and would thereby promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.

Rule 17Ad-22(e)(13) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure NSCC has the authority and operational capacity to take timely action to contain

losses and continue to meet its obligations.⁶³ As described above, the proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken together, are designed to enhance the resiliency of NSCC's loss allocation process. Having a resilient loss allocation process would help ensure that NSCC can effectively and timely address losses relating to or arising out of either the default of one or more Members or one or more non-default loss events, which in turn would help NSCC contain losses and continue to meet its clearance and settlement obligations. Therefore, NSCC believes that the proposed rule changes to enhance the resiliency of NSCC's loss allocation process are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of NSCC's default rules and procedures.⁶⁴ The proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) improve the overall transparency and

⁶³ 17 CFR 240.17Ad-22(e)(13).

⁶⁴ 17 CFR 240.17Ad-22(e)(23)(i).

accessibility of the provisions in the Rules governing loss allocation, and (iii) make conforming and technical changes, would not only ensure that NSCC's loss allocation rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of other DTCC Clearing Agencies, but also would help to ensure that NSCC's loss allocation rules are transparent and clear to Members. Aligning the loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable Members to better understand the key aspects of NSCC's default rules and procedures and provide Members with increased predictability and certainty regarding their exposures and obligations. As such, NSCC believes that the proposed rule changes to align the loss allocation rules of the DTCC Clearing Agencies as well as to improve the overall transparency and accessibility of NSCC's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

Similarly, the proposed rule changes to NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Having clear voluntary termination provisions would enable Members to better understand NSCC's voluntary termination process and provide Members with increased predictability and certainty regarding their rights and obligations with respect to such process. As such, NSCC believes that the proposed rule changes to the voluntary termination provision are also consistent with Rule 17Ad-22(e)(23)(i) under the Act.

(B) Clearing Agency's Statement on Burden on Competition

NSCC does not believe that the proposed rule changes to enhance the resiliency of NSCC's loss allocation process would impact competition.⁶⁵ As described above, the proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken together, are intended to enhance the overall resiliency of NSCC's loss allocation process, and would apply equally to all Members. While the proposed rule changes would amend the manner in which NSCC's corporate contribution and loss allocation are calculated and applied, such proposed rule changes would maintain NSCC's current core loss allocation waterfall in the case of a loss relating to or arising out of the default of a Member for whom NSCC has ceased to act following application of the defaulting Member's resources, i.e., NSCC's corporate contribution and loss allocation among Members. With respect to a loss or liability arising from a non-default loss event, the proposed rule changes clarify NSCC's contribution to such loss and liability, but, as with losses and liabilities arising from a Member default event, the proposed rule changes would maintain the loss mutualization requirement under the current Rule 4. While the calculation of the loss

⁶⁵ 15 U.S.C. 78q-1(b)(3)(I).

obligations associated with non-default losses would change under the proposal, NSCC would maintain this aspect of the loss allocation waterfall (i.e., loss mutualization among Members for non-default losses). Based on the foregoing, NSCC believes that these proposed rule changes to enhance the resiliency of NSCC's loss allocation process would not have any impact on competition.

NSCC does not believe the proposed rule change to reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit would impact competition.⁶⁶ This proposed rule change is intended to enable firms who have exited NSCC to have use of their Clearing Fund deposit sooner, while at the same time protecting NSCC because such return would only occur if all obligations of the terminated Member to NSCC have been satisfied. While the proposed rule change would reduce the applicable timeframe, it does not change the requirement that the return occur after all obligations to NSCC have been satisfied and the proposed rule change would apply equally to all Members. Based on the foregoing, NSCC believes that the proposed rule change to reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit would not have any impact on competition.

NSCC also does not believe that the proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) increase the transparency and accessibility of provisions in the Rules governing loss allocation, (iii) clarify NSCC's voluntary termination provisions, and (iv) make conforming and technical changes, would impact competition.⁶⁷ These changes would apply equally to all Members.

⁶⁶ Id.

⁶⁷ Id.

Alignment of the loss allocation rules of the DTCC Clearing Agencies are intended to increase the consistency of the Rules with the rules of other DTCC Clearing Agencies in order to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and accessible provisions in the Rules governing loss allocation are intended to improve the readability and clarity of the Rules regarding the loss allocation process. Clarifying NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Making conforming and technical changes to ensure the Rules remain clear and accurate would facilitate Members' understanding of the Rules and their obligations thereunder. As such, NSCC believes that these proposed rule changes would not have any impact on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments relating to this proposed rule change have not been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

III. Date of Effectiveness of the Proposed Rule Change, and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the 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. Please include File Number SR-NSCC-2017-018 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-2017-018. 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-2017-018 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶⁸

Secretary

⁶⁸ 17 CFR 200.30-3(a)(12).



TEXT OF PROPOSED RULE CHANGE

Bold and underlined text indicates proposed added language

~~**Bold and strikethrough text**~~ indicates proposed deleted language

Bold, double-underlined and italicized text indicates additional language proposed by this Amendment No. 1

~~***Bold, strikethrough and dotted underlined text***~~ indicates deleted language proposed by this Amendment No. 1

RULE 1. DEFINITIONS AND DESCRIPTIONS

Unless the context requires otherwise, the terms defined in this Rule shall, for all purposes of these Rules and Procedures, have the meanings herein specified.

Actual Deposit

The term "Actual Deposit" has the meaning specified in Rule 4.

Average RFD

The term "Average RFD" has the meaning specified in Rule 4.

Clearing Fund Cash

The term "Clearing Fund Cash" has the meaning specified in Rule 4.

Corporate Contribution

The term "Corporate Contribution" has the meaning specified in Rule 4.

Corporation

The term "Corporation" means National Securities Clearing Corporation.

Declared Non-Default Loss Event

The term "Declared Non-Default Loss Event" has the meaning specified in Rule 4.

Defaulting Member

The term "Defaulting Member" has the meaning specified in Rule 4.

Defaulting Member Event

The term "Defaulting Member Event" has the meaning specified in Rule 4.

Eligible Letter of Credit

The term "Eligible Letter of Credit" has the meaning specified in Rule 4.

Event Period

The term "Event Period" has the meaning specified in Rule 4.

Insurance Deposit

The term "Insurance Deposit" has the meaning specified in Rule 4.

Insurance Participant

The term "Insurance Participant" has the meaning specified in Rule 4.

Issuer

The term "Issuer" has the meaning specified in Rule 4.

Lender

The term "Lender" has the meaning specified in Rule 4.

Loss Allocation Cap

The term "Loss Allocation Cap" has the meaning specified in Rule 4.

Loss Allocation Notice

The term "Loss Allocation Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notice

The term "Loss Allocation Withdrawal Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notification Period

The term "Loss Allocation Withdrawal Notification Period" has the meaning specified in Rule 4.

Mutual Fund Deposit

The term "Mutual Fund Deposit" has the meaning specified in Rule 4.

Mutual Fund Participant

The term "Mutual Fund Participant" has the meaning specified in Rule 4.

Required Fund Deposit

The term "Required Fund Deposit" has the meaning specified in Rule 4.

Termination Date

The term "Termination Date" has the meaning specified in Rule 2B.

The Corporation

The term "the Corporation" means the ~~National Securities Clearing Corporation.~~

Voluntary Termination Notice

The term "Voluntary Termination Notice" has the meaning specified in Rule 2B.

RULE 2B. ONGOING MEMBERSHIP REQUIREMENTS AND MONITORING

SEC. 4. ONGOING MONITORING

(e) The Corporation may require a Member or Limited Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Procedure XV (which additional deposit shall constitute a portion of the Member's or Limited Member's Required **Fund** Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member or Limited Member. The Corporation may also retain any deposit in excess of the Required **Fund** Deposit of a Member or Limited Member that has been placed on the Watch List as provided in Section 9 of Rule 4.

SEC. 5. VOLUNTARY ~~RETIREMENT~~TERMINATION

A Member, Fund Member, Insurance Carrier/Retirement Services Member, Municipal Comparison Only Member, Mutual Fund/Insurance Services Member, Data Services Only Member, Investment Manager/Agent Member, AIP Member, Third Party Provider Member or Third Party Administrator Member each may elect to voluntarily ~~retire~~terminate such membership by providing the Corporation with a written notice of such termination ("Voluntary Termination Notice"). The participant shall specify in the Voluntary Termination Notice an effective, a desired date for its withdrawal from membership (the "Termination Date"); provided, however, such Termination Date date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from such participant. The Corporation's acceptance shall be evidenced by a notice to the Corporation's participants announcing the participant's ~~retirement termination~~ and the last trade date for the participant. The effective date of the retirement participant's termination shall be the final settlement date of all transactions of the participant (the "Retirement Termination Date"). After the close of business on As of the Termination Date, a participant that terminates its membership in the Corporation shall no longer be eligible or required to submit transactions to the Corporation for clearance and settlement, unless the Board determines otherwise in order to ensure an orderly liquidation of the

participant's open obligations. If any transaction is submitted to the Corporation by such participant that is scheduled to settle on or after the Termination Date, such participant's Voluntary Termination Notice will be deemed void, and the participant will remain subject to these Rules and Procedures as if it had not given such Voluntary Termination Notice.

A participant's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the **Retirement Termination** Date (including, but not limited to, any pro-rata charge made by the Corporation pursuant to Section **84** of Rule 4). **The return of the participant's Clearing Fund deposit shall be governed by Sections 7, 13 and 14 of Rule 4, as applicable. If an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant will need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the participant.**

RULE 4. CLEARING FUND

SEC. 1. **Required Fund Deposits.** Each Member ~~and Mutual Fund/Insurance Services Member shall, and each Fund Member and each Insurance Carrier/Retirement Services Member may be required to,~~ make and maintain on an ongoing basis a deposit to the Clearing Fund; ~~such deposits to the Clearing Fund shall be held by the Corporation to be applied as provided in this Rule.~~¹ The amount of each ~~such participant's~~ Member's required deposit shall be ~~fixed~~ determined by the Corporation in accordance with ~~one or more formulas specified by the Board of Directors and included in the Procedure XV and other applicable Rules and~~ Procedures (the "Required Fund Deposit"). ~~The basis of each formula shall be use of the Corporation's facilities.~~ The minimum Required Fund Deposit for each Member shall be \$10,000 ~~unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The minimum Required Deposit for a ~~Mutual Fund/Insurance Services Member who uses the Mutual Fund Services shall be \$5,000 unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The Corporation may require any such ~~participant~~ Member to deposit additional amounts to the Clearing Fund pursuant to Rule 15 ~~and such amounts shall be part of the participant's Required Deposit.~~ A Member may in its discretion maintain additional deposits at the Corporation, subject to any Procedures or other requirements the Corporation may establish for such excess amounts. For purposes of these Rules and Procedures, such additional deposits shall be deemed to be part of the Clearing Fund and the Member's Actual Deposit but shall not be deemed to be part of the Member's Required Fund Deposit.

The Corporation, ~~in its discretion,~~ may permit ~~part of a Member's, Insurance Carrier/Retirement Services Member's or Fund Member's deposit to be evidenced by an open account indebtedness secured by Members to satisfy their Required Fund Deposit obligations through a combination of cash and open account indebtedness secured by~~ Eligible Clearing Fund Securities, ~~provided that the percentage of such participant's Required Deposit that may be collateralized with Eligible Clearing Fund Securities and the collateral value of pledged Eligible Clearing Fund Securities shall be as set forth, as further described~~ in Procedure XV². The aggregate of cash deposited, the collateral value of pledged Eligible

¹ Clearing Fund deposits for Sponsored Accounts (as defined in Procedure IX.B.) relative to such Sponsored Accounts' DTC activity will be calculated and held by DTC in accordance with their procedures, and shall not be included in determining the Required Fund Deposit or the minimum cash requirement.

² In addition, the Corporation reserves the right to require participants to post a letter of credit in an instance where the Corporation, in its discretion, believes the participant presents legal risk. In such circumstances the Corporation may require part of a participant's deposit to be evidenced by an open account indebtedness ~~secured~~supported by one or more irrevocable ~~L~~C letters of ~~C~~Credit with a maturity of no more than one year issued on behalf of the participant in favor of the Corporation ~~(i)~~ under which a bank, trust company or United States branch or agency of a foreign bank (hereinafter, an "Issuer"), in each case approved by the Corporation for such purpose, is obligated to honor drafts

Clearing Fund Securities determined in accordance with Section III of Procedure XV, and the face amount of any Eligible Letters of Credit shall not at any time be less than the Member's Required Fund Deposit.

~~The collateral value of the Eligible Clearing Fund Securities and the face amount of Letters of Credit (if any Letters of Credit are required by the Corporation) shall not at any time be less in the aggregate than the amount of the participant's open account indebtedness. Each Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Member's open account indebtedness or placed by a Member in the possession of the Corporation (or its agents acting on its behalf) (collectively with any Eligible Letters of Credit issued on behalf of a Member in favor of the Corporation, the Member's "Actual Deposit"), in each case to secure all such Member's obligations to the Corporation. The Corporation shall be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The Eligible Clearing Fund Securities shall be pledged to secure a Member's open account indebtedness shall be delivered to the Corporation's account at DTC, or on such other terms and conditions as the Corporation shall may require. The Corporation may in its discretion hold pledged Eligible Clearing Fund Securities in its account at a financial institution designated by the Corporation including, in the Corporation's discretion, the pledge by Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members to the Corporation's account at a Qualified Securities Depository designated by such participant. Eligible Clearing Fund Securities that are not pledged at a Qualified Securities Depository shall be held by the Corporation for its account by a bank or trust company (other than the participant) designated by the Corporation.~~

~~Each participant's Required Deposit shall be allocated by the Corporation among the Mutual Fund Services, the Insurance and Retirement Processing Services and the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the~~

up to a specified amount drawn on it by the Corporation, ~~provided that and (ii)~~ the terms and conditions of ~~any such Letter of Credit are deemed which the Corporation determines are~~ acceptable to the Corporation in its sole discretion (each such letter of credit, an "Eligible Letter of Credit"). Any amount drawn on any Eligible Letters of Credit shall be deposited into, and constitute an additional cash deposit to, the Clearing Fund and shall reduce the participant's open account indebtedness by a corresponding amount. Within ten (10) calendar days prior to the stated expiration date of any such Eligible Letter of Credit or within such time as the Corporation shall direct upon receipt by the Corporation of written notice from an approved bank of an earlier expiration date of any Eligible Letter of Credit securing supporting a participant's open account indebtedness, such participant shall make a substitution for the Eligible Letter of Credit, in accordance with the provisions of this Rule, in the amount required, effective upon or prior to the expiration of the Eligible Letter of Credit.

~~participant participates. The allocation for each System, shall bear the same percentage relationship to the participant's Required Deposit as the participant's use of that System bears to his use of all services offered by the Corporation as measured by settlement dollars. The allocation for the Mutual Fund Services and the Insurance and Retirement Processing Services shall be the dollar amount required to be deposited pursuant to the Clearing Fund formula. The portion of the Clearing Fund allocated for the Mutual Fund Services shall be known as the "Mutual Fund Allocation". The portion of the Clearing Fund allocated for the Insurance and Retirement Processing Services shall be known as the "Insurance Allocation". The portion of the Clearing Fund allocated for each System shall be known as the "Fund" for that System. For example, the portion of the Required Deposit of each Member which shall be allocated for the CNS System shall be known as the Member's "CNS Fund Deposit" and the aggregate of the CNS Fund Deposits shall be known as the "CNS Fund."~~

SEC. 2. Permitted Use, Investment, and Maintenance of Clearing Fund Assets. The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including each Member's obligations with respect to any loss allocations as set forth in Section 4 of this Rule, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in this section.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 4 of this Rule.

The Corporation may invest any cash in the Clearing Fund, including (i) cash deposited by a Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, "Clearing Fund Cash"), in accordance with the Clearing Agency Investment Policy adopted by the Corporation.

~~The Corporation shall not be required to segregate any Fund for a System, the Mutual Fund Allocation, or the Insurance Allocation from the Clearing Fund. The Corporation's each Member's Actual Deposit, but shall maintain~~ books and records shall, however, identify the percentage of each Member's Required Deposit which

~~is at any time allocated to a Fund for a System, to the Mutual Fund Allocation, or the Insurance Allocation. That percentage of (a) the participant's actual cash deposit to the Clearing Fund, and (b) each Eligible Clearing Fund Security pledged to the Corporation by the Member and (c) the face amount of each Letter of Credit (if required by the Corporation) issued on behalf of the participant in favor of the Corporation shall be deemed allocated to the Fund for the System concerning the assets that constitute each Member's Actual Deposit.~~

~~SEC. 2. Subject to the limitations contained in this Rule and the use of a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit as provided in Section 3 of this Rule to satisfy his obligations to the Corporation, the use of~~

~~(a) (1) each Fund shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation arising in the System to which the Fund pertains, and~~

~~(2) the Mutual Fund Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Mutual Fund Services, and~~

~~(3) the Insurance Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Insurance and Retirement Processing Services, and~~

~~(b) the Clearing Fund, which consists of all Clearing Fund deposits except for deposits made in respect of the Mutual Fund Services and Insurance and Retirement Processing Services, shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~Any cash in the Clearing Fund may be partially or wholly invested in securities issued or guaranteed as to principal and interest by the United States or agencies or instrumentalities of the United States, repurchase agreements relating to such securities or, certificates of deposit or deposit accounts insured by the Federal Deposit Insurance Corporation, "FDIC", or otherwise pursuant to the investment policy adopted by the Corporation.~~

~~Each participant Member shall be entitled to any interest earned or paid on pledged Eligible Clearing Fund Securities or Clearing Fund cash deposits.³ Any interest on pledged Eligible Clearing Fund Securities that is received by the~~

³ Sponsored Accounts (as defined in Procedure IX.B.) will receive interest earned or paid on their Clearing Fund deposits held at DTC at such rate or rates as DTC pays to its participants.

Corporation shall be credited to the Member's cash deposit to the Clearing Fund, except in the event of a default by such Member on any obligations to the Corporation, in which case the Corporation may exercise its rights under Section 3 of this Rule.

~~No cash in the Clearing Fund and no proceeds of any loans made to the Corporation upon the pledge, by the Corporation, of Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or the assignment or transfer, by the Corporation, of Letters of Credit (if any) (or the proceeds thereof) issued on behalf of such participant in favor of the Corporation, to secure the participant's open account indebtedness ("Clearing Fund Cash") and no money payments received from Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members and payable to others ("Cash Receipts") shall be used by the Corporation for any purpose other than (a) the investment of any Clearing Fund Cash or Cash Receipts in securities issued or guaranteed as to principal and interest by the United States or its agencies or invested in certificates of deposit or similar deposits of FDIC approved banks selected by the Corporation, or deposited by the Corporation in its name in a depository or depositories selected by the Corporation, (b) the payment of Cash Receipts to the persons entitled thereto for the purposes for which such Cash Receipts were received by the Corporation, including the allocation of fees, fines and other charges receivable by the Corporation to the Corporation's general account, (c) the application of Clearing Fund Cash to satisfy (i) any loss or liability of the Corporation to the extent permissible pursuant to this Section and Sections 3 and 4 of this Rule or (ii) the return of the deposit of such a participant pursuant to Sections 6 or 9 of this Rule and (d) the loan of Clearing Fund Cash to the Corporation to permit the Corporation to meet its settlement obligations to its participants.~~

SEC. 3. Application of Clearing Fund Deposits and Other Amounts to Members' Obligations. ~~If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member is obligated to the Corporation pursuant to these Rules and Procedures, other than for a pro rata charge governed by Section 5 of this Rule, and (i) fails to satisfy the obligation or (ii) the obligation is a Cross-Guaranty Obligation, the Corporation shall apply to such obligation the portion, of the participant's amount of such Member's a~~Actual dDeposit, any amounts available under a Clearing Agency Cross-Guaranty Agreement, and any proceeds of any of the foregoing to satisfy necessary to eliminate the obligation. ~~Upon the Corporation's demand the participant shall deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any resulting deficiency in his Required Deposit. and the Corporation may take any and all actions with respect to such assets and amounts, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Member's Actual Deposit as compared~~

to its Required Fund Deposit, the Member shall immediately replenish its Actual Deposit. If the ~~participant Member shall fail~~ to do so, the Corporation may take disciplinary action against such ~~participant Member~~ pursuant to Rule 46 or Rule 48. Any disciplinary action ~~which that~~ the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership ~~by the participant~~ shall not affect the ~~Member's~~ obligations ~~of the participant~~ to the Corporation or any remedy to which the Corporation may be entitled under applicable law.

~~In applying a Member's or Mutual Fund/Insurance Services Member's actual deposit to his obligations to the Corporation, the Corporation shall first apply that portion of his actual deposit which has been allocated to the Mutual Fund Allocation to obligations arising in the Mutual Fund Services, to the Insurance Allocation to obligations arising in the Insurance and Retirement Processing Services and to any Fund to obligations arising in the System to which the Fund pertains. If after such application the participant remains obligated in one or more Systems, the Corporation shall apply any remaining deposit to his remaining obligation to each such System, in the same proportion that each obligation bears to the total remaining obligations to the Systems. If the participant thereafter remains obligated to the Corporation, any remaining deposit shall be applied thereto.~~

~~Notwithstanding the foregoing, to the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the Off the Market Transaction, or on whose behalf the Off the Market Transaction was submitted, to the Corporation; however, no allocation shall be made if such Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures.~~

~~SEC. 4. **Loss Allocation Waterfall, Off-the-Market Transactions.** If the Corporation incurs a loss or liability (i) relating to or arising out of a default of a Member for whom the Corporation has ceased to act pursuant to Rule 46 (such Member being referred to as a "Defaulting Member") that is not satisfied pursuant to Sections 3, 13 or 14 of this Rule (a "Defaulting Member Event") or (ii) otherwise incident to the clearance and settlement business of the Corporation as determined below (a "Declared Non-Default Loss Event") in a System which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Fund for that System. The Corporation shall not apply any other portion of the Clearing Fund to any such loss or liability. Corporation shall address the loss or liability as follows:~~

~~If the Corporation incurs a loss or liability in the Mutual Fund Services or the Insurance and Retirement Processing Services which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the~~

~~Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Mutual Fund Allocation for the Mutual Fund Services or the Allocation for the Insurance and Retirements Processing Service.~~

~~If the Corporation incurs any loss or liability otherwise than in a System which is not satisfied pursuant to Section 3 of this Rule or the second paragraph of Section 4 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Clearing Fund.~~

~~If the retained earnings applied to the loss or liability are insufficient to eliminate the loss or liability, the Fund allocated for the System in which the loss or liability occurred, the Mutual Fund Allocation, the Insurance Allocation or the Clearing Fund, whichever applicable, shall be applied to eliminate the excess loss, provided, however, that if a loss or liability occurs simultaneously in a System, the Insurance and Retirement Processing Services and/or the Mutual Fund Services and any other service whose transactions are not guaranteed and such losses or liabilities are not satisfied by the application of retained earnings, the Fund for the System, the Insurance Allocation and the Mutual Fund Allocation shall be applied before the Clearing Fund is applied. If a Fund or the Mutual Fund Allocation or the Insurance Allocation or the Clearing Fund is applied to a loss or liability, the Corporation shall provide 5 business days' prior notice to each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member and to the Securities and Exchange Commission, stating the amount to be applied and the reasons therefore.~~

~~If a Fund is applied, each Member who participated in the System, other than the Member or Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his or their allocation to the Fund, less the proportion of such allocation attributable to the additional amount the Member was required to deposit pursuant to Rule 15, (as such allocation was fixed at the time the loss or liability is discovered). If the Mutual Fund Allocation or the Insurance Allocation, as the case may be, is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member who participated in the Mutual Fund Services or Insurance and Retirement Processing Services, as the case may be, other than the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or Members, Insurance Carrier/Retirement Services Members or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based on his or their allocation to the Mutual Fund Allocation or Insurance Allocation, as the case may be.~~

~~If the Clearing Fund is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member, other than the Member or Members, Mutual Fund/Insurance Services~~

~~Member or Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Member or Insurance Carriers Members, or Fund Member or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his Required Deposit, less the amount of his Mutual Fund Services deposit, or Insurance and Retirement Processing Services deposit, as the case may be, and less the additional amount he was required to deposit pursuant to Rule 15 (as such Required Deposit was fixed at the time the loss or liability is discovered), without regard for any allocation to a Fund for a System.~~

~~SEC. 5. Except as provided in Section 8 of this Rule, if a pro rata charge is made pursuant to Section 4 of this Rule against a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit, and as a consequence such participant's remaining deposit to the Clearing Fund is less than his Required Deposit, the participant shall, upon the Corporation's demand, deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any deficiency in his Required Deposit. If the participant shall fail to do so, the Corporation may take disciplinary action against the participant pursuant to Rule 46 or Rule 48. Any disciplinary action which the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership by the participant shall not affect the obligations of the participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law.~~

For the purposes of this Rule, the following terms shall have the following meanings:

"Defaulting Member" shall mean a Member for which the Corporation has ceased to act pursuant to Rule 46.

"Defaulting Member Event" shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 46.

"Declared Non-Default Loss Event" shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

If the Corporation incurs a loss or liability arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation shall address the loss or liability as follows:

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) business days (an “Event Period”) shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for a *the* Defaulting Member (or the next business day, if such day is not a business day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the determination by the Board of Directors that the applicable loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner. *Declared Non-Default Loss Event* (or the next business day, if such day is not a business day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 3 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

The Corporation shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.

In the case of losses and liabilities relating to or arising out of a Declared Non-Default Loss Event, all Members shall be subject to loss allocation. In the case of losses and liabilities relating to or arising out of a Defaulting Member Event, only non-defaulting Members shall be subject to loss allocation. After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with

Section 6 of this Rule shall be subject to loss allocation with respect to that Event Period. The Corporation shall notify Members subject to loss allocation of the amounts being allocated to them (“Loss Allocation Notice”) in successive rounds of loss allocations.

Each Member that is a Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Member for which the Corporation ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule.

Each loss allocation shall be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.
Loss Allocation Notice.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Withdrawal Notification Period”) to notify the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, and thereby benefit from its Loss Allocation Cap. The “Loss Allocation Cap” of a Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule shall be subject to further loss allocation with respect to that Event Period.

Each Member's pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member's "Average RFD"), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round. Each Member's maximum payment obligation with respect to any loss allocation round shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period or (y) its Average RFD (such amount shall be each Member's "Loss Allocation Cap").

Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second business day after the Corporation issues any such notice. Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second business day after the Corporation issues such notice, unless the Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round pursuant to Section 6 of this Rule.

Notwithstanding Section 9 of this Rule, to the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

If a Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with Section 3 of this Rule.

If a Member notifies the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member shall comply with the provisions of Section 6 of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member fails to comply with the provisions of Section 6 of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction; however, no allocation shall be made if the Defaulting Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures, prior to its default.

SEC. 5. *Corporate Contribution.* For any loss allocation pursuant to Section 4 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) business days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution.

Nothing in these Rules and Procedures shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether *arising out of or relating to a* Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

SEC. 6. *Withdrawal Following Loss Allocation.* If a Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss allocation *round* as set forth in Section 4 of this Rule ("Loss Allocation Withdrawal Notice"), the Member shall:

(i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period,

(ii) cease all activity that would result in transactions being submitted to the Corporation for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member's withdrawal, and

(iii) ensure that all clearance and settlement activity for which such Member is obligated to the Corporation is fully and finally settled by the effective date of the Member's withdrawal from membership, including, without limitation, by resolving by such date all fails and buy-in obligations.

A Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

If the Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to Section 4 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.

~~SEC. 67. Return of Members' Clearing Fund Deposits. A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member or his successor in interest shall be entitled to the return of his actual deposit 90 days after:~~

~~(i) the participant ceases to be a participant and~~

~~(ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund or any Fund have been closed, and~~

~~(iii) all obligations to the Corporation for which the participant was responsible while a participant have been satisfied or, at the discretion of the Corporation, have been deducted by the Corporation from the participant's actual deposit; provided, however, that the participant has presented to the Corporation such indemnities or guarantees as the Corporation deems satisfactory or another participant has been substituted on all transactions and obligations of the participant.~~

~~In the absence of an acceptable guarantee, indemnity or substitution, the greater of:~~

~~(a) 25% of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's average clearing fund requirement over the 12 months immediately prior to the date the participant ceases to be such, or~~

~~(b) \$100,000,~~

~~or, if the participant's actual clearing fund deposit is less than \$100,000, the entire deposit, shall be returned no later than 2 years (4 years for Members who have Sponsored Accounts at a Qualified Securities Depository) after (i), (ii) and (iii) above have occurred.~~

~~A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member shall be entitled to the return of his Mutual Fund Services deposit or Insurance and Retirement Processing Services deposit, as the case may be, ninety (90) days after all Mutual Fund Services transactions or Insurance and Retirement Processing Services transactions, as the case may be, for which he was responsible have been satisfied.~~

~~Any obligation of participant to the Corporation unsatisfied at the time he ceases to be a participant shall not be affected by such cessation of membership.~~

~~If a Member gives notice to the Corporation of its election to withdraw from membership, the Member's Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied. Notwithstanding the foregoing, the Corporation may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.~~

~~SEC. 78. Changes in Members' Required Fund Deposits. ~~Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members~~ Each Member shall deposit in the Clearing Fund such amount ~~which~~ that is necessary to satisfy any increase in ~~his~~ its Required Fund Deposit within such time as the Corporation shall require. At the time the increase becomes effective, the ~~participant's~~ Member's obligations to the Corporation shall be determined in accordance with the increased Required Fund Deposit whether or not the ~~increase in his Required Deposit has been made~~ Member has satisfied such increased amount.~~

~~SEC. 89. Excess Clearing Fund Deposits. ~~If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~~~

~~or Fund Member, within 10 business days after receipt of notice of a pro rata charge pursuant to Section 4 of this Rule, gives notice to the Corporation of his election to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, he shall nevertheless remain obligated for the pro rata charge; however, his obligation in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Required Deposit less the portion of this deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, and his obligation in respect of a pro rata charge from the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Mutual Fund Services deposit or the Insurance and Retirement Processing Services deposit, as the case may be, as fixed immediately prior to the time of the pro rata charge. The Corporation may make additional pro rata charges attributable to the same loss or liability. In such instance, notwithstanding the foregoing limitation, the obligation of a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, who after receipt of notice of an additional charge elects to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, to the greater of (a) his Required Deposit less the portion of his deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge, or (b) the amount of all prior pro rata charges, attributable to the same loss or liability in respect of which his right to limit such obligation, as provided above, has not been timely exercised, and in respect of a Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, pro rata charge to the greater of (a) the deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge or (b) the amount of all prior pro rata charges in respect of which his right to limit such obligations, as provided above, has not been timely exercised. If the amount of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member or Fund Member's actual deposit is less than his Required Deposit and, accordingly, his actual deposit is insufficient to satisfy the pro rata charge as limited by this Section 8, he shall be obligated to make up the deficiency in his Required Deposit notwithstanding the fact that he subsequently ceases to be a participant, or terminates his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be.~~

~~**SEC. 9.**—The Corporation shall determine with such frequency as it shall, from time to time to specify, whether the amount deposited by each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~

~~or Fund Member to the Clearing Fund may be in excess of such Member's participant's Required Fund Deposit. On any day that the Corporation has determined that an excess deposit exists with respect to any Member, the Corporation will, in the form and manner required by the Corporation, notify each such Member of such excess. and provided notification that the Clearing Fund deposit of a participant exceeds its Required Deposit, then upon such participant's request, provided in such form and within such timeframe as determined by the Corporation from time to time, the Corporation shall cause to be returned to the participant cash on deposit (in excess of the minimum amount of cash required to be maintained in the Clearing Fund) and/or Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) securing such participant's open account indebtedness in an aggregate amount equal to such excess or such lesser amount as the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member may request; provided, however, that such excess shall not be returned (a) until any amount which is required to be charged against the participant's Required Deposit is paid by the participant to the Corporation and/or (b) if the Corporation determines that the participant's current month's use of one or more services is materially different than the previous month's use of such service(s) upon which such excess deposit is based. Subject to the Corporation's rights under these Rules and Procedures to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value in accordance with Section III of Procedure XV on the day of such withdrawal) as the Member requests. Notwithstanding the foregoing, the Corporation may, in its discretion, determine to withhold all or part of any excess deposit of a Memberparticipant if such Memberparticipant has been placed on the Watch List pursuant to these Rules and Procedures or if the Corporation determines that the Member's anticipated activities in the Corporation in the near future may reasonably be expected to be materially different than its activities of the recent past.~~

The provisions of this Section 9 of Rule 4 shall not limit the rights or remedies of the Corporation as provided by Rule 15 of the Rules and Procedures of the Corporation.

SEC. 10. No waiver; Subsequent Recovery Against Loss Amounts. No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules and Procedures. If a loss charged pro rata is afterward recovered by the Corporation, in whole or in part, the net amount of the recovery shall be credited to the ~~p~~Persons, including the Corporation, against whom the loss was charged in proportion to the amounts charged against them.

SEC. 11. **Substitution or Withdrawal of Pledged Securities.** Upon notice to the Corporation provided in such form and within such timeframe as determined by the Corporation from time to time, a **participant Member** may withdraw **or substitute pledged** Eligible Clearing Fund Securities ~~from pledge~~, provided that the **participant Member continues to has, effective simultaneously with such withdrawal, deposited cash with, or pledged additional Eligible Clearing Fund Securities to, the Corporation which in the aggregate, secure the open account indebtedness of the participant and/or satisfy his at all times its Required Fund Deposit.**

SEC. 12. **Authority of Corporation.** In furtherance of the rights of the Corporation pursuant to these Rules **and Procedures**, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign ~~(each, a "Pledge")~~ any or all ~~a~~Actual ~~d~~Deposits ~~of Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members and Fund Members to the Clearing Fund which shall consist of (i) Clearing Fund Cash, (ii) securities, repurchase agreements, deposits or other instruments in which Clearing Fund Cash is invested and (iii) Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member, or Letters of Credit issued on behalf of any such participant in favor of the Corporation (if any such Letters of Credit are required by the Corporation), in each case to secure the participant's obligations to the Corporation under these Rules, together with the proceeds of any of the foregoing, and any proceeds thereof~~ for the purpose of securing loans made to the Corporation (the party making any such loan to the Corporation hereinafter referred to as the "Lender"); provided that the proceeds of such loans are used for a purpose permissible under Section 2 of this Rule. Such loans shall be on terms and conditions deemed necessary or advisable by the Corporation (including collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ to the Corporation for which such property and **Eligible** ~~l~~Letters of ~~e~~Credit (if any) were pledged to or deposited with the Corporation; provided, however, that if any such loan is made as a result of a loss or liability suffered by the Corporation, the Corporation will promptly, but in no event later than 30 **calendar** days from the day the loan is made, repay the loan in full. No Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ shall have any right, claim or action against any secured Lender (or any collateral agent of such secured Lender) for the return, or otherwise in respect, of any such collateral ~~P~~ledged by the Corporation to such secured Lender (or its collateral agent), so long as any loans made by such Lender to the Corporation or other obligations, secured by such collateral, are unpaid and outstanding. Subject to the foregoing and to the terms and conditions of such loan, the Corporation shall remain obligated to each such **participant Member** to return, and to allow substitution for or withdrawal of, cash, and Eligible Clearing Fund Securities, and **Eligible** ~~l~~Letters of ~~e~~Credit (if any) pledged or deposited by such **participant Member** as a Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund~~, or otherwise to collateralize such **participant's Member's** obligations to the Corporation,

under the circumstances and within the time frames specified in these Rules and Procedures. In the event of any conflict or inconsistency between this Rule 4 and any agreement between the Corporation and any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member~~, this Rule 4 shall govern and prevail.

SEC. 13. Mutual Fund Deposits. Each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member shall, and each Fund Member (collectively with such Members and Mutual Fund/Insurance Services Members, "Mutual Fund Participants") may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Mutual Fund Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit shall be a separate and additional component of such Member's deposit to the Clearing Fund but shall not constitute part of such Member's Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to Section 4 of this Rule.

If any Mutual Fund Participant fails to satisfy any obligation to the Corporation relating to the Mutual Fund Services, notwithstanding the Corporation's right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, the Corporation shall first apply such Mutual Fund Participant's Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated to the Corporation, the Corporation shall apply such Member's Actual Deposit in accordance with Section 3 of this Rule. The Corporation shall next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations, in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants and, after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Mutual Fund Participants are Members. If any loss or liability remains thereafter and there are no continuing Mutual Fund Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any participant's Mutual Fund Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

A Mutual Fund Participant that elects to withdraw from membership shall be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Mutual Fund Participant was responsible while a Mutual Fund Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Mutual Fund Deposits.

SEC. 14. Insurance Deposits. Each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, "Insurance Participants") may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Insurance Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Insurance Deposits).

If any Insurance Participant fails to satisfy any obligation to the Corporation relating to the Insurance and Retirement Processing Services, the Corporation shall first apply such Insurance Participant's Insurance Deposit. If after such application any loss or liability remains, the Corporation shall next allocate such remaining loss or liability to the other Insurance Participants in successive rounds of loss allocations, in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants and, after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any Insurance Participant's Insurance Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

An Insurance Participant that elects to withdraw from membership shall be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Insurance Participant was responsible while an Insurance Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Insurance Deposits.

RULE 4(A). SUPPLEMENTAL LIQUIDITY DEPOSITS

SEC. 2. *Defined Terms.* The following terms shall have the meanings specified:

“Special Activity Prefund Deposit” means a cash deposit of a Member to the Clearing Fund made by wire transfer to an account designated by the Corporation:

- a. that is in excess of the Required **Fund** Deposit of the Member;

“Special Activity Supplemental Liquidity Need” means, on any Special Activity Business Day, the amount by which the Special Activity Daily Liquidity Need of the Corporation exceeds the sum of all Required **Fund** Deposits.

SEC. 11. *Ceasing to be a Participant.* Special Activity Supplemental Deposits shall not be subject to the provisions of Section ~~67~~ of Rule 4 relating to the ~~90~~**thirty (30)** **calendar** day deferral of refunds of deposits to the Clearing Fund when a Member ceases to be a participant.

SEC. 13. *Application of Special Activity Supplemental Deposits.*

- a. A Special Activity Supplemental Deposit of a Member may not be withdrawn by the Member unless it is entitled to a return of such deposit pursuant to Sections 9 or 10 above.
- b. A Special Activity Supplemental Deposit of a Member shall form a part of the ~~a~~**Actual d**Deposit of the Member to the Clearing Fund but shall be in addition to, and separate from, (i) the Required **Fund** Deposit of the Member and (ii) any other deposit of the Member to the Clearing Fund.
- c. A Special Activity Supplemental Deposit of a Member (i) may be invested, paid, applied and loaned as provided in Section 2 of Rule 4 and (ii) may be used to satisfy a loss or liability as provided in Sections ~~3~~ **or 13** of Rule 4.
- d. A Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any *pro rata* charge pursuant to Section 4 of Rule 4.

RULE 13. EXCEPTION PROCESSING

Notwithstanding any provisions in these Rules **and Procedures** to the contrary, in the event that a security may not otherwise be eligible for processing through the CNS, Balance Order or other ~~S~~system, the Corporation, in its sole discretion, may adopt, from time to time, procedures deemed appropriate for the processing of such security. Any such procedures shall be promptly communicated to Members by the Corporation and the Members shall be bound by the procedures set forth in such notice as fully as though such procedures were now a part of the Rules **and Procedures** of the Corporation. Each such notice shall be effective only for the security covered therein.

RULE 15. ASSURANCES OF FINANCIAL RESPONSIBILITY AND OPERATIONAL CAPABILITY

SEC. 2. (a) Each Member or Limited Member, or any applicant to become such, shall furnish to the Corporation such adequate assurances of its financial responsibility and operational capability as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation, its participants, creditors or investors, to safeguard securities and funds in the custody or control of the Corporation and for which the Corporation is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions. Upon the request of a participant or applicant, or otherwise, the Corporation may choose to confer with the participant or applicant before or after requiring it to furnish adequate assurances pursuant to this Rule.

(b) Adequate assurances of the financial responsibility or operational capability of a participant or applicant to become such, as may be required pursuant to these Rules and Procedures, may include, but shall not be limited to, as appropriate under the context of the participant's use of the Corporation's services:

- (i) additional reporting by the participant (or by the entity providing a guarantee) of its financial or operational condition at such intervals and in such detail as the Corporation shall determine;
- (ii) entering into agreements concerning the provision of operational support services by an entity acceptable to the Corporation;
- (iii) restrictions on the participant's use of the Corporation's services;
- (iv) increased Clearing Fund deposits (including additional amounts required in respect of trade activity received by the Corporation after calculation of the applicable Required Fund Deposit);
- (v) additional payments to the Corporation in such amounts as may be determined by the Corporation each morning reflecting a percentage of up to 100 percent of the participant's (i) average amount of total daily net debit positions or (ii) morning gross debit activity;
- (vi) delivering securities to the Member only against immediate payment by the Member to the Corporation; and

- (vii) assurances as may be required pursuant to the Corporation's Guidelines and/or Procedures.

RULE 42. WIND-DOWN OF A MEMBER, FUND MEMBER OR INSURANCE
CARRIER/RETIREMENT SERVICES MEMBER

The Corporation may, in its discretion, impose conditions on, or take actions with respect to, the Wind-Down Member as appropriate to mitigate risk the Corporation perceives may be presented by the Wind-Down Member, including but not limited to, the following:

- (i) Permitting the Wind-Down Member to submit to the Corporation only transactions that serve to support the wind-down;
- (ii) Permitting the Wind-Down Member to continue use of one or more of the Corporation's services, notwithstanding that it may not meet some or all of the financial or operational requirements for continuance as a Member or Limited Member, as applicable;
- (iii) Restricting or modifying the Wind-Down Member's use of any or all of the Corporation's services (whether generally, or with respect to certain transactions);
- (iv) Requiring additional assurances of the financial responsibility or operational capability of the Wind-Down Member through, for example, submission of a guaranty of the Wind-Down Member's obligations to the Corporation by an entity acceptable to the Corporation and/or additional reporting by the Wind-Down Member;
- (v) Agreeing to complete one or more trades to which the Wind-Down Member is a party prior to the time the Corporation's guaranty otherwise would become effective pursuant to these Rules and Procedures;
- (vi) Requiring the Wind-Down Member to post increased Clearing Fund deposits and/or to post its Required **Fund** Deposit all in cash or in proportions of cash, qualifying bonds and **e**Eligible Letters of Credit different from those permitted under Rule 4;
- (vii) Prohibiting the Wind-Down Member from withdrawing Clearing Fund on deposit in excess of its Required **Fund** Deposit;
- (viii) Calculating the Required **Fund** Deposit of the Wind-Down Member in a manner different from the applicable formulae provided in the Procedures, in order to more appropriately reflect the risk presented by the Wind-Down Member to the Corporation, such as for example, not applying certain components of such calculation; or

- (ix) Liquidating by buying-in or selling-out, as applicable, any open positions of the Wind-Down Member, for the benefit of such Wind-Down Member with any profit or loss resulting therefrom being debited or credited, as applicable, to the settlement account of the Wind-Down Member.

PROCEDURE III. TRADE RECORDING SERVICE (INTERFACE WITH QUALIFIED CLEARING AGENCIES)

B. Settlement of Option Exercises and Assignments and Settlement of Stock Futures Reaching Maturity

Unless otherwise agreed between OCC and the Corporation, E&A/Delivery Transactions are received by the Corporation from OCC each day on which both the Corporation and OCC are open for accepting trades for clearance. Subject to the paragraph below, the Corporation's guarantee pursuant to Addendum K shall become effective for each E&A/Delivery Transaction when the Required **Fund** Deposits to the Clearing Fund, after taking into account that E&A/Delivery Transaction, are received by the Corporation from all Participating Members.

If (i) a Participating Member has failed to satisfy its Clearing Fund obligations to the Corporation pursuant to Procedure XV, or (ii) the Corporation has declined or ceased to act for a Participating Member pursuant to these Rules **and Procedures** prior to the time that the Corporation's guarantee of such Participating Member's E&A/Delivery Transactions become effective (such Participating Member, a "Defaulting Participating Member"), then none of the E&A/Delivery Transactions involving such defaulting Participating Member for which the Corporation's guarantee pursuant to Addendum K has not yet become effective shall be guaranteed by the Corporation, and all such E&A/Delivery Transactions shall be exited out of the CNS Accounting Operation or the Balance Order Accounting Operation, as applicable, unless otherwise agreed between OCC and the Corporation. The Corporation shall have no further obligation regarding the settlement of the exited E&A/Delivery Transactions, other than such obligations as the Corporation may have pursuant to its arrangement with OCC, and the non-defaulting Participating Members' Required **Fund** Deposit to the Clearing Fund will be recalculated excluding the exited E&A/Delivery Transactions.

PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS¹

I.(B) Additional Clearing Fund Formula

(4) Bank Holiday Charge

For purposes of this section, “Holiday” means any day on which equities markets are open for trading, but the Board of Governors of the Federal Reserve System observes a holiday and banks are closed.

On the business day prior to any Holiday, the Corporation may require each Member to make an additional Clearing Fund deposit (“Bank Holiday Charge”). The Bank Holiday Charge approximates the exposure that a Member’s trading activity on the applicable Holiday could pose to the Corporation. Since the Corporation cannot collect margin on the Holiday, the Bank Holiday Charge is due on the business day prior to the applicable Holiday.

The methodology for calculating a Bank Holiday Charge shall be determined by the Corporation in advance of each applicable Holiday. The Bank Holiday Charge approximates each Member’s Required **Fund** Deposit to address the exposure that such Member’s trading activity on the Holiday could pose to the Corporation. The Corporation shall have the discretion to calculate the Bank Holiday Charge based on its assessment of market conditions at the time the Bank Holiday Charge is calculated (such as, for example, significant market occurrences that could impact market price volatility). The Corporation shall inform Members of the methodology it will use to calculate the Bank Holiday Charge by an Important Notice issued no later than 10 business days prior to the day on which the applicable Bank Holiday Charge is applied. Examples of potential methodologies for the Bank Holiday Charge may include, but shall not be limited to, time scaling of the volatility charge or a stress scenario that reflects potential market price volatility on the Holiday.

II. Minimum Clearing Fund and Additional Deposit Requirements

- (A) Each Member of the Corporation shall be required to contribute a minimum of \$10,000 (the “minimum contribution”). The first 40% (but no less than \$10,000) of a Member’s Required **Fund** Deposit must be in cash and the remaining amount, may be evidenced by open account indebtedness secured by the pledge of Eligible Clearing Fund Securities, which shall be valued, for collateral

¹ All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

purposes, as set forth in subsection III below. A Mutual Fund/Insurance Services Member's entire deposit is required to be in cash.

1. Special Provisions Related to Eligible Clearing Fund Securities:

- (a) Any deposits of Eligible Clearing Fund Agency Securities⁷ or Eligible Clearing Fund Mortgage-Backed Securities⁸, respectively, in excess of 25 percent of the Member's Required **Fund Deposit** will be subject to an additional haircut equal to twice the percentage as specified in the proposed haircut schedule detailed in subsection III below, and
 - (b) No more than 20 percent of a Member's Required **Fund Deposit** secured by pledged Eligible Agency Securities may be of a single issuer.
- (B) All Clearing Fund requirements and other deposit requirements shall be made by Members and Mutual Fund/Insurance Services Members, within one hour of demand unless otherwise determined by the Corporation; provided, however, that to the extent the Member and Mutual Fund/Insurance Services Member is meeting such obligation with a (1) deposit of cash, such deposit shall be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire, and (2) delivery of eligible securities, such delivery shall be received within the deadlines established by ~~a Qualified Securities Depository~~ **DTC**. At the discretion of the Corporation, cash deposits may be included as part of the Member's or Mutual Fund/Insurance Services Member's, daily settlement obligation.
- (C) Additional Clearing Fund deposits shall not be requested unless they exceed such threshold as determined by the Corporation from time to time; provided that the affected Member or Limited Member is not on the Watch List.
- (D) Where the amount of a Member's and Mutual Fund/Insurance Services Member's deficiency is in excess of \$1,000 but less than \$5,000, the Corporation may require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000, the Corporation may require payment in multiples of \$5,000.

⁷ A Member that is an Agency may not pledge Eligible Clearing Fund Agency Securities of which it is the issuer.

⁸ With regard to a Member that pledges Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, such securities will be subject to a premium haircut, as set forth in subsection III below.

ADDENDUM E

~~STATEMENT OF POLICY~~

~~APPLICATION OF RETAINED EARNINGS – MEMBER IMPAIRMENTS~~

~~Under Rule 4, Section 4, if the Corporation suffers a loss or liability by reason of a Member's impairment, and such loss or liability is not satisfied or otherwise made good from the impaired Member's Clearing Fund deposit, the Corporation, in its discretion, may either satisfy such loss or liability or any part thereof out of its then existing retained earnings or, after appropriate notice to both the membership and the Securities and Exchange Commission, directly from the Clearing Fund deposits of all other Members on a pro rata basis.~~

~~While neither the Corporation nor its three predecessor clearing agencies have ever subjected their memberships to such a pro rata assessment, the ability exists for the Corporation to bypass completely its retained earnings. Since the Board of Directors of the Corporation is desirous of clarifying its intentions with respect to the usage of retained earnings in Member impairment situations, the Board has adopted this Policy Statement.~~

~~The Board of Directors of the Corporation hereby advises the membership of the Corporation that pursuant to Rule 4, Section 4 of the Rules of the Corporation, the Corporation will apply no less than twenty five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability.~~

~~Nothing herein, however, shall prevent the Corporation from applying more than twenty five percent (25%) of its then existing retained earnings, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time of the Member impairment.~~

~~This Policy Statement may not be changed, modified or altered, without thirty days prior written notice to the membership and to the Securities and Exchange Commission. Any such change, modification or alteration shall only be prospective in effect, and shall not be applicable to any losses or liability previously incurred as a result of prior Member impairments.~~

(ADDENDUM LETTER RESERVED FOR FUTURE USE)

ADDENDUM K

**~~INTERPRETATION OF THE BOARD OF DIRECTORS
APPLICATION OF CLEARING FUND~~THE CORPORATION'S GUARANTY**

~~Pursuant to Rule 47, the Board of Directors has the authority to interpret the Rules of the Corporation. The purpose of this interpretation is to clarify certain provisions of Rule 4 and the extent to which the Clearing Fund may be applied to a loss or liability of the Corporation.~~

~~I. APPLICATION OF THE CLEARING FUND TO LOSSES SUSTAINED BY A SYSTEM~~

- ~~1. Section 1 of Rule 4 provides that each Member's Required Deposit shall be allocated by the Corporation among the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the Member participates.~~
- ~~2. The Corporation has in practice assumed responsibility for completion of transactions in each of the following services, and has deemed each of these services to be a System, even though the Corporation has not previously made a formal designation of each such service as a System within the definition of Section 1 of Rule 4:~~

The Corporation guarantees the completion of compared and locked-in CNS and balance orders transactions from a fixed point in the clearance and settlement process.¹ CNS transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures. Balance order transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures through the close of business on T+2. If the contra party to a same day or one day settling trade is a member of an interfacing clearing corporation, such guarantee shall not be applicable unless an agreement to guarantee such trade exists between the Corporation and the interfacing clearing corporation. The Corporation has also adopted a policy of guaranteeing the completion of when-issued and when-distributed trades, as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures and will consider all when-issued and when-

¹ The trade guarantee of obligations arising out of the exercise or assignment of options that are settled at the Corporation is addressed in a separate arrangement between NSCC and Options Clearing Corporation, as referred to in Procedure III of the Rules and Procedures, and is not addressed in these Rules and Procedures.

distributed trades of Members as if they were CNS transactions for surveillance purposes regardless of the accounting operation in which they ultimately settle.

~~3. In connection with the expansion by the Corporation of its clearance and settlement business, it has become desirable for the Corporation to make formal designations of the services constituting Systems within the definition of Section 1 of Rule 4. Accordingly, the Board hereby designates the services referred to in paragraph 1.2. above as services for which the Corporation assumes the responsibility for the completion of transactions, and therefore as Systems within the Rule 4, Section 1 definition. These services are the only services so designated as of this date.~~

~~II. APPLICATION OF THE CLEARING FUND TO EXCESS LOSSES AND LOSSES OUTSIDE OF A SYSTEM~~

~~1. Section 2(b) of Rule 4 provides that the use of the Clearing Fund in its entirety (which consists in part of all the Funds) shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~2. Pursuant to Section 2(b) of Rule 4, the entire Clearing Fund must be available to satisfy losses arising outside of a System.~~

~~There are various circumstances pursuant to which the entire Clearing Fund may be available to satisfy losses outside of a System:~~

- ~~• One circumstance arises out of the Mutual Fund Services. Members that do not participate in the Mutual Fund Services are shielded from exposures to the Mutual Fund Services losses as long as the Corporation continues to have active participants in Mutual Fund Services.~~

~~If the Corporation were to have an unsatisfied Mutual Fund Services loss, such loss may be satisfied from the entire Clearing Fund (less the amounts paid in respect of the Mutual Fund Services).~~

- ~~• An additional circumstance arises out of the Insurance and Retirement Processing Services. If the Corporation were to have an unsatisfied loss due to a Member's, Mutual Fund/Insurance Services Member's or Insurance Carrier/Retirement Services Member's use of the Insurance and Retirement Processing Services, such loss may be satisfied from the entire Clearing Fund.~~

ADDENDUM O
ADMISSION OF NON-US ENTITIES AS DIRECT NSCC MEMBERS

Admission of Non-US Entities¹

- Foreign Legal Opinion – obtain an opinion of reputable foreign counsel satisfactory to NSCC providing, among other things, that the agreements described above may be enforced against the foreign entity in the courts of its home country or other jurisdictions where the entity or its property may be found.²

¹ This policy statement excludes Non-U.S. entities that are insurance companies.

² NSCC reserves the right to require the entity to deposit additional amounts to the Clearing Fund and to post an **Eligible Letter of Credit** in an instance where NSCC, in its sole discretion, believes the entity presents legal risk.



NATIONAL
SECURITIES
CLEARING
CORPORATION

RULES & PROCEDURES

TEXT OF PROPOSED RULE CHANGE

Bold and underlined text indicates proposed added language

~~Bold and strikethrough text~~ indicates proposed deleted language

RULE 1. DEFINITIONS AND DESCRIPTIONS

Unless the context requires otherwise, the terms defined in this Rule shall, for all purposes of these Rules **and Procedures**, have the meanings herein specified.

Actual Deposit

The term "Actual Deposit" has the meaning specified in Rule 4.

Average RFD

The term "Average RFD" has the meaning specified in Rule 4.

Clearing Fund Cash

The term "Clearing Fund Cash" has the meaning specified in Rule 4.

Corporate Contribution

The term "Corporate Contribution" has the meaning specified in Rule 4.

Corporation

The term "Corporation" means National Securities Clearing Corporation.

Declared Non-Default Loss Event

The term "Declared Non-Default Loss Event" has the meaning specified in Rule 4.

Defaulting Member

The term "Defaulting Member" has the meaning specified in Rule 4.

Defaulting Member Event

The term "Defaulting Member Event" has the meaning specified in Rule 4.

Eligible Letter of Credit

The term "Eligible Letter of Credit" has the meaning specified in Rule 4.

Event Period

The term "Event Period" has the meaning specified in Rule 4.

Insurance Deposit

The term "Insurance Deposit" has the meaning specified in Rule 4.

Insurance Participant

The term "Insurance Participant" has the meaning specified in Rule 4.

Issuer

The term "Issuer" has the meaning specified in Rule 4.

Lender

The term "Lender" has the meaning specified in Rule 4.

Loss Allocation Cap

The term "Loss Allocation Cap" has the meaning specified in Rule 4.

Loss Allocation Notice

The term "Loss Allocation Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notice

The term "Loss Allocation Withdrawal Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notification Period

The term "Loss Allocation Withdrawal Notification Period" has the meaning specified in Rule 4.

Mutual Fund Deposit

The term "Mutual Fund Deposit" has the meaning specified in Rule 4.

Mutual Fund Participant

The term "Mutual Fund Participant" has the meaning specified in Rule 4.

Required Fund Deposit

The term "Required Fund Deposit" has the meaning specified in Rule 4.

Termination Date

The term "Termination Date" has the meaning specified in Rule 2B.

The Corporation

The term "the Corporation" means the ~~National Securities Clearing Corporation.~~

Voluntary Termination Notice

The term "Voluntary Termination Notice" has the meaning specified in Rule 2B.

RULE 2B. ONGOING MEMBERSHIP REQUIREMENTS AND MONITORING

SEC. 4. ONGOING MONITORING

(e) The Corporation may require a Member or Limited Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Procedure XV (which additional deposit shall constitute a portion of the Member's or Limited Member's Required **Fund** Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member or Limited Member. The Corporation may also retain any deposit in excess of the Required **Fund** Deposit of a Member or Limited Member that has been placed on the Watch List as provided in Section 9 of Rule 4.

SEC. 5. VOLUNTARY ~~RETIREMENT~~TERMINATION

A Member, Fund Member, Insurance Carrier/Retirement Services Member, Municipal Comparison Only Member, Mutual Fund/Insurance Services Member, Data Services Only Member, Investment Manager/Agent Member, AIP Member, Third Party Provider Member or Third Party Administrator Member each may elect to voluntarily ~~retire~~terminate such membership by providing the Corporation with a written notice of such termination ("Voluntary Termination Notice"). The participant shall specify in the Voluntary Termination Notice a desired date for its withdrawal from membership; provided, however, such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from such participant. The Corporation's acceptance shall be evidenced by a notice to the Corporation's participants announcing the participant's ~~retirement~~termination and the last trade date for the participant. The effective date of the ~~retirement~~ participant's termination shall be the final settlement date of all transactions of the participant (the "~~Retirement~~ Termination Date"). After the close of business on the Termination Date, a participant that terminates its membership in the Corporation shall no longer be eligible or required to submit transactions to the Corporation for clearance and settlement, unless the Board determines otherwise in order to ensure an orderly liquidation of the participant's open obligations. If any transaction is submitted to the Corporation by such

participant that is scheduled to settle after the Termination Date, such participant's Voluntary Termination Notice will be deemed void, and the participant will remain subject to these Rules and Procedures as if it had not given such Voluntary Termination Notice.

A participant's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the **Retirement Termination** Date (including, but not limited to, any pro-rata charge made by the Corporation pursuant to Section **84** of Rule 4). **The return of the participant's Clearing Fund deposit shall be governed by Sections 7, 13 and 14 of Rule 4, as applicable. If an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant will need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the participant.**

RULE 4. CLEARING FUND

SEC. 1. **Required Fund Deposits.** Each Member ~~and Mutual Fund/Insurance Services Member shall, and each Fund Member and each Insurance Carrier/Retirement Services Member may be required to,~~ make and maintain on an ongoing basis a deposit to the Clearing Fund; ~~such deposits to the Clearing Fund shall be held by the Corporation to be applied as provided in this Rule.~~¹ The amount of each ~~such participant's~~ Member's required deposit shall be ~~fixed~~ determined by the Corporation in accordance with ~~one or more formulas specified by the Board of Directors and included in the Procedure XV and other applicable Rules and~~ Procedures (the "Required Fund Deposit"). ~~The basis of each formula shall be use of the Corporation's facilities.~~ The minimum Required Fund Deposit for each Member shall be \$10,000 ~~unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The minimum Required Deposit for a Mutual Fund/Insurance Services Member who uses the Mutual Fund Services shall be \$5,000 ~~unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The Corporation may require any such ~~participant~~ Member to deposit additional amounts to the Clearing Fund pursuant to Rule 15 ~~and such amounts shall be part of the participant's Required Deposit.~~ A Member may in its discretion maintain additional deposits at the Corporation, subject to any Procedures or other requirements the Corporation may establish for such excess amounts. For purposes of these Rules and Procedures, such additional deposits shall be deemed to be part of the Clearing Fund and the Member's Actual Deposit but shall not be deemed to be part of the Member's Required Fund Deposit.

The Corporation, ~~in its discretion,~~ may permit ~~part of a Member's, Insurance Carrier/Retirement Services Member's or Fund Member's deposit to be evidenced by an open account indebtedness secured by Members to satisfy their Required Fund Deposit obligations through a combination of cash and open account indebtedness secured by~~ Eligible Clearing Fund Securities, ~~provided that the percentage of such participant's Required Deposit that may be collateralized with Eligible Clearing Fund Securities and the collateral value of pledged Eligible Clearing Fund Securities shall be as set forth, as further described~~ in Procedure XV². The aggregate of cash deposited, the collateral value of pledged Eligible

¹ Clearing Fund deposits for Sponsored Accounts (as defined in Procedure IX.B.) relative to such Sponsored Accounts' DTC activity will be calculated and held by DTC in accordance with their procedures, and shall not be included in determining the Required Fund Deposit or the minimum cash requirement.

² In addition, the Corporation reserves the right to require participants to post a letter of credit in an instance where the Corporation, in its discretion, believes the participant presents legal risk. In such circumstances the Corporation may require part of a participant's deposit to be evidenced by an open account indebtedness ~~secured~~supported by one or more irrevocable ~~L~~letters of ~~C~~credit with a maturity of no more than one year issued on behalf of the participant in favor of the Corporation (i) under which a bank, trust company or United States branch or agency of a foreign bank (hereinafter, an "Issuer"), in each case approved by the Corporation for such purpose, is obligated to honor drafts

Clearing Fund Securities determined in accordance with Section III of Procedure XV, and the face amount of any Eligible Letters of Credit shall not at any time be less than the Member's Required Fund Deposit.

~~The collateral value of the Eligible Clearing Fund Securities and the face amount of Letters of Credit (if any Letters of Credit are required by the Corporation) shall not at any time be less in the aggregate than the amount of the participant's open account indebtedness. Each Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Member's open account indebtedness or placed by a Member in the possession of the Corporation (or its agents acting on its behalf) (collectively with any Eligible Letters of Credit issued on behalf of a Member in favor of the Corporation, the Member's "Actual Deposit"), in each case to secure all such Member's obligations to the Corporation. The Corporation shall be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The Eligible Clearing Fund Securities shall be pledged to secure a Member's open account indebtedness shall be delivered to the Corporation's account at DTC, or on such other terms and conditions as the Corporation shall may require. The Corporation may in its discretion hold pledged Eligible Clearing Fund Securities in its account at a financial institution designated by the Corporation including, in the Corporation's discretion, the pledge by Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members to the Corporation's account at a Qualified Securities Depository designated by such participant. Eligible Clearing Fund Securities that are not pledged at a Qualified Securities Depository shall be held by the Corporation for its account by a bank or trust company (other than the participant) designated by the Corporation.~~

~~Each participant's Required Deposit shall be allocated by the Corporation among the Mutual Fund Services, the Insurance and Retirement Processing Services and the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the~~

up to a specified amount drawn on it by the Corporation, ~~provided that and (ii)~~ the terms and conditions of ~~any such Letter of Credit are deemed which the Corporation determines are~~ acceptable to the Corporation in its sole discretion (each such letter of credit, an "Eligible Letter of Credit"). Any amount drawn on any Eligible Letters of Credit shall be deposited into, and constitute an additional cash deposit to, the Clearing Fund and shall reduce the participant's open account indebtedness by a corresponding amount. Within ten (10) calendar days prior to the stated expiration date of any such Eligible Letter of Credit or within such time as the Corporation shall direct upon receipt by the Corporation of written notice from an approved bank of an earlier expiration date of any Eligible Letter of Credit securing supporting a participant's open account indebtedness, such participant shall make a substitution for the Eligible Letter of Credit, in accordance with the provisions of this Rule, in the amount required, effective upon or prior to the expiration of the Eligible Letter of Credit.

~~participant participates. The allocation for each System, shall bear the same percentage relationship to the participant's Required Deposit as the participant's use of that System bears to his use of all services offered by the Corporation as measured by settlement dollars. The allocation for the Mutual Fund Services and the Insurance and Retirement Processing Services shall be the dollar amount required to be deposited pursuant to the Clearing Fund formula. The portion of the Clearing Fund allocated for the Mutual Fund Services shall be known as the "Mutual Fund Allocation". The portion of the Clearing Fund allocated for the Insurance and Retirement Processing Services shall be known as the "Insurance Allocation". The portion of the Clearing Fund allocated for each System shall be known as the "Fund" for that System. For example, the portion of the Required Deposit of each Member which shall be allocated for the CNS System shall be known as the Member's "CNS Fund Deposit" and the aggregate of the CNS Fund Deposits shall be known as the "CNS Fund."~~

SEC. 2. Permitted Use, Investment, and Maintenance of Clearing Fund Assets. The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including each Member's obligations with respect to any loss allocations as set forth in Section 4 of this Rule, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in this section.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 4 of this Rule.

The Corporation may invest any cash in the Clearing Fund, including (i) cash deposited by a Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, "Clearing Fund Cash"), in accordance with the Clearing Agency Investment Policy adopted by the Corporation.

~~The Corporation shall not be required to segregate any Fund for a System, the Mutual Fund Allocation, or the Insurance Allocation from the Clearing Fund. The Corporation's each Member's Actual Deposit, but shall maintain~~ books and records shall, however, identify the percentage of each Member's Required Deposit which

~~is at any time allocated to a Fund for a System, to the Mutual Fund Allocation, or the Insurance Allocation. That percentage of (a) the participant's actual cash deposit to the Clearing Fund, and (b) each Eligible Clearing Fund Security pledged to the Corporation by the Member and (c) the face amount of each Letter of Credit (if required by the Corporation) issued on behalf of the participant in favor of the Corporation shall be deemed allocated to the Fund for the System concerning the assets that constitute each Member's Actual Deposit.~~

~~SEC. 2. Subject to the limitations contained in this Rule and the use of a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit as provided in Section 3 of this Rule to satisfy his obligations to the Corporation, the use of~~

~~(a) (1) each Fund shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation arising in the System to which the Fund pertains, and~~

~~(2) the Mutual Fund Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Mutual Fund Services, and~~

~~(3) the Insurance Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Insurance and Retirement Processing Services, and~~

~~(b) the Clearing Fund, which consists of all Clearing Fund deposits except for deposits made in respect of the Mutual Fund Services and Insurance and Retirement Processing Services, shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~Any cash in the Clearing Fund may be partially or wholly invested in securities issued or guaranteed as to principal and interest by the United States or agencies or instrumentalities of the United States, repurchase agreements relating to such securities or, certificates of deposit or deposit accounts insured by the Federal Deposit Insurance Corporation, "FDIC", or otherwise pursuant to the investment policy adopted by the Corporation.~~

~~Each participant Member shall be entitled to any interest earned or paid on pledged Eligible Clearing Fund Securities or Clearing Fund cash deposits.³ Any interest on pledged Eligible Clearing Fund Securities that is received by the~~

³ Sponsored Accounts (as defined in Procedure IX.B.) will receive interest earned or paid on their Clearing Fund deposits held at DTC at such rate or rates as DTC pays to its participants.

Corporation shall be credited to the Member's cash deposit to the Clearing Fund, except in the event of a default by such Member on any obligations to the Corporation, in which case the Corporation may exercise its rights under Section 3 of this Rule.

~~No cash in the Clearing Fund and no proceeds of any loans made to the Corporation upon the pledge, by the Corporation, of Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or the assignment or transfer, by the Corporation, of Letters of Credit (if any) (or the proceeds thereof) issued on behalf of such participant in favor of the Corporation, to secure the participant's open account indebtedness ("Clearing Fund Cash") and no money payments received from Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members and payable to others ("Cash Receipts") shall be used by the Corporation for any purpose other than (a) the investment of any Clearing Fund Cash or Cash Receipts in securities issued or guaranteed as to principal and interest by the United States or its agencies or invested in certificates of deposit or similar deposits of FDIC approved banks selected by the Corporation, or deposited by the Corporation in its name in a depository or depositories selected by the Corporation, (b) the payment of Cash Receipts to the persons entitled thereto for the purposes for which such Cash Receipts were received by the Corporation, including the allocation of fees, fines and other charges receivable by the Corporation to the Corporation's general account, (c) the application of Clearing Fund Cash to satisfy (i) any loss or liability of the Corporation to the extent permissible pursuant to this Section and Sections 3 and 4 of this Rule or (ii) the return of the deposit of such a participant pursuant to Sections 6 or 9 of this Rule and (d) the loan of Clearing Fund Cash to the Corporation to permit the Corporation to meet its settlement obligations to its participants.~~

SEC. 3. Application of Clearing Fund Deposits and Other Amounts to Members' Obligations. ~~If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member is obligated to the Corporation pursuant to these Rules and Procedures, other than for a pro rata charge governed by Section 5 of this Rule, and (i) fails to satisfy the obligation or (ii) the obligation is a Cross-Guaranty Obligation, the Corporation shall apply to such obligation the portion, of the participant's amount of such Member's a~~Actual dDeposit, any amounts available under a Clearing Agency Cross-Guaranty Agreement, and any proceeds of any of the foregoing to satisfy necessary to eliminate the obligation. ~~Upon the Corporation's demand the participant shall deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any resulting deficiency in his Required Deposit. and the Corporation may take any and all actions with respect to such assets and amounts, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Member's Actual Deposit as compared~~

to its Required Fund Deposit, the Member shall immediately replenish its Actual Deposit. If the ~~participant Member shall fails~~ to do so, the Corporation may take disciplinary action against such ~~participant Member~~ pursuant to Rule 46 or Rule 48. Any disciplinary action ~~which that~~ the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership ~~by the participant~~ shall not affect the ~~Member's~~ obligations ~~of the participant~~ to the Corporation or any remedy to which the Corporation may be entitled under applicable law.

~~In applying a Member's or Mutual Fund/Insurance Services Member's actual deposit to his obligations to the Corporation, the Corporation shall first apply that portion of his actual deposit which has been allocated to the Mutual Fund Allocation to obligations arising in the Mutual Fund Services, to the Insurance Allocation to obligations arising in the Insurance and Retirement Processing Services and to any Fund to obligations arising in the System to which the Fund pertains. If after such application the participant remains obligated in one or more Systems, the Corporation shall apply any remaining deposit to his remaining obligation to each such System, in the same proportion that each obligation bears to the total remaining obligations to the Systems. If the participant thereafter remains obligated to the Corporation, any remaining deposit shall be applied thereto.~~

~~Notwithstanding the foregoing, to the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the Off the Market Transaction, or on whose behalf the Off the-Market Transaction was submitted, to the Corporation; however, no allocation shall be made if such Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures.~~

SEC. 4. **Loss Allocation Waterfall, Off-the-Market Transactions.** ~~If the Corporation incurs a loss or liability in a System which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Fund for that System. The Corporation shall not apply any other portion of the Clearing Fund to any such loss or liability.~~

~~If the Corporation incurs a loss or liability in the Mutual Fund Services or the Insurance and Retirement Processing Services which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Mutual Fund Allocation for the Mutual Fund Services or the Allocation for the Insurance and Retirements Processing Service.~~

~~If the Corporation incurs any loss or liability otherwise than in a System which is not satisfied pursuant to Section 3 of this Rule or the second paragraph of Section 4 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Clearing Fund.~~

~~If the retained earnings applied to the loss or liability are insufficient to eliminate the loss or liability, the Fund allocated for the System in which the loss or liability occurred, the Mutual Fund Allocation, the Insurance Allocation or the Clearing Fund, whichever applicable, shall be applied to eliminate the excess loss, provided, however, that if a loss or liability occurs simultaneously in a System, the Insurance and Retirement Processing Services and/or the Mutual Fund Services and any other service whose transactions are not guaranteed and such losses or liabilities are not satisfied by the application of retained earnings, the Fund for the System, the Insurance Allocation and the Mutual Fund Allocation shall be applied before the Clearing Fund is applied. If a Fund or the Mutual Fund Allocation or the Insurance Allocation or the Clearing Fund is applied to a loss or liability, the Corporation shall provide 5 business days' prior notice to each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member and to the Securities and Exchange Commission, stating the amount to be applied and the reasons therefore.~~

~~If a Fund is applied, each Member who participated in the System, other than the Member or Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his or their allocation to the Fund, less the proportion of such allocation attributable to the additional amount the Member was required to deposit pursuant to Rule 15, (as such allocation was fixed at the time the loss or liability is discovered). If the Mutual Fund Allocation or the Insurance Allocation, as the case may be, is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member who participated in the Mutual Fund Services or Insurance and Retirement Processing Services, as the case may be, other than the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or Members, Insurance Carrier/Retirement Services Members or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based on his or their allocation to the Mutual Fund Allocation or Insurance Allocation, as the case may be.~~

~~If the Clearing Fund is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member, other than the Member or Members, Mutual Fund/Insurance Services Member or Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Member or Insurance Carriers Members, or Fund Member or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his Required Deposit, less the amount of his Mutual Fund Services deposit, or Insurance and Retirement Processing~~

~~Services deposit, as the case may be, and less the additional amount he was required to deposit pursuant to Rule 15 (as such Required Deposit was fixed at the time the loss or liability is discovered), without regard for any allocation to a Fund for a System.~~

~~SEC. 5. Except as provided in Section 8 of this Rule, if a pro rata charge is made pursuant to Section 4 of this Rule against a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit, and as a consequence such participant's remaining deposit to the Clearing Fund is less than his Required Deposit, the participant shall, upon the Corporation's demand, deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any deficiency in his Required Deposit. If the participant shall fail to do so, the Corporation may take disciplinary action against the participant pursuant to Rule 46 or Rule 48. Any disciplinary action which the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership by the participant shall not affect the obligations of the participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law.~~

For the purposes of this Rule, the following terms shall have the following meanings:

"Defaulting Member" shall mean a Member for which the Corporation has ceased to act pursuant to Rule 46.

"Defaulting Member Event" shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 46.

"Declared Non-Default Loss Event" shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

If the Corporation incurs a loss or liability arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation shall address the loss or liability as follows:

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) business days (an "Event Period") shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for the Defaulting Member (or the next business day, if such day is not a business day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 3 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

The Corporation shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.

Each Member that is a Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Member for which the Corporation ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not

submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule.

Each loss allocation shall be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Withdrawal Notification Period”) to notify the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, and thereby benefit from its Loss Allocation Cap. The “Loss Allocation Cap” of a Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule shall be subject to further loss allocation with respect to that Event Period.

Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second business day after the Corporation issues any such notice. Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second business day after the Corporation issues such notice, unless the Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round pursuant to Section 6 of this Rule.

To the extent that a Member’s Loss Allocation Cap exceeds the Member’s Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Member, up to the Member’s Loss Allocation Cap.

If a Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with Section 3 of this Rule.

If a Member notifies the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member shall comply with the provisions of Section 6 of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member fails to comply with the provisions of Section 6 of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction; however, no allocation shall be made if the Defaulting Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures, prior to its default.

SEC. 5. Corporate Contribution. For any loss allocation pursuant to Section 4 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) business days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution.

Nothing in these Rules and Procedures shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

SEC. 6. Withdrawal Following Loss Allocation. If a Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss

allocation round as set forth in Section 4 of this Rule (“Loss Allocation Withdrawal Notice”), the Member shall:

(i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period,

(ii) cease all activity that would result in transactions being submitted to the Corporation for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member’s withdrawal, and

(iii) ensure that all clearance and settlement activity for which such Member is obligated to the Corporation is fully and finally settled by the effective date of the Member’s withdrawal from membership, including, without limitation, by resolving by such date all fails and buy-in obligations.

A Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

If the Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to Section 4 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.

~~SEC. 67. *Return of Members’ Clearing Fund Deposits.* A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member or his successor in interest shall be entitled to the return of his actual deposit 90 days after:~~

~~(i) the participant ceases to be a participant and~~

~~(ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund or any Fund have been closed, and~~

~~(iii) all obligations to the Corporation for which the participant was responsible while a participant have been satisfied or, at the discretion of the Corporation, have been deducted by the Corporation from the participant’s actual deposit; provided, however, that the participant has presented to the Corporation such indemnities or guarantees as the Corporation deems satisfactory or another participant has been substituted on all transactions and obligations of the participant.~~

~~In the absence of an acceptable guarantee, indemnity or substitution, the greater of:~~

~~(a) 25% of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's average clearing fund requirement over the 12 months immediately prior to the date the participant ceases to be such, or~~

~~(b) \$100,000,~~

~~or, if the participant's actual clearing fund deposit is less than \$100,000, the entire deposit, shall be returned no later than 2 years (4 years for Members who have Sponsored Accounts at a Qualified Securities Depository) after (i), (ii) and (iii) above have occurred.~~

~~A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member shall be entitled to the return of his Mutual Fund Services deposit or Insurance and Retirement Processing Services deposit, as the case may be, ninety (90) days after all Mutual Fund Services transactions or Insurance and Retirement Processing Services transactions, as the case may be, for which he was responsible have been satisfied.~~

~~Any obligation of participant to the Corporation unsatisfied at the time he ceases to be a participant shall not be affected by such cessation of membership.~~

If a Member gives notice to the Corporation of its election to withdraw from membership, the Member's Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied. Notwithstanding the foregoing, the Corporation may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.

SEC. 78. Changes in Members' Required Fund Deposits. ~~Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members~~ Each Member shall deposit in the Clearing Fund such amount ~~which that~~ is necessary to satisfy any increase in ~~his its~~ Required **Fund** Deposit within such time as the Corporation shall require. At the time the increase becomes effective, the ~~participant's Member's~~ obligations to the Corporation shall be determined in accordance with the increased Required **Fund** Deposit whether or not the ~~increase in his Required Deposit has been made~~ Member has satisfied such increased amount.

SEC. 89. Excess Clearing Fund Deposits. ~~If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~

~~or Fund Member, within 10 business days after receipt of notice of a pro rata charge pursuant to Section 4 of this Rule, gives notice to the Corporation of his election to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, he shall nevertheless remain obligated for the pro rata charge; however, his obligation in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Required Deposit less the portion of this deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, and his obligation in respect of a pro rata charge from the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Mutual Fund Services deposit or the Insurance and Retirement Processing Services deposit, as the case may be, as fixed immediately prior to the time of the pro rata charge. The Corporation may make additional pro rata charges attributable to the same loss or liability. In such instance, notwithstanding the foregoing limitation, the obligation of a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, who after receipt of notice of an additional charge elects to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, to the greater of (a) his Required Deposit less the portion of his deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge, or (b) the amount of all prior pro rata charges, attributable to the same loss or liability in respect of which his right to limit such obligation, as provided above, has not been timely exercised, and in respect of a Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, pro rata charge to the greater of (a) the deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge or (b) the amount of all prior pro rata charges in respect of which his right to limit such obligations, as provided above, has not been timely exercised. If the amount of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member or Fund Member's actual deposit is less than his Required Deposit and, accordingly, his actual deposit is insufficient to satisfy the pro rata charge as limited by this Section 8, he shall be obligated to make up the deficiency in his Required Deposit notwithstanding the fact that he subsequently ceases to be a participant, or terminates his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be.~~

~~**SEC. 9.**—The Corporation shall determine with such frequency as it shall, from time to time to specify, whether the amount deposited by each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~

~~or Fund Member~~ to the Clearing Fund may be in excess of such Member's participant's Required Fund Deposit. On any day that the Corporation has determined that an excess deposit exists with respect to any Member, the Corporation will, in the form and manner required by the Corporation, notify each such Member of such excess. ~~and provided notification that the Clearing Fund deposit of a participant exceeds its Required Deposit, then upon such participant's request, provided in such form and within such timeframe as determined by the Corporation from time to time, the Corporation shall cause to be returned to the participant cash on deposit (in excess of the minimum amount of cash required to be maintained in the Clearing Fund) and/or Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) securing such participant's open account indebtedness in an aggregate amount equal to such excess or such lesser amount as the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member may request; provided, however, that such excess shall not be returned (a) until any amount which is required to be charged against the participant's Required Deposit is paid by the participant to the Corporation and/or (b) if the Corporation determines that the participant's current month's use of one or more services is materially different than the previous month's use of such service(s) upon which such excess deposit is based.~~ Subject to the Corporation's rights under these Rules and Procedures to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value in accordance with Section III of Procedure XV on the day of such withdrawal) as the Member requests. Notwithstanding the foregoing, the Corporation may, in its discretion, determine to withhold all or part of any excess deposit of a Memberparticipant if such Memberparticipant has been placed on the Watch List pursuant to these Rules and Procedures or if the Corporation determines that the Member's anticipated activities in the Corporation in the near future may reasonably be expected to be materially different than its activities of the recent past.

The provisions of this Section 9 of Rule 4 shall not limit the rights or remedies of the Corporation as provided by Rule 15 of the Rules and Procedures of the Corporation.

SEC. 10. No waiver; Subsequent Recovery Against Loss Amounts. No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules and Procedures. If a loss charged pro rata is afterward recovered by the Corporation, in whole or in part, the net amount of the recovery shall be credited to the persons, including the Corporation, against whom the loss was charged in proportion to the amounts charged against them.

SEC. 11. **Substitution or Withdrawal of Pledged Securities.** Upon notice to the Corporation provided in such form and within such timeframe as determined by the Corporation from time to time, a **participant Member** may withdraw **or substitute pledged** Eligible Clearing Fund Securities ~~from pledge~~, provided that the **participant Member continues to has, effective simultaneously with such withdrawal, deposited cash with, or pledged additional Eligible Clearing Fund Securities to, the Corporation which in the aggregate, secure the open account indebtedness of the participant and/or satisfy his at all times its Required Fund Deposit.**

SEC. 12. **Authority of Corporation.** In furtherance of the rights of the Corporation pursuant to these Rules **and Procedures**, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign ~~(each, a "Pledge")~~ any or all ~~a~~Actual ~~d~~Deposits ~~of Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members and Fund Members to the Clearing Fund which shall consist of (i) Clearing Fund Cash, (ii) securities, repurchase agreements, deposits or other instruments in which Clearing Fund Cash is invested and (iii) Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member, or Letters of Credit issued on behalf of any such participant in favor of the Corporation (if any such Letters of Credit are required by the Corporation), in each case to secure the participant's obligations to the Corporation under these Rules, together with the proceeds of any of the foregoing, and any proceeds thereof~~ for the purpose of securing loans made to the Corporation (the party making any such loan to the Corporation hereinafter referred to as the "Lender"); provided that the proceeds of such loans are used for a purpose permissible under Section 2 of this Rule. Such loans shall be on terms and conditions deemed necessary or advisable by the Corporation (including collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ to the Corporation for which such property and **Eligible** ~~l~~Letters of ~~e~~Credit (if any) were pledged to or deposited with the Corporation; provided, however, that if any such loan is made as a result of a loss or liability suffered by the Corporation, the Corporation will promptly, but in no event later than 30 **calendar** days from the day the loan is made, repay the loan in full. No Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ shall have any right, claim or action against any secured Lender (or any collateral agent of such secured Lender) for the return, or otherwise in respect, of any such collateral ~~P~~ledged by the Corporation to such secured Lender (or its collateral agent), so long as any loans made by such Lender to the Corporation or other obligations, secured by such collateral, are unpaid and outstanding. Subject to the foregoing and to the terms and conditions of such loan, the Corporation shall remain obligated to each such **participant Member** to return, and to allow substitution for or withdrawal of, cash, and Eligible Clearing Fund Securities, and **Eligible** ~~l~~Letters of ~~e~~Credit (if any) pledged or deposited by such **participant Member** as a Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund~~, or otherwise to collateralize such **participant's Member's** obligations to the Corporation,

under the circumstances and within the time frames specified in these Rules and Procedures. In the event of any conflict or inconsistency between this Rule 4 and any agreement between the Corporation and any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member~~, this Rule 4 shall govern and prevail.

SEC. 13. Mutual Fund Deposits. Each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member shall, and each Fund Member (collectively with such Members and Mutual Fund/Insurance Services Members, "Mutual Fund Participants") may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Mutual Fund Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit shall be a separate and additional component of such Member's deposit to the Clearing Fund but shall not constitute part of such Member's Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to Section 4 of this Rule.

If any Mutual Fund Participant fails to satisfy any obligation to the Corporation relating to the Mutual Fund Services, notwithstanding the Corporation's right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, the Corporation shall first apply such Mutual Fund Participant's Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated to the Corporation, the Corporation shall apply such Member's Actual Deposit in accordance with Section 3 of this Rule. The Corporation shall next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations, in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants and, after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Mutual Fund Participants are Members. If any loss or liability remains thereafter and there are no continuing Mutual Fund Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any participant's Mutual Fund Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

A Mutual Fund Participant that elects to withdraw from membership shall be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Mutual Fund Participant was responsible while a Mutual Fund Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Mutual Fund Deposits.

SEC. 14. Insurance Deposits. Each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, "Insurance Participants") may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Insurance Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Insurance Deposits).

If any Insurance Participant fails to satisfy any obligation to the Corporation relating to the Insurance and Retirement Processing Services, the Corporation shall first apply such Insurance Participant's Insurance Deposit. If after such application any loss or liability remains, the Corporation shall next allocate such remaining loss or liability to the other Insurance Participants in successive rounds of loss allocations, in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants and, after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any Insurance Participant's Insurance Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

An Insurance Participant that elects to withdraw from membership shall be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Insurance Participant was responsible while an Insurance Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Insurance Deposits.

RULE 4(A). SUPPLEMENTAL LIQUIDITY DEPOSITS

SEC. 2. *Defined Terms.* The following terms shall have the meanings specified:

“Special Activity Prefund Deposit” means a cash deposit of a Member to the Clearing Fund made by wire transfer to an account designated by the Corporation:

- a. that is in excess of the Required **Fund** Deposit of the Member;

“Special Activity Supplemental Liquidity Need” means, on any Special Activity Business Day, the amount by which the Special Activity Daily Liquidity Need of the Corporation exceeds the sum of all Required **Fund** Deposits.

SEC. 11. *Ceasing to be a Participant.* Special Activity Supplemental Deposits shall not be subject to the provisions of Section ~~67~~ of Rule 4 relating to the ~~90~~**thirty (30)** **calendar** day deferral of refunds of deposits to the Clearing Fund when a Member ceases to be a participant.

SEC. 13. *Application of Special Activity Supplemental Deposits.*

- a. A Special Activity Supplemental Deposit of a Member may not be withdrawn by the Member unless it is entitled to a return of such deposit pursuant to Sections 9 or 10 above.
- b. A Special Activity Supplemental Deposit of a Member shall form a part of the ~~a~~**Actual d**Deposit of the Member to the Clearing Fund but shall be in addition to, and separate from, (i) the Required **Fund** Deposit of the Member and (ii) any other deposit of the Member to the Clearing Fund.
- c. A Special Activity Supplemental Deposit of a Member (i) may be invested, paid, applied and loaned as provided in Section 2 of Rule 4 and (ii) may be used to satisfy a loss or liability as provided in Sections ~~3~~ **or 13** of Rule 4.
- d. A Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any *pro rata* charge pursuant to Section 4 of Rule 4.

RULE 13. EXCEPTION PROCESSING

Notwithstanding any provisions in these Rules and Procedures to the contrary, in the event that a security may not otherwise be eligible for processing through the CNS, Balance Order or other ~~S~~system, the Corporation, in its sole discretion, may adopt, from time to time, procedures deemed appropriate for the processing of such security. Any such procedures shall be promptly communicated to Members by the Corporation and the Members shall be bound by the procedures set forth in such notice as fully as though such procedures were now a part of the Rules and Procedures of the Corporation. Each such notice shall be effective only for the security covered therein.

RULE 15. ASSURANCES OF FINANCIAL RESPONSIBILITY AND OPERATIONAL CAPABILITY

SEC. 2. (a) Each Member or Limited Member, or any applicant to become such, shall furnish to the Corporation such adequate assurances of its financial responsibility and operational capability as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation, its participants, creditors or investors, to safeguard securities and funds in the custody or control of the Corporation and for which the Corporation is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions. Upon the request of a participant or applicant, or otherwise, the Corporation may choose to confer with the participant or applicant before or after requiring it to furnish adequate assurances pursuant to this Rule.

(b) Adequate assurances of the financial responsibility or operational capability of a participant or applicant to become such, as may be required pursuant to these Rules **and Procedures**, may include, but shall not be limited to, as appropriate under the context of the participant's use of the Corporation's services:

- (i) additional reporting by the participant (or by the entity providing a guarantee) of its financial or operational condition at such intervals and in such detail as the Corporation shall determine;
- (ii) entering into agreements concerning the provision of operational support services by an entity acceptable to the Corporation;
- (iii) restrictions on the participant's use of the Corporation's services;
- (iv) increased Clearing Fund deposits (including additional amounts required in respect of trade activity received by the Corporation after calculation of the applicable Required **Fund** Deposit);
- (v) additional payments to the Corporation in such amounts as may be determined by the Corporation each morning reflecting a percentage of up to 100 percent of the participant's (i) average amount of total daily net debit positions or (ii) morning gross debit activity;
- (vi) delivering securities to the Member only against immediate payment by the Member to the Corporation; and

- (vii) assurances as may be required pursuant to the Corporation's Guidelines and/or Procedures.

RULE 42. WIND-DOWN OF A MEMBER, FUND MEMBER OR INSURANCE
CARRIER/RETIREMENT SERVICES MEMBER

The Corporation may, in its discretion, impose conditions on, or take actions with respect to, the Wind-Down Member as appropriate to mitigate risk the Corporation perceives may be presented by the Wind-Down Member, including but not limited to, the following:

- (i) Permitting the Wind-Down Member to submit to the Corporation only transactions that serve to support the wind-down;
- (ii) Permitting the Wind-Down Member to continue use of one or more of the Corporation's services, notwithstanding that it may not meet some or all of the financial or operational requirements for continuance as a Member or Limited Member, as applicable;
- (iii) Restricting or modifying the Wind-Down Member's use of any or all of the Corporation's services (whether generally, or with respect to certain transactions);
- (iv) Requiring additional assurances of the financial responsibility or operational capability of the Wind-Down Member through, for example, submission of a guaranty of the Wind-Down Member's obligations to the Corporation by an entity acceptable to the Corporation and/or additional reporting by the Wind-Down Member;
- (v) Agreeing to complete one or more trades to which the Wind-Down Member is a party prior to the time the Corporation's guaranty otherwise would become effective pursuant to these Rules and Procedures;
- (vi) Requiring the Wind-Down Member to post increased Clearing Fund deposits and/or to post its Required **Fund** Deposit all in cash or in proportions of cash, qualifying bonds and **e**Eligible Letters of Credit different from those permitted under Rule 4;
- (vii) Prohibiting the Wind-Down Member from withdrawing Clearing Fund on deposit in excess of its Required **Fund** Deposit;
- (viii) Calculating the Required **Fund** Deposit of the Wind-Down Member in a manner different from the applicable formulae provided in the Procedures, in order to more appropriately reflect the risk presented by the Wind-Down Member to the Corporation, such as for example, not applying certain components of such calculation; or

- (ix) Liquidating by buying-in or selling-out, as applicable, any open positions of the Wind-Down Member, for the benefit of such Wind-Down Member with any profit or loss resulting therefrom being debited or credited, as applicable, to the settlement account of the Wind-Down Member.

PROCEDURE III. TRADE RECORDING SERVICE (INTERFACE WITH QUALIFIED CLEARING AGENCIES)

B. Settlement of Option Exercises and Assignments and Settlement of Stock Futures Reaching Maturity

Unless otherwise agreed between OCC and the Corporation, E&A/Delivery Transactions are received by the Corporation from OCC each day on which both the Corporation and OCC are open for accepting trades for clearance. Subject to the paragraph below, the Corporation's guarantee pursuant to Addendum K shall become effective for each E&A/Delivery Transaction when the Required **Fund** Deposits to the Clearing Fund, after taking into account that E&A/Delivery Transaction, are received by the Corporation from all Participating Members.

If (i) a Participating Member has failed to satisfy its Clearing Fund obligations to the Corporation pursuant to Procedure XV, or (ii) the Corporation has declined or ceased to act for a Participating Member pursuant to these Rules **and Procedures** prior to the time that the Corporation's guarantee of such Participating Member's E&A/Delivery Transactions become effective (such Participating Member, a "Defaulting Participating Member"), then none of the E&A/Delivery Transactions involving such defaulting Participating Member for which the Corporation's guarantee pursuant to Addendum K has not yet become effective shall be guaranteed by the Corporation, and all such E&A/Delivery Transactions shall be exited out of the CNS Accounting Operation or the Balance Order Accounting Operation, as applicable, unless otherwise agreed between OCC and the Corporation. The Corporation shall have no further obligation regarding the settlement of the exited E&A/Delivery Transactions, other than such obligations as the Corporation may have pursuant to its arrangement with OCC, and the non-defaulting Participating Members' Required **Fund** Deposit to the Clearing Fund will be recalculated excluding the exited E&A/Delivery Transactions.

PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS¹

I.(B) Additional Clearing Fund Formula

(4) Bank Holiday Charge

For purposes of this section, “Holiday” means any day on which equities markets are open for trading, but the Board of Governors of the Federal Reserve System observes a holiday and banks are closed.

On the business day prior to any Holiday, the Corporation may require each Member to make an additional Clearing Fund deposit (“Bank Holiday Charge”). The Bank Holiday Charge approximates the exposure that a Member’s trading activity on the applicable Holiday could pose to the Corporation. Since the Corporation cannot collect margin on the Holiday, the Bank Holiday Charge is due on the business day prior to the applicable Holiday.

The methodology for calculating a Bank Holiday Charge shall be determined by the Corporation in advance of each applicable Holiday. The Bank Holiday Charge approximates each Member’s Required **Fund** Deposit to address the exposure that such Member’s trading activity on the Holiday could pose to the Corporation. The Corporation shall have the discretion to calculate the Bank Holiday Charge based on its assessment of market conditions at the time the Bank Holiday Charge is calculated (such as, for example, significant market occurrences that could impact market price volatility). The Corporation shall inform Members of the methodology it will use to calculate the Bank Holiday Charge by an Important Notice issued no later than 10 business days prior to the day on which the applicable Bank Holiday Charge is applied. Examples of potential methodologies for the Bank Holiday Charge may include, but shall not be limited to, time scaling of the volatility charge or a stress scenario that reflects potential market price volatility on the Holiday.

II. Minimum Clearing Fund and Additional Deposit Requirements

- (A) Each Member of the Corporation shall be required to contribute a minimum of \$10,000 (the “minimum contribution”). The first 40% (but no less than \$10,000) of a Member’s Required **Fund** Deposit must be in cash and the remaining amount, may be evidenced by open account indebtedness secured by the pledge of Eligible Clearing Fund Securities, which shall be valued, for collateral

¹ All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

purposes, as set forth in subsection III below. A Mutual Fund/Insurance Services Member's entire deposit is required to be in cash.

1. Special Provisions Related to Eligible Clearing Fund Securities:

- (a) Any deposits of Eligible Clearing Fund Agency Securities⁷ or Eligible Clearing Fund Mortgage-Backed Securities⁸, respectively, in excess of 25 percent of the Member's Required **Fund** Deposit will be subject to an additional haircut equal to twice the percentage as specified in the proposed haircut schedule detailed in subsection III below, and
 - (b) No more than 20 percent of a Member's Required **Fund** Deposit secured by pledged Eligible Agency Securities may be of a single issuer.
- (B) All Clearing Fund requirements and other deposit requirements shall be made by Members and Mutual Fund/Insurance Services Members, within one hour of demand unless otherwise determined by the Corporation; provided, however, that to the extent the Member and Mutual Fund/Insurance Services Member is meeting such obligation with a (1) deposit of cash, such deposit shall be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire, and (2) delivery of eligible securities, such delivery shall be received within the deadlines established by ~~a Qualified Securities Depository~~ **DTC**. At the discretion of the Corporation, cash deposits may be included as part of the Member's or Mutual Fund/Insurance Services Member's, daily settlement obligation.
- (C) Additional Clearing Fund deposits shall not be requested unless they exceed such threshold as determined by the Corporation from time to time; provided that the affected Member or Limited Member is not on the Watch List.
- (D) Where the amount of a Member's and Mutual Fund/Insurance Services Member's deficiency is in excess of \$1,000 but less than \$5,000, the Corporation may require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000, the Corporation may require payment in multiples of \$5,000.

⁷ A Member that is an Agency may not pledge Eligible Clearing Fund Agency Securities of which it is the issuer.

⁸ With regard to a Member that pledges Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, such securities will be subject to a premium haircut, as set forth in subsection III below.

ADDENDUM E

~~STATEMENT OF POLICY~~

~~APPLICATION OF RETAINED EARNINGS – MEMBER IMPAIRMENTS~~

~~Under Rule 4, Section 4, if the Corporation suffers a loss or liability by reason of a Member's impairment, and such loss or liability is not satisfied or otherwise made good from the impaired Member's Clearing Fund deposit, the Corporation, in its discretion, may either satisfy such loss or liability or any part thereof out of its then existing retained earnings or, after appropriate notice to both the membership and the Securities and Exchange Commission, directly from the Clearing Fund deposits of all other Members on a pro rata basis.~~

~~While neither the Corporation nor its three predecessor clearing agencies have ever subjected their memberships to such a pro rata assessment, the ability exists for the Corporation to bypass completely its retained earnings. Since the Board of Directors of the Corporation is desirous of clarifying its intentions with respect to the usage of retained earnings in Member impairment situations, the Board has adopted this Policy Statement.~~

~~The Board of Directors of the Corporation hereby advises the membership of the Corporation that pursuant to Rule 4, Section 4 of the Rules of the Corporation, the Corporation will apply no less than twenty five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability.~~

~~Nothing herein, however, shall prevent the Corporation from applying more than twenty five percent (25%) of its then existing retained earnings, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time of the Member impairment.~~

~~This Policy Statement may not be changed, modified or altered, without thirty days prior written notice to the membership and to the Securities and Exchange Commission. Any such change, modification or alteration shall only be prospective in effect, and shall not be applicable to any losses or liability previously incurred as a result of prior Member impairments.~~

(ADDENDUM LETTER RESERVED FOR FUTURE USE)

ADDENDUM K

**INTERPRETATION OF THE BOARD OF DIRECTORS
APPLICATION OF CLEARING FUND THE CORPORATION'S GUARANTY**

~~Pursuant to Rule 47, the Board of Directors has the authority to interpret the Rules of the Corporation. The purpose of this interpretation is to clarify certain provisions of Rule 4 and the extent to which the Clearing Fund may be applied to a loss or liability of the Corporation.~~

~~I. APPLICATION OF THE CLEARING FUND TO LOSSES SUSTAINED BY A SYSTEM~~

- ~~1. Section 1 of Rule 4 provides that each Member's Required Deposit shall be allocated by the Corporation among the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the Member participates.~~
- ~~2. The Corporation has in practice assumed responsibility for completion of transactions in each of the following services, and has deemed each of these services to be a System, even though the Corporation has not previously made a formal designation of each such service as a System within the definition of Section 1 of Rule 4:~~

The Corporation guarantees the completion of compared and locked-in CNS and balance orders transactions from a fixed point in the clearance and settlement process.¹ CNS transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures. Balance order transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures through the close of business on T+2. If the contra party to a same day or one day settling trade is a member of an interfacing clearing corporation, such guarantee shall not be applicable unless an agreement to guarantee such trade exists between the Corporation and the interfacing clearing corporation. The Corporation has also adopted a policy of guaranteeing the completion of when-issued and when-distributed trades, as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures and will consider all when-issued and when-

¹ The trade guarantee of obligations arising out of the exercise or assignment of options that are settled at the Corporation is addressed in a separate arrangement between NSCC and Options Clearing Corporation, as referred to in Procedure III of the Rules and Procedures, and is not addressed in these Rules and Procedures.

distributed trades of Members as if they were CNS transactions for surveillance purposes regardless of the accounting operation in which they ultimately settle.

~~3. In connection with the expansion by the Corporation of its clearance and settlement business, it has become desirable for the Corporation to make formal designations of the services constituting Systems within the definition of Section 1 of Rule 4. Accordingly, the Board hereby designates the services referred to in paragraph 1.2. above as services for which the Corporation assumes the responsibility for the completion of transactions, and therefore as Systems within the Rule 4, Section 1 definition. These services are the only services so designated as of this date.~~

~~II. APPLICATION OF THE CLEARING FUND TO EXCESS LOSSES AND LOSSES OUTSIDE OF A SYSTEM~~

~~1. Section 2(b) of Rule 4 provides that the use of the Clearing Fund in its entirety (which consists in part of all the Funds) shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~2. Pursuant to Section 2(b) of Rule 4, the entire Clearing Fund must be available to satisfy losses arising outside of a System.~~

~~There are various circumstances pursuant to which the entire Clearing Fund may be available to satisfy losses outside of a System:~~

- ~~• One circumstance arises out of the Mutual Fund Services. Members that do not participate in the Mutual Fund Services are shielded from exposures to the Mutual Fund Services losses as long as the Corporation continues to have active participants in Mutual Fund Services.~~

~~If the Corporation were to have an unsatisfied Mutual Fund Services loss, such loss may be satisfied from the entire Clearing Fund (less the amounts paid in respect of the Mutual Fund Services).~~

- ~~• An additional circumstance arises out of the Insurance and Retirement Processing Services. If the Corporation were to have an unsatisfied loss due to a Member's, Mutual Fund/Insurance Services Member's or Insurance Carrier/Retirement Services Member's use of the Insurance and Retirement Processing Services, such loss may be satisfied from the entire Clearing Fund.~~

ADDENDUM O
ADMISSION OF NON-US ENTITIES AS DIRECT NSCC MEMBERS

Admission of Non-US Entities¹

- Foreign Legal Opinion – obtain an opinion of reputable foreign counsel satisfactory to NSCC providing, among other things, that the agreements described above may be enforced against the foreign entity in the courts of its home country or other jurisdictions where the entity or its property may be found.²

¹ This policy statement excludes Non-U.S. entities that are insurance companies.

² NSCC reserves the right to require the entity to deposit additional amounts to the Clearing Fund and to post an **Eligible Letter of Credit** in an instance where NSCC, in its sole discretion, believes the entity presents legal risk.

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 197 SECURITIES AND EXCHANGE COMMISSION File No.* SR 2017 * 806
 WASHINGTON, D.C. 20549
 Form 19b 4 Amendment No. (req. for Amendments *) 1

Filing by National Securities Clearing Corporation
 Pursuant to Rule 19b 4 under the Securities Exchange Act of 1934

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

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) *	Section 806(e)(2) *
<input checked="" type="checkbox"/>	<input type="checkbox"/>
	Section 3C(b)(2) *
	<input type="checkbox"/>

Exhibit 2 Sent As Paper Document	Exhibit 3 Sent As Paper Document
<input type="checkbox"/>	<input type="checkbox"/>

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Contact Information

Provide the name, telephone number, and e mail address of the person on the staff of the self regulatory organization prepared to respond to questions and comments on the action.

First Name * Rosa Last Name * Chang

Title * Executive Director and Associate General Counsel

E mail * [REDACTED]

Telephone * [REDACTED] Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date 06/28/2018 Managing Director and Deputy General Counsel

By Nikki Poulos

(Name *)

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

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information *

Add Remove View

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

Exhibit 1 - Notice of Proposed Rule Change *

Add Remove View

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

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

Add Remove View

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

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

Add Remove View

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

Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

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

Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

Add Remove View

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

Exhibit 5 - Proposed Rule Text

Add Remove View

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

Partial Amendment

Add Remove View

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

1. Text of Advance Notice

(a) This advance notice of National Securities Clearing Corporation (“NSCC”) consists of proposed modifications to NSCC’s Rules and Procedures (“Rules”),¹ annexed hereto as Exhibit 5. The proposed rule change would amend provisions in the Rules regarding loss allocation as well as make other changes, as described in greater detail below.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The filing of this advance notice with the Securities and Exchange Commission (“Commission”) was approved by NSCC’s Board of Directors on October 18, 2017.

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Not applicable.

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

Not applicable.

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

Written comments relating to this proposal have not been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

6. Extension of Time Period for Commission Action

Not applicable.

¹ Capitalized terms not defined herein are defined in the Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

- (a) Not applicable.
- (b) Not applicable.
- (c) Not applicable.
- (d) Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Exchange Act

Not applicable.

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

Description of Amendment No. 1

This filing constitutes Amendment No. 1 (“Amendment”) to advance notice SR-NSCC-2017-806 (“Advance Notice”) previously filed by NSCC on December 18, 2017.² This Amendment amends and replaces the Advance Notice in its entirety. NSCC submits this Amendment in order to further clarify the operation of the proposed rule changes on loss allocation by providing additional information and examples. In particular, this Amendment would:

- (i) Clarify which Members would be subject to loss allocation with respect to Defaulting Member Events (as defined below and in the proposed rule change) and Declared Non-Default Loss Events (as defined below and in the proposed rule change) occurring during an Event Period (as defined below and in the proposed rule change). Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member (as defined below and in the proposed rule change)) and each Declared Non-Default Loss Event occurring during the Event Period. Proposed Section 4 of Rule 4 would also make it clear that any Member for which NSCC ceases to act on a

² See Securities Exchange Act Release No. 82584 (January 24, 2018), 83 FR 4377 (January 30, 2018) (SR-NSCC-2017-806).

non-business day, triggering an Event Period that commences on the next business day, would be deemed to be a Member on the first day of that Event Period.

- (ii) Clarify the obligations and Loss Allocation Cap (as defined below and in the proposed rule change) of a Member that withdraws from membership in respect of a loss allocation round. Specifically, pursuant to the Amendment, proposed Section 6 of Rule 4 would provide that the Member would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap as fixed in the round for which it withdrew.
- (iii) Clarify that a Member would be obligated to NSCC for all losses and liabilities incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to the Member. Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member.
- (iv) Clarify that, although a Defaulting Member would not be allocated a ratable share of losses and liabilities arising out of or relating to its own Defaulting Member Event, it would remain obligated to NSCC for all such losses and liabilities. Specifically, pursuant to the Amendment, proposed Section 10 of Rule 4 would provide that no loss allocation under Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any loss or liability to which the Member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under Rule 4.

In addition, pursuant to the Amendment, NSCC is making other clarifying and technical changes to the proposed rule change, as proposed herein.

Nature of the Proposed Change

The primary purpose of this proposed rule change is to amend NSCC's loss allocation rules in order to enhance the resiliency of NSCC's loss allocation process so that NSCC can take timely action to address multiple loss events that occur in succession during a short period of time (defined and explained in detail below). In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of The Depository Trust & Clearing Corporation ("DTCC"), namely The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC") (including the Government Securities Division ("FICC/GSD") and the Mortgage-Backed Securities Division ("FICC/MBSD")), and NSCC (collectively, the "DTCC Clearing Agencies"), so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies, (ii) increase transparency and accessibility of the loss allocation rules by enhancing their readability and clarity, (iii) reduce the time within which NSCC is required to

return a former Member's Clearing Fund deposit, (iv) increase clarity of the voluntary termination provisions, and (v) make conforming and technical changes.

(i) Background

Central counterparties ("CCPs") play a key role in financial markets by mitigating counterparty credit risk on transactions between market participants. CCPs achieve this by providing guaranties to participants and, as a consequence, are typically exposed to credit risks that could lead to default losses. In addition, in performing its critical functions, a CCP could be exposed to non-default losses that are otherwise incident to the CCP's clearance and settlement business.

A CCP's rulebook should provide a complete description of how losses would be allocated to participants if the size of the losses exceeded the CCP's pre-funded resources. Doing so provides for an orderly allocation of losses, and potentially allows the CCP to continue providing critical services to the market and thereby results in significant financial stability benefits. In addition, a clear description of the loss allocation process offers transparency and accessibility to the CCP's participants.

Current NSCC Loss Allocation Process

As a CCP, NSCC's loss allocation process is a key component of its risk management process. Risk management is the foundation of NSCC's ability to guarantee settlement, as well as the means by which NSCC protects itself and its Members from the risks inherent in the clearance and settlement process. NSCC's risk management process must account for the fact that, in certain extreme circumstances, the collateral and other financial resources that secure NSCC's risk exposures may not be sufficient to fully cover losses resulting from the liquidation of the portfolio of a Member for whom NSCC has ceased to act.³

The Rules currently provide for a loss allocation process through which both NSCC (by applying no less than 25% of its retained earnings in accordance with Addendum E) and its Members would share in the allocation of a loss resulting from the default of a Member for whom NSCC has ceased to act pursuant to the Rules. The Rules also recognize that NSCC may incur losses outside the context of a defaulting Member that are otherwise incident to NSCC's clearance and settlement business.

³ When NSCC restricts a Member's access to services generally, NSCC is said to have "ceased to act" for the Member. Rule 46 (Restrictions on Access to Services) sets out the circumstances under which NSCC may cease to act for a Member, and Rule 18 (Procedures for When the Corporation Declines or Ceases to Act) sets out the types of actions NSCC may take when it ceases to act for a Member. Supra note 1.

NSCC's loss allocation rules currently provide that in the event NSCC ceases to act for a Member, the amounts on deposit to the Clearing Fund from the defaulting Member, along with any other resources of, or attributable to, the defaulting Member that NSCC may access under the Rules (e.g., payments from Clearing Agency Cross-Guaranty Agreements), are the first source of funds NSCC would use to cover any losses that may result from the closeout of the defaulting Member's guaranteed positions. If these amounts are not sufficient to cover all losses incurred, then NSCC will apply the following available resources, in the following loss allocation waterfall order:

First, as provided in Addendum E, NSCC's corporate contribution of at least 25 percent of NSCC's retained earnings existing at the time of a Member impairment, or such greater amount as the Board of Directors may determine; and

Second, if a loss still remains, as and in the manner provided in Rule 4, the required Clearing Fund deposits of Members who are non-defaulting Members on the date of default.

Pursuant to current Section 5 of Rule 4, if, as a result of applying the Clearing Fund deposit of a Member, the Member's actual Clearing Fund deposit is less than its Required Deposit, it will be required to eliminate such deficiency in order to satisfy its Required Deposit amount. Pursuant to current Section 4 of Rule 4, Members can also be assessed for non-default losses incident to the operation of the clearance and settlement business of NSCC. Pursuant to current Section 8 of Rule 4, Members may withdraw from membership within specified timeframes after a loss allocation charge to limit their obligation for future assessments.

Overview of the Proposed Rule Changes

A. Changes to Enhance Resiliency of NSCC's Loss Allocation Process

In order to enhance the resiliency of NSCC's loss allocation process, NSCC proposes to change the manner in which each of the aspects of the loss allocation waterfall described above would be employed. NSCC would retain the current core loss allocation process following the application of the defaulting Member's resources, i.e., first, by applying NSCC's corporate contribution, and second, by pro rata allocations to Members. However, NSCC would clarify or adjust certain elements and introduce certain new loss allocation concepts, as further discussed below. In addition, the proposed rule change would address the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time, also as described below.

Accordingly, NSCC is proposing five (5) key changes to enhance NSCC's loss allocation process:

(1) Changing the calculation and application of NSCC's corporate contribution.

As stated above, Addendum E currently provides that NSCC will contribute no less than 25% of its retained earnings (or such higher amount as the Board of Directors shall determine) to a loss or liability that is not satisfied by the impaired Member's Clearing Fund deposit. Under the proposal, NSCC would amend the calculation of its corporate contribution from a percentage of its retained earnings to a mandatory amount equal to 50% of the NSCC General Business Risk Capital Requirement.⁴ NSCC's General Business Risk Capital Requirement, as defined in NSCC's Clearing Agency Policy on Capital Requirements,⁵ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended (the "Act").⁶ The proposed Corporate Contribution (as defined in the proposed rule change) would be held in addition to NSCC's General Business Risk Capital Requirement.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than those from Member impairments. Under the proposal, NSCC would apply its corporate contribution to non-default losses as well. The proposed Corporate Contribution would apply to losses arising from Defaulting Member Events and Declared Non-Default Loss Events (as such terms are defined below and in the proposed rule change), and would be a mandatory contribution by NSCC prior to any allocation of the loss among NSCC's Members.⁷ As proposed, if the Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following two hundred fifty (250) business days⁸ in order to

⁴ NSCC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of NSCC's critical operations, and (iii) an amount determined based on an analysis of NSCC's estimated operating expenses for a six (6) month period.

⁵ See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-NSCC-2017-004).

⁶ 17 CFR 240.17Ad-22(e)(15).

⁷ The proposed rule change would not require a Corporate Contribution with respect to the use of the Clearing Fund as a liquidity resource; however, if NSCC uses the Clearing Fund as a liquidity resource for more than 30 calendar days, as set forth in proposed Section 2 of Rule 4, then NSCC would have to consider the amount used as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and allocate the loss pursuant to proposed Section 4 of Rule 4, which would then require the application of a Corporate Contribution.

⁸ Rule 1 defines "business day" as "any day on which the Corporation is open for business. However, on any business day that banks or transfer agencies in New York State are closed or a Qualified Securities Depository is closed, no deliveries of securities and no

permit NSCC to replenish the Corporate Contribution.⁹ To ensure transparency, Members would receive notice of any such reduction to the Corporate Contribution.

As compared to the current approach of applying “no less than” a percentage of retained earnings to defaulting Member losses, the proposed Corporate Contribution would be a fixed percentage of NSCC’s General Business Risk Capital Requirement, which would provide greater transparency and accessibility to Members. The proposed Corporate Contribution would apply not only towards losses and liabilities arising out of or relating to Defaulting Member Events but also those arising out of or relating to Declared Non-Default Loss Events, which is consistent with the current industry guidance that “a CCP should identify the amount of its own resources to be applied towards losses arising from custody and investment risk, to bolster confidence that participants’ assets are prudently safeguarded.”¹⁰

Under the current Addendum E, NSCC has the discretion to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as result of a Member’s impairment. This option would be retained and expanded under the proposal so that it would be clear that NSCC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of NSCC, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

The proposed rule changes relating to the calculation and application of the Corporate Contribution are set forth in proposed Sections 4 and 5 of Rule 4, as further described below.

(2) Introducing an Event Period.

In order to clearly define the obligations of NSCC and its Members regarding loss allocation and to balance the need to manage the risk of sequential loss events against Members’ need for certainty concerning their maximum loss allocation exposures, NSCC is proposing to introduce the concept of an “Event Period” to the Rules to address the losses and liabilities that may arise from or relate to multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Specifically, the proposal would group Defaulting

payments of money shall be made through the facilities of the Corporation.” Supra note 1.

⁹ NSCC believes that two hundred and fifty (250) business days would be a reasonable estimate of the time frame that NSCC would require to replenish the Corporate Contribution by equity in accordance with NSCC’s Clearing Agency Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

¹⁰ See Resilience of central counterparties (CCPs): Further guidance on the PFMI, issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, at 42 (July 2017), available at www.bis.org/cpmi/publ/d163.pdf.

Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days (“Event Period”) for purposes of allocating losses to Members in one or more rounds (as described below), subject to the limitations of loss allocation set forth in the proposed rule change and as explained below.¹¹ In the case of a loss or liability arising from or relating to a Defaulting Member Event, an Event Period would begin on the day NSCC notifies Members that it has ceased to act¹² for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a loss or liability arising from or relating to a Declared Non-Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Defaulting Member Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for Defaulting Member Events or Declared Non-Default Loss Events occurring during overlapping ten (10) business day periods.

The amount of losses that may be allocated by NSCC, subject to the required Corporate Contribution, and to which a Loss Allocation Cap would apply for any Member that elects to withdraw from membership in respect of a loss allocation round, would include any and all losses from any Defaulting Member Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.¹³

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 4 of Rule 4, as further described below.

¹¹ NSCC believes that having a ten (10) business day Event Period would provide a reasonable period of time to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

¹² Supra note 3.

¹³ As discussed below, each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period.

(3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

Each loss allocation would be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.¹⁴ The “Loss Allocation Cap” of a Member would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

¹⁴ Pursuant to the current Section 8 of Rule 4, the time period for a participant to give notice of its election to terminate its business with NSCC in respect of a pro rata charge is ten (10) business days after receiving notice of a pro rata charge. Supra note 1.

NSCC believes that it is appropriate to shorten such time period from ten (10) business days to five (5) business days because NSCC needs timely notice of which Members would remain in its membership for purposes of calculating the loss allocation for any subsequent round. NSCC believes that five (5) business days would provide Members with sufficient time to decide whether to cap their loss allocation obligations by withdrawing from their membership in NSCC.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

The amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if NSCC has a \$5 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Members subject to the loss allocation is \$4 billion, the first round would begin when NSCC issues the first Loss Allocation Notice for that Event Period. NSCC could issue one or more Loss Allocation Notices for the first round until the sum of losses allocated equals \$4 billion. Once the \$4 billion is allocated, the first round would end and NSCC would need a second round in order to allocate the remaining \$1 billion of loss. NSCC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Members the option to limit their loss allocation exposure at the beginning of each round. As proposed and as described further below, a Member could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to withdraw from membership within five (5) business days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 4 of Rule 4, as further described below.

- (4) Implementing a “look-back” period to calculate a Member’s loss allocation pro rata share and its Loss Allocation Cap.

Currently, the Rules calculate a Member’s pro rata share for purposes of loss allocation based on the Member’s “allocation for a System,” which in turn is based on settlement dollar amounts. Therefore, a Member’s loss allocation obligations are currently based on the Member’s activity in each of the various services or “Systems” offered by NSCC.¹⁵ The Rules do not anticipate the possibility of more than one Defaulting Member Event or Declared Non-Default Loss Event in quick succession.

¹⁵ NSCC’s current loss allocation rules pre-date NSCC’s move to a risk-based margining methodology.

Given NSCC's risk-based margining methodology, NSCC believes that it would be more appropriate to determine a Member's pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC, which is represented by the Member's Required Deposit (NSCC is proposing that "Required Deposits" be renamed "Required Fund Deposits," as described below). Accordingly, NSCC is proposing to calculate each Member's pro rata share of losses and liabilities to be allocated in any round (as described above and in the proposed rule change) to be equal to (i) the Member's Average RFD divided by (ii) the sum of Average RFD amounts for all Members that are subject to loss allocation in such round.

Additionally, as described above and in the proposed rule change, if a Member withdraws from membership pursuant to proposed Section 6 of Rule 4, NSCC is proposing that the Member's Loss Allocation Cap be equal to the greater of (i) its Required Fund Deposit on the first day of the applicable Event Period or (ii) its Average RFD.

NSCC believes that employing a backward-looking average to calculate a Member's loss allocation pro rata share and Loss Allocation Cap would disincentivize Member behavior that could heighten volatility or reduce liquidity in markets in the midst of a financial crisis. Specifically, the proposed look-back period would discourage a Member from reducing its settlement activity during a time of stress primarily to limit its loss allocation pro rata share, which, as proposed, would now be based on the Member's average settlement activity over the look-back period rather than its settlement activity at a point in time that the Member may not be able to estimate. Similarly, NSCC believes that taking a backward-looking average into consideration when determining a Member's Loss Allocation Cap would also deter a Member from reducing its settlement activity during a time of stress primarily to limit its Loss Allocation Cap.

NSCC believes that having a look-back period of seventy (70) business days is appropriate, because it would be long enough to enable NSCC to capture a full calendar quarter of a Member's activities, including quarterly option expirations, and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred, but not too long that the Member's business strategy and outlook could have shifted significantly, resulting in material changes to the size of its portfolios.

The proposed rule changes relating to the implementation of a look-back period are set forth in proposed Section 4 of Rule 4, as further described below.

(5) Capping withdrawing Members' loss allocation exposure and related changes.

NSCC's current loss allocation rules allow a Member to withdraw if the Member notifies NSCC, within ten (10) business days after receipt of notice of a pro rata charge, of its election to terminate its membership and thereby avail itself of a cap on loss allocation, which is its Required Deposit as fixed immediately prior to the time of the pro rata charge. As discussed above, the proposed rule change would continue providing Members the opportunity to limit their loss allocation exposure by offering withdrawal options; however, the cap on loss allocation would be calculated differently and the associated withdrawal process would also be modified as it relates to withdrawals associated with the loss allocation process. In particular, the proposed

rule change would shorten the withdrawal notification period from ten (10) business days to five (5) business days, and would also change the beginning of such notification period from the receipt of the notice of a pro rata charge to the issuance of the notice, as further described below.

As proposed, if a Member timely provides notice of its withdrawal from membership in respect of a loss allocation round, the maximum amount of losses it would be responsible for would be its Loss Allocation Cap,¹⁶ provided that the Member complies with the requirements of the withdrawal process in proposed Section 6 of Rule 4.¹⁷

Currently, NSCC's loss allocation provisions provide that if a pro rata charge is made against a Member's actual Clearing Fund deposit, and as result thereof the Member's deposit is less than its Required Deposit, the Member will, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. To increase transparency of the timeframe under which NSCC would require funds from Members to satisfy their loss allocation obligations, NSCC is proposing that Members would receive two (2) business days' notice of a loss allocation, and Members would be required to pay the requisite amount no later than the second business day following issuance of such notice.¹⁸ Members would have five (5) business days¹⁹ from the issuance of the first Loss Allocation Notice in any round of an Event Period to decide whether to withdraw from membership.²⁰

Each round would allow a Member the opportunity to notify NSCC of its election to withdraw from membership after satisfaction of the losses allocated in such round. Multiple Loss Allocation Notices may be issued with respect to each round to allocate losses up to the round cap.

¹⁶ If a Member's Loss Allocation Cap exceeds the Member's then-current Required Fund Deposit, it must still cover the excess amount.

¹⁷ For the avoidance of doubt, pursuant to Section 13(d) of Rule 4(A) (Supplemental Liquidity Deposits), a Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any pro rata charge pursuant to Section 4 of Rule 4. Supra note 1.

¹⁸ NSCC believes that allowing Members two (2) business days to satisfy their loss allocation obligations would provide Members sufficient notice to arrange funding, if necessary, while allowing NSCC to address losses in a timely manner.

¹⁹ Supra note 14.

²⁰ NSCC believes that setting the start date of the withdrawal notification period to the date of issuance of a notice would provide a single withdrawal timeframe that would be consistent across the Members.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Members included in the round. If a Member provides notice of its election to withdraw from membership, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover NSCC's losses, a second round will be noticed to those Members that did not elect to withdraw from membership in the previous round; however, as noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, a Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member must: (i) specify in its Loss Allocation Withdrawal Notice (as defined below and in the proposed rule change) an effective date of withdrawal, which date shall be no later than ten (10) business days following the last day of the applicable Loss Allocation Withdrawal Notification Period (as defined below and in the proposed rule change) (i.e., no later than ten (10) business days after the 5th business day following the first Loss Allocation Notice in that round of loss allocation),²¹ (ii) cease all activity that would result in transactions being submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member's withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully and finally settled by the effective date of the Member's withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

As proposed, a Member that withdraws in compliance with proposed Section 6 of Rule 4 would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

The proposed rule changes are designed to enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated. To the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

The proposed rule changes relating to capping withdrawing Members' loss allocation exposure and related changes to the withdrawal process are set forth in proposed Sections 4 and 6 of Rule 4, as further described below.

²¹ NSCC believes that having an effective date of withdrawal that is not later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period would provide Members with a reasonable period of time to wind down their activities at NSCC while minimizing any uncertainty typically associated with a longer withdrawal period.

B. Changes to Align Loss Allocation Rules

The proposed rule changes would align the loss allocation rules, to the extent practicable and appropriate, of the three DTCC Clearing Agencies so as to provide consistent treatment, especially for firms that are participants of two or more DTCC Clearing Agencies. As proposed, the loss allocation waterfall and certain related provisions, e.g., returning a former Member's Clearing Fund, would be consistent across the DTCC Clearing Agencies to the extent practicable and appropriate. The proposed rule changes of NSCC that would align loss allocation rules of the DTCC Clearing Agencies are set forth in proposed Sections 1, 2, 7, and 12 of Rule 4, as further described below.

C. Clarifying Changes Relating to Loss Allocation

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to Members. In particular, NSCC is proposing the following changes relating to loss allocation to clarify Members' obligations for Declared Non-Default Loss Events.

Aside from losses that NSCC might face as a result of a Defaulting Member Event, NSCC could incur non-default losses incident to its clearance and settlement business.²² The Rules currently permit NSCC to apply Clearing Fund to non-default losses. Specifically, pursuant to Section 2(b) of Rule 4,²³ NSCC can use the Clearing Fund to satisfy losses or liabilities of NSCC incident to the operation of the clearance and settlement business of NSCC. Section II of Addendum K provides additional details regarding the application of the Clearing Fund to losses outside of a System.

If there is a failure of NSCC following a non-default loss, such occurrence would affect Members in much the same way as a failure of NSCC following a Defaulting Member Event. Accordingly, NSCC is proposing rule changes to enhance the provisions relating to non-default losses by clarifying Members' obligations for such losses.

Specifically, NSCC is proposing enhancement of the governance around non-default losses that would trigger loss allocation to Members by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that NSCC

²² Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

²³ Section 2(b) of Rule 4 provides that "the use of the Clearing Fund...shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses and liabilities of a System." Supra note 1.

would then be required to promptly notify Members of this determination, which is referred to in the proposed rule as a Declared Non-Default Loss Event. In addition, NSCC is proposing to better align the interests of NSCC with those of its Members by stipulating a mandatory Corporate Contribution apply to a Declared Non-Default Loss Event prior to any allocation of the loss among Members, as described above. Additionally, NSCC is proposing language to clarify Members' obligations for Declared Non-Default Loss Events.

The proposed rule changes relating to Declared Non-Default Loss Events and Members' obligations for such events are set forth in proposed Section 4 of Rule 4, as further described below.

D. Reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit

The proposed rule change would reduce the time period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.

NSCC believes that shortening the time period for the return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they could have use of the deposits sooner than under the current Rules while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied, which would include both matured as well as contingent obligations.

The proposed rule changes relating to the reduced time period in which NSCC is required to return the Clearing Fund deposit of a former Member are set forth in proposed Section 7 of Rule 4, as further described below.

The foregoing changes as well as other changes (including a number of conforming and technical changes) that NSCC is proposing in order to improve the transparency and accessibility of the Rules are described in detail below.

E. Loss Allocation Waterfall Comparison

The following example²⁴ illustrates the differences between the current and proposed loss allocation provisions:

²⁴ For purposes of this example, NSCC has assumed that the losses occurred with guaranteed CNS activity of Members, and NSCC allocated all such Members' deposits to the Clearing Fund to CNS activity (which is typically more than 99% of the NSCC daily gross settlement amount).

Assumptions:

- (i) Member A defaults on a business day (Day 1). On the same day, NSCC ceases to act for Member A and notifies Members of the cease to act. After liquidating Member A's portfolio and applying Member A's Clearing Fund deposit, NSCC has a loss of \$350 million.
- (ii) Member X voluntarily retires from membership five (5) business days after NSCC ceases to act for Member A (Day 6).
- (iii) Member B defaults seven (7) business days after NSCC ceases to act for Member A (Day 8). On the same day, NSCC ceases to act for Member B and notifies Members of the cease to act. After liquidating Member B's portfolio and applying Member B's Clearing Fund deposit, NSCC has a loss of \$350 million.
- (iv) The current NSCC loss provisions require NSCC to contribute no less than 25% of its retained earnings as a corporate contribution. For the purposes of this example, it is assumed that NSCC will contribute 25% of its retained earnings. The amount of NSCC's retained earnings is \$416 million.
- (v) NSCC's General Business Risk Capital Requirement is \$154 million.

Current Loss Allocation:

Under the current loss allocation provisions, with respect to the losses arising out of Member A's default, NSCC will contribute \$104 million ($\$416 \text{ million} * 25\%$) from retained earnings and then allocate the remaining loss of \$246 million ($\$350 \text{ million} - \104 million) to Members.

With respect to losses arising out of Member B's default, NSCC will contribute \$78 million ($(\$416 \text{ million} - \$104 \text{ million}) * 25\%$) from retained earnings and then allocate the remaining loss of \$272 million ($\$350 \text{ million} - \78 million) to Members. Because Member X voluntarily retired before NSCC ceased to act for Member B, Member X is not subject to loss allocation with respect to losses arising out of Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC will contribute \$182 million of retained earnings and will allocate losses of \$518 million to Members.

Proposed Loss Allocation:

Under the proposed loss allocation provisions, a Defaulting Member Event with respect to Member A's default would have occurred on Day One, and a Defaulting Member Event with respect to Member B's default would have occurred on Day 8. Because the Defaulting Member Events occurred during a 10-business day period, they would be grouped together into an Event

Period for purposes of allocating losses to Members. The Event Period would begin on the 1st business day and end on the 10th business day.

With respect to losses arising out of Member A's default, NSCC would apply a Corporate Contribution of \$77 million (\$154 million * 50%) and then allocate the remaining loss of \$273 million (\$350 million - \$77 million) to Members. With respect to losses arising out of Member B's default, NSCC would not apply a Corporate Contribution since it would have already contributed the maximum Corporate Contribution of 50% of its General Business Risk Capital Requirement. NSCC would allocate the losses of \$350 million arising out of Member B's default to Members. Because Member X was a Member on the first day of the Event Period, Member X would be subject to loss allocation with respect to all events occurring during the Event Period, even if the event occurred after its retirement. Therefore, Member X would be subject to loss allocation with respect to Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC would apply a Corporate Contribution of \$77 million and would allocate losses of \$623 million to Members. The principal differences in the above example are due to (i) the proposed changes to the calculation and application of the Corporate Contribution and (ii) the proposed introduction of an Event Period.

(ii) Detailed Description of the Proposed Rule Changes Related to Loss Allocation

A. Proposed Changes to Rule 4 (Clearing Fund)

Overview of Rule 4 (Clearing Fund)

Rule 4 currently addresses Clearing Fund requirements and loss allocation obligations. While Procedure XV addresses the various Clearing Fund calculations, Rule 4 sets forth rights, obligations and other aspects associated with the Clearing Fund, as well as the loss allocation process. Rule 4 is currently organized into 12 sections. NSCC is proposing changes to each section, and consolidating provisions in Rule 4 relating to Mutual Fund Services and Insurance and Retirement Processing Services into new sections, as described below.

Section 1

Section 1 of Rule 4 currently sets forth the requirement that each Member and Mutual Fund/Insurance Services Member shall, and each Fund Member and Insurance Carrier/Retirement Services Member may, be required to make a deposit to the Clearing Fund. Section 1 currently provides that each participant's Required Deposit is based on one or more formulas specified by NSCC's Board of Directors. The basis of each such formula is participants' usage of NSCC's facilities. Section 1 also currently sets forth the minimum amount of each participant category's Required Deposit.

Current Section 1 allows a portion of a participant's Clearing Fund deposit to be evidenced by an open account indebtedness secured by Eligible Clearing Fund Securities, subject to certain limitations set forth in Procedure XV, and sets forth the various requirements

associated with the deposit of Eligible Clearing Fund Securities. Current Section 1 also permits NSCC to require participants to post a letter of credit where NSCC believes the participants present legal risk.

Current Section 1 also provides that NSCC allocate the Clearing Fund by types of service (e.g., Mutual Fund Services) as well as by Systems (e.g., CNS), and divide the Clearing Fund into separate “Allocations” for each such service and separate “Funds” for each such System.

Under the proposed rule change, NSCC is proposing to add a subheading of “Required Fund Deposits” to Section 1 and restructure Section 1 so that it applies to Members only and delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Section 1.²⁵ Provisions of Rule 4 regarding Mutual Fund/Insurance Services Members and Fund Members would be covered in a new proposed Section 13 to Rule 4, discussed below. Provisions of Rule 4 regarding Insurance Carrier/Retirement Services Members would be covered in a new proposed Section 14 to Rule 4, discussed below.

Under the proposed rule change, Section 1 would continue to have the same provisions as they relate to Members except for the following: (i) the language throughout the section would be reorganized, streamlined and clarified, (ii) “Required Deposits” would be renamed “Required Fund Deposits,”²⁶ which is a more descriptive term to refer to Members’ deposits required for the Clearing Fund, and would harmonize with the rules of FICC/GSD and FICC/MBSD²⁷ and the term used in such rules,²⁸ (iii) a sentence would be added regarding additional deposits maintained by the Members at NSCC, (iv) the provision regarding the Clearing Fund being

²⁵ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Sections 2, 3, 4, 5, 6, 7, 8, 9, and 12 of Rule 4.

²⁶ In addition to Section 1 of Rule 4, NSCC is proposing to rename “Required Deposits” to “Required Fund Deposits” in Sections 2, 3, 4, 8, 9, and 11 of Rule 4.

²⁷ FICC/GSD Rulebook (“FICC/GSD Rules”), available at http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf and FICC/MBSD Clearing Rules (“FICC/MBSD Rules”), available at http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf.

²⁸ See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 27.

allocated by Systems and services would be deleted,²⁹ and (v) change “Rules” to “Rules and Procedures” to better reflect the name of NSCC’s rulebook.³⁰

The proposed sentence regarding additional deposits to the Clearing Fund would permit Members to post such additional deposits at their discretion and would make clear that such additional deposits would be deemed to be part of the Clearing Fund and the Member’s Actual Deposit (as discussed below and as defined in the proposed rule change) but would not be deemed to be part of the Member’s Required Fund Deposit.

NSCC proposes to add language in Section 1 to make it clear that each Member would grant NSCC a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure the Member’s open account indebtedness or placed by the Member in NSCC’s possession (or its agents acting on its behalf) to secure all such Member’s obligations to NSCC, and that NSCC would be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The additional language would further harmonize the Rules with language used in the FICC/GSD Rules and FICC/MBSD Rules,³¹ thus providing consistent treatment of pledged resources for firms that are members of both NSCC and FICC.

NSCC proposes to clarify the language in footnote 2 of Section 1. In addition, NSCC proposes to add “Eligible Letter of Credit” as a defined term to refer to letters of credit posted by participants if required by NSCC,³² which would harmonize the term with the term used in the FICC/GSD Rules and FICC/MBSD Rules,³³ thus providing consistent terminology for firms that are members of both NSCC and FICC.

Similarly, NSCC proposes to add “Actual Deposit” as a defined term in Section 1 to refer to Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure a Member’s open account indebtedness or placed by a Member in the possession of NSCC (or its agents acting on its behalf) and any Eligible Letters of Credit issued on behalf of a Member in favor of NSCC.

²⁹ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to the Clearing Fund being allocated by Systems and services from Sections 2, 3, and 4 of Rule 4.

³⁰ In addition to Section 1 of Rule 4, NSCC is proposing to change “Rules” to “Rules and Procedures” in Sections 9 and 12 of Rule 4.

³¹ See Section 4 of FICC/GSD Rule 4 and Section 4 of FICC/MBSD Rule 4, supra note 27.

³² In addition to Section 1 of Rule 4, NSCC is also proposing to rename “Letter of Credit” to “Eligible Letter of Credit” in Sections 2 and 12 of Rule 4.

³³ See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 27.

Instead of requiring participants to pledge Eligible Clearing Fund Securities to NSCC's account at a Qualified Securities Depository designated by the participants, NSCC proposes to clarify and streamline Section 1 of proposed Rule 4 to provide that Eligible Clearing Fund Securities pledged to secure a Member's open account indebtedness would be delivered to NSCC's account at DTC.

NSCC would delete the provision regarding allocation of the Clearing Fund by Systems and services, as this provision is no longer relevant under the proposed rule change. Provisions relating to Mutual Fund Services and Insurance and Retirement Processing Services in Section 1 (as well as other sections in Rule 4) would be consolidated in the proposed new Sections 13 and 14, entitled "Mutual Fund Deposits" and "Insurance Deposits," respectively.

To consolidate provisions regarding the maintenance, investment and permitted use of Clearing Fund, NSCC would move the last paragraph of Section 1 about segregation and maintenance of Clearing Fund (again, in terms of "Fund," "System," and "Allocation," as discussed above) to Section 2.

In addition, NSCC proposes to correct a typographical error in the reference to a footnote in Section 1 of Rule 4. Specifically, there is an incorrect reference to footnote 22 in the second paragraph of Section 1 in current Rule 4. NSCC is proposing to change this reference to reflect the correct footnote, which is footnote 2.

Section 2

Section 2 of Rule 4 currently covers the permitted uses of the Clearing Fund (again by "Fund" and "Allocation," as set forth in current Section 1), including the investment of Clearing Fund Cash and Cash Receipts, as well as participants' rights to any interest earned or paid on pledged Eligible Clearing Fund Securities or cash deposits.

NSCC is proposing to add a subheading of "Permitted Use, Investment, and Maintenance of Clearing Fund Assets" to Section 2 and restructure Section 2 so that it applies to Members only. NSCC is also proposing to restructure Section 2 so that the permitted use of Clearing Fund appears first, then the investment of Clearing Fund, followed by maintenance of Clearing Fund.

Under the proposed rule change, the permitted use of Clearing Fund paragraph would continue to have the same provisions as they relate to how the Clearing Fund can be used by NSCC, except the provisions would be streamlined and clarified. Specifically, in order to be consistent with the proposed change in Section 4 (as described below) regarding NSCC requiring Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact), NSCC is proposing to modify the permitted use of Clearing Fund to make it clear that the Clearing Fund can be used by NSCC to secure each Member's performance of obligations to NSCC, including each Member's obligations with respect to any loss allocations as set forth in Section 4 of Rule 4. NSCC is also proposing to delete the defined term of Cash Receipts and related provisions from Rule 4 because, unlike the Clearing Fund, Cash Receipts are money payments received from participants and payable to others; therefore, NSCC believes that continuing to include Cash Receipts in Rule 4 is no longer necessary and may cause confusion among Members.

NSCC is proposing to add a paragraph that provides that each time NSCC uses any part of the Clearing Fund to provide liquidity to NSCC to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity for more than thirty (30) calendar days, NSCC, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, would consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with proposed Section 4 of Rule 4. NSCC believes that this proposed change would increase transparency and accessibility of the Rules for Members by specifying a point in time by which NSCC would need to replenish the Clearing Fund through loss allocation if NSCC uses the Clearing Fund to provide or secure liquidity to NSCC to meet its settlement obligations. NSCC believes that a period of thirty (30) calendar days would be appropriate because it would provide sufficient time for NSCC to determine whether it would be able to obtain the necessary funds from liquidation of the portfolio of the Defaulting Member to repay the used Clearing Fund amount. In addition, this proposed change would also harmonize this section with the comparable section in the FICC/GSD Rules and FICC/MBSD Rules,³⁴ so as to provide consistent treatment for firms that are members of both NSCC and FICC.

Proposed Section 2 would continue to have the same provisions concerning the investment and maintenance of the Clearing Fund, except these provisions would also be streamlined and clarified. Specifically, NSCC is proposing language to make it clear that it may invest cash in the Clearing Fund in accordance with the Clearing Agency Investment Policy adopted by NSCC.³⁵ NSCC would revise the relocated sentence from Section 1 which provides that NSCC shall not be required to segregate any Clearing Fund (again, in terms of “Fund,” “System,” and “Allocation,” as discussed above) in order to (i) conform to the proposed deletions in Section 1 and use the newly defined term of “Actual Deposit” as set forth in Section 1 and (ii) make clear that NSCC would not be required to segregate a Member’s Actual Deposit

³⁴ See Section 5 of FICC/GSD Rule 4 and Section 5 of FICC/MBSD Rule 4, supra note 27.

³⁵ See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-NSCC-2016-003). The Clearing Agency Investment Policy (the “Policy”) governs the management, custody, and investment of cash deposited to the Clearing Fund, the proprietary liquid net assets (cash and cash equivalents) of NSCC and other funds held by NSCC. The Policy sets forth guiding principles for the investment of those funds, which include adherence to a conservative investment philosophy that places the highest priority on maximizing liquidity and avoiding risk, as well as mandating the segregation and separation of funds. The Policy also addresses the process for evaluating credit ratings of counterparties and identifies permitted investments within specified parameters. In general, assets are required to be held by regulated and creditworthy financial institution counterparties and invested in financial instruments that, with respect to the Clearing Fund, may include deposits with banks, including the Federal Reserve Bank of New York, collateralized reverse-repurchase agreements, direct obligations of the U.S. government and money-market mutual funds.

but that NSCC would maintain books and records concerning the assets that constitute each Member's Actual Deposit.

Under the proposed rule change, Members would continue to be entitled to any interest earned or paid on Clearing Fund cash deposits and pledged Eligible Clearing Fund Securities; however, NSCC is proposing additional language to make it clear that interest on pledged Eligible Clearing Fund Securities that is received by NSCC would be credited to a Member's cash deposits to the Clearing Fund, except in the event of a default by such Member on any obligations to NSCC, in which case NSCC may exercise its rights under proposed Section 3 of Rule 4.

Section 3

Section 3 of Rule 4 currently provides that NSCC may apply a participant's actual deposit to any obligation the participant has to NSCC that the participant has failed to satisfy and to any Cross-Guaranty Obligation. Participants are required to eliminate any resulting deficiencies in their Required Deposits within such time as NSCC requires. Section 3 also currently provides for the manner in which loss allocation would apply with respect to Off-the-Market Transactions.

Under the proposed rule change, NSCC is proposing to add a subheading of "Application of Clearing Fund Deposits and Other Amounts to Members' Obligations" and to delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into Funds/Allocations by Systems and services. Under the proposed rule change, NSCC would retain the provisions in Section 3 regarding applying the Member's Actual Deposit to satisfy an obligation to NSCC that a Member fails to satisfy and the requirement to replenish the Required Fund Deposit as necessary, but NSCC proposes to add clarifying language that, in addition to a Member's Actual Deposit, NSCC will also apply any amounts available under a Clearing Agency Cross-Guaranty Agreement and any proceeds therefrom to satisfy the obligation. NSCC also proposes to add language making it clear that NSCC may take any and all actions with respect to the assets and amounts referenced in the prior sentence, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that NSCC determines is appropriate.

Under the proposed rule change, NSCC would move the provision regarding allocation of losses from Off-the-Market Transactions to proposed Section 4 of Rule 4, which addresses allocation of losses to Members. NSCC would streamline and clarify the remaining provisions for transparency and accessibility.

Section 4 and Section 5

Current Section 4 of Rule 4 contains NSCC's current loss allocation waterfall, which would be initiated if NSCC incurs a loss or liability in a System that is not satisfied pursuant to current Section 3. Section 4 currently provides for the following loss allocation waterfall:

- (i) Application of NSCC's existing retained earnings or such lesser part³⁶ of the existing retained earnings unless the Board of Directors elects to apply the Fund/Allocation for a particular System or service.
- (ii) If a loss or liability remains after the application of the retained earnings, NSCC would apply the Clearing Fund (this application is subject to the current structure where the Rules provide that the Clearing Fund is allocated to different Systems/services).
 - a. NSCC is required to provide participants and the Commission with 5 business days' prior notice before applying the Clearing Fund.
 - b. Participants (other than those responsible for causing the loss or liability) would be charged pro rata based upon their allocation to the applicable Fund, less any amounts that participants were required to deposit pursuant to Rule 15.

Section 5 of Rule 4 currently states that if a pro rata charge is made pursuant to Rule 4 against a participant's actual Clearing Fund deposit, and as a consequence thereof the participant's remaining deposit is less than its Required Deposit, the participant would, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. Current Section 5 further provides that if the participant does not take this required action, NSCC may take disciplinary action against the participant, and any disciplinary action taken against the participant or the voluntary or involuntary termination of the participant's membership will not affect the obligations of the participant to NSCC or any remedy to which NSCC may be entitled under applicable law.

Under the proposed rule change, NSCC is proposing to add a subheading of "Loss Allocation Waterfall, Off-the-Market Transactions" to Section 4 and delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into Funds/Allocations by System or service. In addition, NSCC is proposing to restructure its loss allocation waterfall as described below.

Under the proposal, Section 4 would make clear that the loss allocation waterfall applies to any loss and liability incurred by NSCC arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event.

As proposed, Section 4 would provide that, for the purposes of Rule 4, the term "Defaulting Member" would mean a Member for which NSCC has ceased to act pursuant to

³⁶ Addendum E provides that NSCC "will apply no less than twenty-five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability." Supra note 1.

Rule 46,³⁷ the term “Defaulting Member Event” would mean the determination by NSCC to cease to act for a Member pursuant to Rule 46, and the term “Declared Non-Default Loss Event” would mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of NSCC may be a significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner. Proposed Section 4 would establish the concept of an “Event Period” to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) business days, which would be grouped into an Event Period.³⁸ As stated above, both Defaulting Member Events or Declared Non-Default Loss Events could occur within the same Event Period.

Under the proposal, an Event Period with respect to a Defaulting Member Event would begin on the day NSCC notifies participants that it has ceased to act for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a Declared Non-Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

As proposed, each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member. Under the proposal, to the extent that such loss or liability is not satisfied pursuant to proposed Section 3 of Rule 4, NSCC would apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as provided in proposed Section 4.

Under proposed Section 4, the loss allocation waterfall would begin with a corporate contribution from NSCC (“Corporate Contribution”), as is the case under the current Rules, but in a different form than under the current Section 4 of Rule 4. Today, pursuant to Addendum E, in the event of a Member impairment, NSCC is required to apply at least 25% of its retained earnings existing at the time of a Member impairment; however, no corporate contribution from NSCC is currently required for losses resulting other than those from Member impairments. Under the proposal, NSCC would amend Section 5 to add a subheading of “Corporate Contribution” and define NSCC’s Corporate Contribution with respect to any loss allocation pursuant to proposed Section 4 of Rule 4, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, as an amount that is equal to fifty (50)

³⁷ NSCC may cease to act for a Member pursuant to any of the circumstances set forth under Rule 46 (Restrictions on Access to Services), including, but not limited to, in the event the Member is in default of any delivery of funds or securities to NSCC. Supra note 1.

³⁸ Supra note 11.

percent of the amount calculated by NSCC in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.³⁹ The proposed rule change would specify that NSCC's General Business Risk Capital Requirement, as defined in NSCC's Clearing Agency Policy on Capital Requirements,⁴⁰ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.⁴¹

As proposed, if NSCC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Defaulting Member Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the two hundred fifty (250) business days thereafter,⁴² the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period. Proposed Section 5 would require NSCC to notify Members of any such reduction to the Corporate Contribution.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than from Member impairments. Under the proposal, NSCC would expand the application of its corporate contribution beyond losses and liabilities from Member impairments. The proposed Corporate Contribution would apply to losses or liabilities relating to or arising out of Defaulting Member Events and Declared Non-Default Loss Events, and would be a mandatory loss contribution by NSCC prior to any allocation of the loss among Members.

Addendum E currently provides NSCC the option to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as the result of a Member's impairment. This option would be retained and expanded under the proposal to also cover non-default losses. Proposed Section 5 would provide that nothing in the Rules would prevent NSCC from voluntarily applying amounts greater than the Corporate Contribution against any NSCC loss or liability, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Proposed Section 4 of Rule 4 would provide that NSCC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, NSCC would allocate such losses and liabilities to Members, as described below.

³⁹ Supra note 4.

⁴⁰ Supra note 5.

⁴¹ Supra note 6.

⁴² Supra note 9.

Proposed Section 4 of Rule 4 would also retain the requirement of loss allocation among Members if a loss or liability remains after the application of the Corporate Contribution, as described above. In contrast to the current Section 4 where NSCC would apply Members' Required Deposits to the mutualized loss allocation amounts, under the proposal, NSCC would require Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact).⁴³ Loss allocation obligations would continue to be calculated based upon a Member's pro rata share of losses and liabilities (although the pro rata share would be calculated differently than it is today), and Members would still retain the ability to voluntarily withdraw from membership and cap their loss allocation obligation (although the loss allocation obligation would also be calculated differently than it is today).

The proposed rule change to Section 4 of Rule 4 would clarify that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. The proposal would make it clear that any Member for which NSCC ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

Under the proposed rule change, a loss allocation "round" would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the round cap. When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

⁴³ NSCC believes that shifting from the two-step methodology of applying the Clearing Fund and then requiring Members to immediately replenish it, to requiring direct payment would increase efficiency while preserving the right to charge a Member's Clearing Fund deposits in the event the Member does not timely pay. Such a failure to pay would trigger recourse to the Clearing Fund deposits of the Member under proposed Section 3 of Rule 4. In addition, this change would provide greater stability for NSCC in times of stress by allowing NSCC to retain the Clearing Fund, its critical prefunded resource, while charging loss allocations. NSCC believes doing so would allow NSCC to cover its current credit exposures to Members at all times. By retaining the Clearing Fund as proposed, NSCC could use the Clearing Fund to secure the performance obligations of Members to NSCC, including their payment obligation for any loss allocation, while maintaining access to prefunded resources. By being able to manage its current credit exposures throughout the loss allocation process, NSCC would be able to continue to provide its critical operations and services during what would be expected to be a stressful period.

As proposed, each loss allocation would be communicated to Members by the issuance of a Loss Allocation Notice. Under the proposal, each Member's pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the Member's Average RFD divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a "Loss Allocation Withdrawal Notification Period") to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.⁴⁴ As proposed, the "Loss Allocation Cap" of a Member would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

NSCC is proposing to clarify that after a first round of loss allocation with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

As proposed, Members would have two (2) business days after NSCC issues a first round Loss Allocation Notice to pay the amount specified in any such notice.⁴⁵ On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because NSCC was only able to allocate up to the round cap), Members would also have two (2) business days after notice by NSCC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless Members have notified (or will timely notify) NSCC of their election to withdraw from membership with respect to a prior loss allocation round pursuant to proposed Section 6 of Rule 4.

As proposed, Section 4 would also provide that, to the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

Under the proposal, if a Member fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, NSCC would have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with proposed Section 3 of Rule 4 described above. Members who wish to withdraw would be required to comply with the requirements in proposed Section 6 of Rule 4, described further below. Specifically, proposed Section 4 of Rule 4 would provide that if, after notifying NSCC of its election to withdraw from membership pursuant to proposed Section 6 of Rule 4, the Member

⁴⁴ Supra note 14.

⁴⁵ Supra note 18.

fails to comply with the provisions of proposed Section 6 of Rule 4, its notice of withdrawal would be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

Under the proposal, NSCC would delete the provision in current Section 4 of Rule 4 that requires NSCC to provide Members and the Commission with 5 business days' prior notice before applying the Clearing Fund to a loss or liability because such requirement would no longer be relevant under the proposed rule change. Under the proposed rule change, NSCC would notify Members subject to loss allocation of the amounts being allocated to them in one or more Loss Allocation Notices. As proposed, instead of applying the Clearing Fund, NSCC would require Members to pay their loss allocation amounts (leaving their Clearing Fund deposits intact). In order to conform to these proposed rule changes, NSCC is proposing to eliminate the required notification to Members regarding the application of Clearing Fund in current Section 4 of Rule 4. NSCC is also proposing to delete the required notification to the Commission regarding the application of Clearing Fund in the same section. While as a practical matter, NSCC would notify the Commission of a decision to loss allocate, NSCC does not believe such notification needs to be specified in the Rules.

Under the proposed rule change, NSCC would move the provision related to Off-the-Market Transactions from current Section 3 of Rule 4 to proposed Section 4 of Rule 4 and clarify that (i) a loss or liability of NSCC in connection with the close-out or liquidation of an Off-the-Market Transaction would be allocated to the Member that was the counterparty to such transaction and (ii) no allocation would be made if the Defaulting Member satisfied all applicable intraday mark-to-market margin charges assessed by NSCC with respect to the Off-the-Market Transaction prior to its default.⁴⁶

Section 6

Proposed Section 6 of Rule 4 would include the provisions regarding withdrawal from membership currently covered by Section 8 of Rule 4. NSCC believes that relocating the provisions on withdrawal from membership as it pertains to loss allocation, so that it comes right after the section on the loss allocation waterfall, would provide for the better organization of Rule 4. As proposed, the subheading for Section 6 would read "Withdrawal Following Loss Allocation."

Currently, Section 8 of Rule 4 provides that participants may notify NSCC within ten (10) business days after receipt of notice of a pro rata charge that they have elected to terminate their membership and thereby avail themselves of a cap on loss allocation, which is currently their Required Deposit as fixed immediately prior to the time of the pro rata charge.

⁴⁶ See Securities Exchange Act Release No. 79598 (December 19, 2016), 81 FR 94462 (December 23, 2016) (SR-NSCC-2016-005), at 94465, and Securities Exchange Act Release No. 79592 (December 19, 2016), 81 FR 94448 (December 23, 2016) (SR-NSCC-2016-803), at 94452.

As stated above, under the proposed rule change, a Member who wishes to withdraw from membership in respect of a loss allocation round must provide notice of its election to withdraw (“Loss Allocation Withdrawal Notice”) within five (5) business days from the issuance of the first Loss Allocation Notice in any round.⁴⁷ In order to avail itself of its Loss Allocation Cap, the Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member must: (i) specify in its Loss Allocation Withdrawal Notice an effective date for withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period (i.e., no later than ten (10) business days after the 5th business day following the first Loss Allocation Notice in that round of loss allocation),⁴⁸ (ii) cease all activity that would result in transactions being submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member’s withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully and finally settled by the effective date of the Member’s withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

Proposed Section 6 of Rule 4 would provide that a Member that withdraws in compliance with the requirements of proposed Section 6 of Rule 4 would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under proposed Rule 4; however, the Member’s aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

NSCC is proposing to include a sentence in proposed Section 6 of Rule 4 to make it clear that if the Member fails to comply with the requirements set forth in that section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to proposed Section 4 of Rule 4 as if it had not given such notice.

Currently, Section 8 also contains provisions regarding additional pro rata charges that may be made by NSCC for the same loss or liability under the existing loss allocation process and the applicable caps that participants wishing to voluntarily terminate their membership after such additional pro rata charges are noticed may avail themselves of. These provisions would be replaced by the loss allocation process contained in proposed Section 4 described above.

Section 7

As proposed, Section 7 would cover the provisions on the return of a Member’s Clearing Fund deposit that are currently covered by Section 6 of Rule 4. Proposed Section 7’s subheading would be “Return of Members’ Clearing Fund Deposits” and would apply only to Members.

⁴⁷ Supra note 14.

⁴⁸ Supra note 21.

Currently, with respect to the return of Clearing Fund deposits, Section 6 of Rule 4 states that NSCC will return a participant's Clearing Fund deposit 90 days after 3 conditions are met: (i) the participant ceases to be a participant, (ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund have been closed, and (iii) all obligations of the participant to NSCC have been satisfied or have been deducted from the participant's Clearing Fund deposit by NSCC, provided that the participant has provided NSCC with satisfactory indemnities or guarantees or another participant has been substituted on all transactions and obligations of the participant.

Current Section 6 provides further that in the absence of an acceptable guarantee, indemnity or substitution, NSCC will retain the entire Clearing Fund deposit of a participant if such deposit is less than \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after conditions described in (i), (ii) and (iii) of the paragraph above have occurred. If the participant's Clearing Fund deposit is equal to or greater than \$100,000, NSCC will retain the greater of twenty-five (25) percent of a participant's average Clearing Fund requirement over the twelve (12) months immediately prior to the date the participant ceased to be a participant, or \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after conditions described in (i), (ii) and (iii) of the paragraph above have occurred.

Current Section 6 states that if a participant made a deposit with respect to the Mutual Fund Services or Insurance and Retirement Processing Services, the participant will be entitled to the return of this deposit ninety (90) days after all associated transactions in these services have been satisfied.

Finally, Section 6 currently provides that any obligation of a participant to NSCC unsatisfied at the time the participant ceases to be a participant will not be affected by such cessation of membership.

Proposed Section 7 would reduce the period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC. NSCC believes that shortening the time periods for the return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they could have use of the deposits sooner than under the current Rules, while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. Proposed Section 7 would also harmonize the retention period for a Member's deposits to the Clearing Fund with the FICC/GSD Rules,⁴⁹ thus providing consistent treatment for firms that are members of both

⁴⁹ Section 10 of FICC/GSD Rule 4, in relevant part, states that "If a Netting Member gives notice to the Corporation pursuant to Rule 3 of its election to terminate its membership in

NSCC and FICC. Similarly, the Clearing Fund deposit retention for Members who have Sponsored Accounts at DTC would be reduced in order to stay consistent with the proposed retention period in the rules of DTC.⁵⁰ In addition, NSCC proposes to make it clear that a Member's obligations to NSCC would include both matured as well as contingent obligations.

Section 8

Proposed Section 8 of Rule 4 would cover the subject matter currently covered in Section 7 of Rule 4. Proposed Section 8's subheading would be "Changes in Members' Required Fund Deposits" and would apply only to Members.

Currently, Section 7 of Rule 4 requires participants to satisfy any increase in their Required Deposit within such time as NSCC requires. At the time the increase becomes effective, the participant's obligations to NSCC will be determined in accordance with the increased Required Deposit whether or not the Member has so increased its deposit. NSCC is not proposing any substantive changes to this provision, which will be renumbered as Section 8 of Rule 4 under the proposed rule change, except for streamlining the provision and limiting its application to Members as stated above.

Section 9

Currently, Section 9 of Rule 4 addresses situations where a participant has excess deposits in the Clearing Fund (i.e., amounts above its Required Deposit). The current provision provides that NSCC will, on any day that NSCC has determined and provided notification that an excess deposit exists with respect to a participant, return an excess amount requested by a participant that follows the formats and timeframe established by NSCC for such request. The current provision makes clear that NSCC will not return the requested excess amount (i) until any amount required to be charged against the participant's Required Deposit is paid by the participant to NSCC and/or (ii) if NSCC determines that the participant's current month's use of one or more services is materially different than the previous month's use upon which such excess is based. Section 9 currently makes clear that, notwithstanding any of the foregoing, NSCC may, in its discretion, withhold any or all of a participant's excess deposit if the

the Netting System, the Member's deposits to the Clearing Fund in the form of cash or securities shall be returned to it within 30 calendar days thereafter ... provided that all amounts owing to the Corporation by the Member have been paid to the Corporation prior to such return and the Member has no remaining open Net Settlement Position, Fail Net Settlement Position, or Forward Net Settlement Position." Supra note 27.

⁵⁰ On December 18, 2017, DTC submitted a proposed rule change and an advance notice to enhance its rules regarding allocation of losses. See Securities Exchange Act Release Nos. 82426 (January 2, 2018), 83 FR 913 (January 8, 2018) (SR-DTC-2017-022) and 82582 (January 24, 2018), 83 FR 4297 (January 30, 2018) (SR-DTC-2017-804). On June 28, 2018, DTC submitted amendments to the proposed rule change and advance notice. Copies of the amendments to the proposed rule change and the advance notice are available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

participant has been placed on the Watch List.⁵¹ Current Section 9 also makes clear that nothing in this section limits NSCC's rights under Rule 15.⁵²

Proposed Section 9 would add a subheading "Excess Clearing Fund Deposits" and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except for streamlining the provisions in this section and eliminating the condition described in clause (i) of the paragraph above that limits participants' ability to request the return of excess amounts on deposit in the Clearing Fund and replacing clause (ii) of the paragraph above with a clause that provides NSCC may, in its discretion, withhold any or all of a participant's excess deposit if NSCC determines that the Member's anticipated activities in NSCC in the near future may reasonably be expected to be materially different than its activities of the recent past. NSCC believes that the proposed additional clause would protect NSCC and its participants because the clause would allow NSCC to retain excess deposits to cover an expected near-term increase in a Member's Required Fund Deposit amount due to the anticipated change in the Member's activities. The proposed additional clause would also align NSCC's Rules with that of FICC/GSD and FICC/MBSD,⁵³ thus providing consistent treatment for firms that are members of both NSCC and FICC.

Section 10

Current Section 10 of Rule 4 provides for crediting persons against whom losses are charged pursuant to Rule 4 if there is a subsequent recovery of such losses by NSCC. NSCC is not proposing any changes to this section other than (i) making it clear that no loss allocation under proposed Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any losses or liabilities to which the Member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under proposed Rule 4, and (ii) adding a subheading "No Waiver; Subsequent Recovery Against Loss Amounts" and replacing "persons" with "Persons," which is currently defined in Rule 1 (Definitions and Descriptions) to mean "a partnership, corporation, limited liability corporation or other organization, entity or an individual." NSCC is proposing the change in (i) above to preserve its legal rights and to make it clear to Members that loss allocation under proposed Rule 4 would not be deemed as NSCC waiving any claims it may have against a Member for any losses or liabilities to which the Member is subject under the Rules. With respect to the proposed change in (ii) above, given that NSCC is a corporation, NSCC believes that the term "Person" already includes NSCC; however,

⁵¹ Pursuant to Section 4 of Rule 2B, a Member could be placed on the Watch List either based on its credit rating of 5, 6 or 7, which can either be generated by the Credit Risk Rating Matrix or from a manual downgrade, or when NSCC deems such placement as necessary to protect NSCC and its Members. Supra note 1.

⁵² Rule 15 permits NSCC to require a Member, Limited Member or any applicant to become either to furnish NSCC adequate assurances of the entity's financial responsibility and operational capability as NSCC may deem necessary. Supra note 1.

⁵³ See Section 9 of FICC/GSD Rule 4 (Clearing Fund and Loss Allocation) and Section 9 of FICC/MBSD Rule 4 (Clearing Fund and Loss Allocation). Supra note 27.

for increased clarity, NSCC is proposing to add “including the Corporation” to make it clear to Members that if there is a subsequent recovery of losses charged pursuant to Rule 4, the net amount of the recovery would be credited to Persons, including NSCC, against whom the loss was charged in proportion to the amounts charged against them.

Section 11

Current Section 11 of Rule 4 provides that a participant may withdraw Eligible Clearing Fund Securities from pledge, provided that the participant has deposited cash with, or pledged additional Eligible Clearing Fund Securities to, NSCC that, in the aggregate, secure the open account indebtedness of the participant and/or satisfy the participant’s Required Deposit. Proposed Section 11 would add a subheading “Substitution or Withdrawal of Pledged Securities” and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except for changes to improve the transparency and accessibility of this section.

Section 12

Current Section 12 of Rule 4 makes it clear that NSCC has certain rights with respect to the Clearing Fund. Proposed Section 12 would add a subheading “Authority of Corporation” and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except to clarify that a reference to 30 days in current Section 12 would mean 30 calendar days.

Section 13

NSCC is proposing to add a new Section 13 to Rule 4 that would be entitled “Mutual Fund Deposits.” Under the proposal, NSCC would consolidate provisions from various sections in the current Rule 4 concerning Mutual Fund/Insurance Services Members and Fund Members and group them into proposed Section 13. Aside from the consolidation, NSCC is not proposing any substantive changes to these provisions, except for changes to (i) reduce NSCC’s retention period of Mutual Fund Deposits when a Mutual Fund Participant (as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with the proposed change in Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

Proposed Section 13 would provide that each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member would, and each Fund Member (collectively with such Members and Mutual Fund/Insurance Services Members, “Mutual Fund Participants”) may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its “Mutual Fund Deposit” and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit would be a separate and additional component of such Member’s deposit to the Clearing Fund but not part of the Member’s Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to proposed Section 4 of Rule 4.

As in the current Rules, proposed Section 13 would also provide that if any Mutual Fund Participant fails to satisfy any obligation to NSCC relating to Mutual Fund Services, notwithstanding NSCC's right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, NSCC would first apply such Mutual Fund Participant's Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated to NSCC, NSCC would apply such Member's Actual Deposit in accordance with proposed Section 3 of Rule 4. NSCC would next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants, and after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Mutual Fund Participants are Members. If any loss or liability remains thereafter and there are no continuing Mutual Fund Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 13 would reduce NSCC's retention period of Mutual Fund Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that a Mutual Fund Participant that elects to withdraw from membership would be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Mutual Fund Participant was responsible while a Mutual Fund Participant. NSCC is proposing this change in order to harmonize the retention period of Mutual Fund Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 13 would make it clear that NSCC's rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Mutual Fund Deposits.

Section 14

NSCC is proposing to add a new Section 14 to Rule 4 that would be entitled "Insurance Deposits." Under the proposal, NSCC would consolidate provisions from various sections in current Rule 4 concerning Insurance Carrier/Retirement Services Members and group them into proposed Section 14. Aside from the consolidation, NSCC is not proposing any substantive changes to these provisions, except for changes to (i) reduce NSCC's retention period of Insurance Deposits when an Insurance Participant (as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with proposed Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

As in the current Rules, proposed Section 14 would provide that each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, "Insurance Participants")

may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its “Insurance Deposit” and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Insurance Deposits). Proposed Section 14 would also provide that if any Insurance Participant fails to satisfy any obligation to NSCC relating to the Insurance and Retirement Processing Services, NSCC would first apply such Insurance Participant’s Insurance Deposit. If after such application any loss or liability remains, NSCC would allocate the remaining loss or liability to the other Insurance Participants in successive rounds of loss allocations in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants, and after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 14 would reduce NSCC’s retention period of Insurance Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that an Insurance Participant that elects to withdraw from membership would be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Insurance Participant was responsible while an Insurance Participant. NSCC is proposing this change in order to harmonize the retention period of Insurance Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 14 would make it clear that NSCC’s rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Insurance Deposits.

B. Proposed Changes to Addendum E (Statement of Policy Application of Retained Earnings Member Impairments) and Addendum K (Interpretation of the Board of Directors Application of Clearing Fund)

Addendum E is a statement of policy that currently provides that NSCC will apply no less than twenty-five (25) percent of its retained earnings to cover losses or liabilities from a Member’s impairment that is not otherwise satisfied by the impaired Member’s Clearing Fund deposit. NSCC is proposing to delete Addendum E in its entirety because it would no longer be relevant given the proposed rule change relating to the Corporate Contribution discussed above.

NSCC is proposing to modify Addendum K to delete all provisions associated with loss allocation and application of the Clearing Fund in connection with a loss or liability incurred by NSCC, including modifying the title of Addendum K. These provisions would no longer be necessary under the proposed rule change because the loss allocation process in its entirety would be governed by Rule 4. In addition, the current language in Addendum K regarding

allocation by System would no longer be applicable under the proposed rule change as described above. NSCC would retain the provisions in Addendum K that pertain to NSCC's guaranty and rename Addendum K "The Corporation's Guaranty." NSCC is also proposing to replace "Rules" with "Rules and Procedures" to better reflect the name of NSCC's rulebook.

(iii) Other Proposed Rule Changes

NSCC is proposing changes to Rule 1 (Definitions and Descriptions), Rule 2B (Ongoing Membership Requirements and Monitoring), Rule 4(A) (Supplemental Liquidity Deposits), Rule 13 (Exception Processing), Rule 15 (Assurances of Financial Responsibility and Operational Capability), Rule 42 (Wind-Down of a Member, Fund Member or Insurance Carrier/Retirement Services Member), Procedure III (Trade Recording Service (Interface with Qualified Clearing Agencies)), Procedure XV (Clearing Fund Formula and Other Matters), and Addendum O (Admission of Non-US Entities as Direct NSCC Members). NSCC is proposing changes to these Rules in order to conform them with the proposed changes to Rule 4 as well as to make certain technical changes to these Rules.

Specifically, NSCC is proposing to add the following defined terms to Rule 1, in alphabetical order: Actual Deposit, Average RFD, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member, Defaulting Member Event, Eligible Letter of Credit, Event Period, Insurance Deposit, Insurance Participant, Issuer, Lender, Loss Allocation Cap, Loss Allocation Notice, Loss Allocation Withdrawal Notice, Loss Allocation Withdrawal Notification Period, Mutual Fund Deposit, Mutual Fund Participant, Required Fund Deposit, Termination Date, and Voluntary Termination Notice.

NSCC is proposing to delete the defined term "The Corporation" in Rule 1 and replace it with "Corporation" in Rule 1. NSCC is proposing to replace "Required Deposits" with "Required Fund Deposits" in Rule 2B, Rule 4(A), Rule 15, Rule 42, Procedure III, and Procedure XV. NSCC is proposing to replace "Rules" with "Rules and Procedures" in Rule 1, Rule 2B, Rule 13, Rule 15, and Procedure III. NSCC is also proposing to replace "Letter of Credit" with "Eligible Letter of Credit" in Rule 42 and Addendum O.

In addition, in Section 5 of Rule 2B, NSCC proposes to change the reference to Section 8 of Rule 4 to reflect the updated section number, which would be to Section 4 of Rule 4. NSCC is also proposing conforming changes to this section to ensure that termination provisions in the Rules, whether voluntary or in response to a loss allocation, are consistent with one another to the extent appropriate.

Currently, Section 5 of Rule 2B provides that participants may elect to voluntarily retire their membership by providing NSCC with written notice of such termination. Such termination will not be effective until accepted by NSCC, which shall be evidenced by a notice to NSCC's participants announcing the participant's retirement and the effective date of the retirement, which is defined as the "Retirement Date." This section also provides that a participant's voluntary termination of membership shall not affect its obligations to NSCC.

Where appropriate, NSCC is proposing changes to align Section 5 of Rule 2B with the proposed new Section 6 of Rule 4, both of which address termination of membership.

Specifically, NSCC is proposing to rename the subheading of Section 5 of Rule 2B to “Voluntary Termination” and to change “retirement” to “termination” and “Retirement Date” to “Termination Date” throughout Section 5 of Rule 2B. NSCC is also proposing to provide that when a participant elects to voluntarily terminate its membership by providing NSCC a written notice of such termination (“Voluntary Termination Notice”), the participant must specify in its Voluntary Termination Notice a desired date for its withdrawal, provided such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to NSCC as of the time such Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC. NSCC is retaining the provision that makes it clear that the termination will not be effective until accepted by NSCC.⁵⁴ NSCC is also retaining the provision that describes NSCC’s acceptance of the termination; however, NSCC is proposing to make it clear that such acceptance, as evidenced by a notice to NSCC’s participants, would (i) be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from the participant and (ii) announce the last trade date for the participant instead of the Termination Date. In addition, NSCC is proposing to make it clear that the Termination Date would be the final settlement date of all transactions of the participant. NSCC is proposing these clarifying changes so that the Rules would align more closely with NSCC’s current practice.

As an example, Member A submits a Voluntary Termination Notice to NSCC on April 1st indicating its desired termination date is June 15th. NSCC would accept such termination request by issuing a notice to Members within 10 business days from April 1st; such notice would provide that the last trade date for Member A is June 12th, and the effective date of Member A’s NSCC membership termination would be the final settlement date of all transactions of Member A. In contrast, if Member A submits a Voluntary Termination Notice on April 1st and indicates its desired termination date is April 5th, NSCC would either (i) accept such termination notice by issuing a notice to Members on or before April 5th; such notice would provide that the last trade date for Member A is April 2nd, and the effective date of Member A’s NSCC membership termination would be the final settlement date of all transactions of Member A, or (ii) if NSCC requires additional time to process the termination, NSCC would accept such termination notice by issuing notice to Members after April 5th but still within 10 business days from April 1st; such notice would provide that the last trade date for Member A is a date after April 2nd, and the effective date of Member A’s NSCC membership termination would be the final settlement date of all transactions of Member A.

⁵⁴ Unlike the Voluntary Termination Notice, the Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4 does not require explicit acceptance by NSCC to be effective. NSCC believes that requiring explicit acceptance of the Loss Allocation Withdrawal Notice could complicate the loss allocation process and potentially result in membership withdrawal being delayed as well as detract from the objective to have NSCC know on a timely basis which Members would remain subject to the subsequent rounds of loss allocation.

NSCC is also proposing to clarify that after the close of business on the Termination Date,⁵⁵ a participant that terminates its membership shall no longer be eligible or required to submit transactions to NSCC for clearance and settlement, unless the Board of Directors determines otherwise in order to ensure an orderly liquidation of the participant's open obligations. If any transaction is submitted to NSCC by such participant that is scheduled to settle after the Termination Date, the participant's Voluntary Termination Notice would be deemed void and the participant would remain subject to the Rules as if it had not given such notice. Furthermore, NSCC is proposing to add a sentence to Section 5 of Rule 2B to refer participants to Sections 7, 13 and 14 of Rule 4, as applicable, regarding provisions on the return of a participant's Clearing Fund deposit and to specify that if an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, would supersede and void any pending Voluntary Termination Notice previously submitted by the participant. As an example, if an Event Period occurs after submission of the Voluntary Termination Notice by a Member but on or prior to the Termination Date, and the Member does not subsequently submit a Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4, then the Member would not benefit from its Loss Allocation Cap, i.e., the Member would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period that commenced on or prior to the Termination Date.

In Rule 4(A), NSCC proposes to amend Section 11 to update a cross-reference to the time period for the refund of deposits to the Clearing Fund when a Member ceases to be a participant in order to align it with proposed Section 7 of Rule 4, which would reduce the time period from 90 days to 30 calendar days. NSCC is also proposing to add a reference to Section 13 of Rule 4 in clause (c) of Section 13 of Rule 4(A) in order to specify that a Special Activity Supplemental Deposit of a Member may be used to satisfy a loss or liability as provided in such new proposed Section 13. NSCC is also proposing technical changes in Sections 2 and 13 of Rule 4(A) to reflect new proposed defined terms in the Rules.

In Rule 13, NSCC would replace "System" with "system" to reflect the proposed deletion of "System" as a defined term from Rule 4 and Addendum K. In Procedure XV, NSCC would replace "Qualified Securities Depository" with "DTC" to be consistent with the proposed change in Section 1 of Rule 4.

Member Outreach

Beginning in August 2017, NSCC conducted outreach to Members in order to provide them with advance notice of the proposed changes. As of the date of this filing, no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

⁵⁵ Account(s) of a terminating participant are generally deactivated after the close of business on the Termination Date.

Implementation Timeframe

Pending Commission approval, NSCC expects to implement this proposal within two (2) business days after approval. Members would be advised of the implementation date of this proposal through issuance of an NSCC Important Notice.

Expected Effect on Risks to the Clearing Agency, its Participants and the Market

NSCC believes that the proposed rule changes to enhance the resiliency of NSCC's loss allocation process and to shorten the time within which NSCC is required to return a former Member's Clearing Fund deposit would reduce the risk of uncertainty to NSCC, its Members and the market overall. Specifically, by modifying the calculation of NSCC's corporate contribution, NSCC would apply a mandatory fixed percentage of its General Business Risk Capital Requirement (as compared to the current Rules which provide for "no less than" a percentage of retained earnings), which would provide greater transparency and accessibility to Members as to how much NSCC would contribute in the event of a loss or liability. By modifying the application of NSCC's corporate contribution to apply to Declared Non-Default Loss Events, in addition to Defaulting Member Events, on a mandatory basis, NSCC would expand the application of its corporate contribution beyond losses and liabilities from Member impairments, which would better align the interests of NSCC with those of its Members by stipulating a mandatory application of the Corporate Contribution to a Declared Non-Default Loss Event prior to any allocation of the loss among Members. Taken together, these proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process by enhancing the calculation and application of NSCC's Corporate Contribution, which is one of the key elements of NSCC's loss allocation process. Moreover, by providing greater transparency and accessibility to Members, as stated above, the proposed rule changes regarding the Corporate Contribution, including the proposed replenishment period, would allow Members to better assess the adequacy of NSCC's loss allocation process.

By introducing the concept of an Event Period, NSCC would be able to group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days for purposes of allocating losses to Members. NSCC believes that the Event Period would provide a defined structure for the loss allocation process to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or market dislocation episode. Having this structure would enhance the overall resiliency of NSCC's loss allocation process because NSCC would be better equipped to address losses that may arise from multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would provide certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

By introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, NSCC would (i) set forth a defined amount that it would allocate to Members during each round (i.e., the round cap), (ii) advise Members of loss allocation obligation information as well as round information through the

issuance of Loss Allocation Notices, and (iii) provide Members with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process because they would enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated and enable NSCC to identify continuing Members for purposes of calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for Members a clear manner and process in which they could cap their loss allocation exposure to NSCC.

By implementing a "look-back" period to calculate a Member's loss allocation obligations and its Loss Allocation Cap, NSCC would discourage Members from reducing their settlement activity during a time of stress primarily to limit their loss allocation obligations. By determining a Member's loss allocation obligations based on the average of its Required Fund Deposit over a look-back period and its Loss Allocation Cap based on the greater of its Required Fund Deposit or the average thereof over a look-back period, NSCC would be able to calculate a Member's pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC. These proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process because they would deter Members from reducing their settlement activity during a time of stress primarily to limit their Loss Allocation Caps.

By reducing the time within which NSCC is required to return a former Member's Clearing Fund deposit, NSCC would enable firms that have exited NSCC to have access to their funds sooner than under the current Rules, while at the same time protecting NSCC and its provision of clearance and settlement services because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. As such, NSCC would maintain the requisite level of Clearing Fund deposit to ensure that it can continue to meet its clearance and settlement obligations.

Management of Identified Risks

NSCC is proposing the rule changes as described in detail above in order to enhance the resiliency of NSCC's loss allocation process and provide transparency and accessibility to Members regarding NSCC's loss allocation process.

Consistency with the Clearing Supervision Act

The proposed rule change would be consistent with Section 805(b) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act").⁵⁶ The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.⁵⁷

⁵⁶ 12 U.S.C. 5464(b).

⁵⁷ Id.

The proposed rule change would enhance the resiliency of NSCC's loss allocation process by (1) modifying the calculation and application of NSCC's corporate contribution, (2) introducing an Event Period, (3) introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implementing a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap. Together, these proposed rule changes would (i) create greater certainty for Members regarding NSCC's obligation towards a loss, (ii) more clearly specify NSCC's and Members' obligations toward a loss and balance the need to manage the risk of sequential defaults and other potential loss events against Members' need for certainty concerning their maximum exposures, and (iii) provide Members the opportunity to limit their exposure to NSCC by capping their exposure to loss allocation. Reducing the risk of uncertainty to NSCC, its Members and the market overall would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, NSCC believes that the proposed rule change to enhance the resiliency of NSCC's loss allocation process is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

By reducing the time within which NSCC is required to return a former Member's Clearing Fund deposit, NSCC would enable firms that have exited NSCC to have access to their funds sooner than under the current Rules while at the same time protecting NSCC and its provision of clearance and settlement services because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. As such, NSCC would maintain the requisite level of Clearing Fund deposit to ensure that it can continue to meet its clearance and settlement obligations. Enabling NSCC to continue to meet its clearance and settlement obligations would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, NSCC believes that this proposed rule change is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change is also consistent with Rules 17Ad-22(e)(13) and 17Ad-22(e)(23)(i), promulgated under the Act.⁵⁸ Rule 17Ad-22(e)(13) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure NSCC has the authority and operational capacity to take timely action to contain losses and continue to meet its obligations.⁵⁹ As described above, the proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back" period to calculate a Member's loss allocation obligation (which would replace the

⁵⁸ 17 CFR 240.17Ad-22(e)(13) and (e)(23)(i).

⁵⁹ 17 CFR 240.17Ad-22(e)(13).

current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken together, are designed to enhance the resiliency of NSCC's loss allocation process. Having a resilient loss allocation process would help ensure that NSCC can effectively and timely address losses relating to or arising out of either the default of one or more Members or one or more non-default loss events, which in turn would help NSCC contain losses and continue to meet its clearance and settlement obligations. Therefore, NSCC believes that the proposed rule changes to enhance the resiliency of NSCC's loss allocation process are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of NSCC's default rules and procedures.⁶⁰ The proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) improve the overall transparency and accessibility of the provisions in the Rules governing loss allocation, and (iii) make conforming and technical changes, would not only ensure that NSCC's loss allocation rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of other DTCC Clearing Agencies, but also would help to ensure that NSCC's loss allocation rules are transparent and clear to Members. Aligning the loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable Members to better understand the key aspects of NSCC's default rules and procedures and provide Members with increased predictability and certainty regarding their exposures and obligations. As such, NSCC believes that the proposed rule changes to align the loss allocation rules of the DTCC Clearing Agencies as well as to improve the overall transparency and accessibility of NSCC's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

Similarly, the proposed rule changes to NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Having clear voluntary termination provisions would enable Members to better understand NSCC's voluntary termination process and provide Members with increased predictability and certainty regarding their rights and obligations with respect to such process. As such, NSCC believes that the proposed rule changes to the voluntary termination provision are also consistent with Rule 17Ad-22(e)(23)(i) under the Act.

11. Exhibits

Exhibit 1 Not applicable.

Exhibit 1A Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 Not applicable.

⁶⁰ 17 CFR 240.17Ad-22(e)(23)(i).

Exhibit 3 Not applicable.

Exhibit 4 Changes to the Rules proposed by this Amendment.

Exhibit 5 Proposed changes to the Rules.

SR-NSCC-2017-806 Amendment No. 1

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[____]; File No. SR-NSCC-2017-806)

[DATE]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Amendment No. 1 to Advance Notice to Amend the Loss Allocation Rules and Make Other Changes

On December 18, 2017, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) an advance notice SR-NSCC-2017-806 (“Advance Notice”) pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)¹ and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”).² The Advance Notice was published in the Federal Register on January 30, 2018.³ Notice is hereby given that on June __, 2018, NSCC filed with the Commission Amendment No. 1 to the Advance Notice, as described in Items I, II and III below, which Items have been prepared by the clearing agency.⁴ Amendment No. 1 supersedes and replaces the

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ See Securities Exchange Act Release No. 82584 (January 24, 2018), 83 FR 4377 (January 30, 2018) (SR-NSCC-2017-806).

⁴ On December 18, 2017, NSCC filed the Advance Notice as a proposed rule change (SR-NSCC-2017-018) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder, 17 CFR 240.19b-4. The proposed rule change was published in the Federal Register on January 8, 2018. See Securities Exchange Act Release No. 82428 (January 2, 2018), 83 FR

Advance Notice in its entirety. The Commission is publishing this notice to solicit comments on Amendment No. 1 to the Advance Notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This Advance Notice consists of proposed modifications to NSCC's Rules and Procedures ("Rules") in order to amend provisions in the Rules regarding loss allocation as well as make other changes, as described in greater detail below.⁵

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the Advance Notice and discussed any comments it received on the Advance Notice. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections A and B below, of the most significant aspects of such statements.

897 (January 8, 2018) (SR-NSCC-2017-018). On June __, 2018, NSCC filed with the Commission Amendment No. 1 to the proposed rule change, which supersedes and replaces the proposed rule change in its entirety. A copy of Amendment No. 1 to the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

⁵ Capitalized terms not defined herein are defined in the Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

Written comments relating to this proposal have not been solicited or received.

NSCC will notify the Commission of any written comments received by NSCC.

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

Description of Amendment No. 1

This filing constitutes Amendment No. 1 (“Amendment”) to Advance Notice previously filed by NSCC on December 18, 2017.⁶ This Amendment amends and replaces the Advance Notice in its entirety. NSCC submits this Amendment in order to further clarify the operation of the proposed rule changes on loss allocation by providing additional information and examples. In particular, this Amendment would:

- (i) Clarify which Members would be subject to loss allocation with respect to Defaulting Member Events (as defined below and in the proposed rule change) and Declared Non-Default Loss Events (as defined below and in the proposed rule change) occurring during an Event Period (as defined below and in the proposed rule change). Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member (as

⁶ See Securities Exchange Act Release No. 82584 (January 24, 2018), 83 FR 4377 (January 30, 2018) (SR-NSCC-2017-806).

defined below and in the proposed rule change)) and each Declared Non-Default Loss Event occurring during the Event Period. Proposed Section 4 of Rule 4 would also make it clear that any Member for which NSCC ceases to act on a non-business day, triggering an Event Period that commences on the next business day, would be deemed to be a Member on the first day of that Event Period.

- (ii) Clarify the obligations and Loss Allocation Cap (as defined below and in the proposed rule change) of a Member that withdraws from membership in respect of a loss allocation round. Specifically, pursuant to the Amendment, proposed Section 6 of Rule 4 would provide that the Member would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap as fixed in the round for which it withdrew.
- (iii) Clarify that a Member would be obligated to NSCC for all losses and liabilities incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to the Member. Specifically, pursuant to the Amendment, proposed Section 4 of Rule 4 would provide that each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member.

- (iv) Clarify that, although a Defaulting Member would not be allocated a ratable share of losses and liabilities arising out of or relating to its own Defaulting Member Event, it would remain obligated to NSCC for all such losses and liabilities. Specifically, pursuant to the Amendment, proposed Section 10 of Rule 4 would provide that no loss allocation under Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any loss or liability to which the Member is subject under the Rules, including, without limitation, any loss or liability to which it may be subject under Rule 4.

In addition, pursuant to the Amendment, NSCC is making other clarifying and technical changes to the proposed rule change, as proposed herein.

Nature of the Proposed Change

The primary purpose of this proposed rule change is to amend NSCC's loss allocation rules in order to enhance the resiliency of NSCC's loss allocation process so that NSCC can take timely action to address multiple loss events that occur in succession during a short period of time (defined and explained in detail below). In connection therewith, the proposed rule change would (i) align the loss allocation rules of the three clearing agencies of The Depository Trust & Clearing Corporation ("DTCC"), namely The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC") (including the Government Securities Division ("FICC/GSD") and the Mortgage-Backed Securities Division ("FICC/MBSD")), and NSCC (collectively, the "DTCC Clearing Agencies"), so as to provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing

Agencies, (ii) increase transparency and accessibility of the loss allocation rules by enhancing their readability and clarity, (iii) reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit, (iv) increase clarity of the voluntary termination provisions, and (v) make conforming and technical changes.

(i) Background

Central counterparties ("CCPs") play a key role in financial markets by mitigating counterparty credit risk on transactions between market participants. CCPs achieve this by providing guaranties to participants and, as a consequence, are typically exposed to credit risks that could lead to default losses. In addition, in performing its critical functions, a CCP could be exposed to non-default losses that are otherwise incident to the CCP's clearance and settlement business.

A CCP's rulebook should provide a complete description of how losses would be allocated to participants if the size of the losses exceeded the CCP's pre-funded resources. Doing so provides for an orderly allocation of losses, and potentially allows the CCP to continue providing critical services to the market and thereby results in significant financial stability benefits. In addition, a clear description of the loss allocation process offers transparency and accessibility to the CCP's participants.

Current NSCC Loss Allocation Process

As a CCP, NSCC's loss allocation process is a key component of its risk management process. Risk management is the foundation of NSCC's ability to guarantee settlement, as well as the means by which NSCC protects itself and its Members from the risks inherent in the clearance and settlement process. NSCC's risk management process must account for the fact that, in certain extreme circumstances, the collateral and other

financial resources that secure NSCC's risk exposures may not be sufficient to fully cover losses resulting from the liquidation of the portfolio of a Member for whom NSCC has ceased to act.⁷

The Rules currently provide for a loss allocation process through which both NSCC (by applying no less than 25% of its retained earnings in accordance with Addendum E) and its Members would share in the allocation of a loss resulting from the default of a Member for whom NSCC has ceased to act pursuant to the Rules. The Rules also recognize that NSCC may incur losses outside the context of a defaulting Member that are otherwise incident to NSCC's clearance and settlement business.

NSCC's loss allocation rules currently provide that in the event NSCC ceases to act for a Member, the amounts on deposit to the Clearing Fund from the defaulting Member, along with any other resources of, or attributable to, the defaulting Member that NSCC may access under the Rules (e.g., payments from Clearing Agency Cross-Guaranty Agreements), are the first source of funds NSCC would use to cover any losses that may result from the closeout of the defaulting Member's guaranteed positions. If these amounts are not sufficient to cover all losses incurred, then NSCC will apply the following available resources, in the following loss allocation waterfall order:

⁷ When NSCC restricts a Member's access to services generally, NSCC is said to have "ceased to act" for the Member. Rule 46 (Restrictions on Access to Services) sets out the circumstances under which NSCC may cease to act for a Member, and Rule 18 (Procedures for When the Corporation Declines or Ceases to Act) sets out the types of actions NSCC may take when it ceases to act for a Member. Supra note 5.

First, as provided in Addendum E, NSCC's corporate contribution of at least 25 percent of NSCC's retained earnings existing at the time of a Member impairment, or such greater amount as the Board of Directors may determine; and Second, if a loss still remains, as and in the manner provided in Rule 4, the required Clearing Fund deposits of Members who are non-defaulting Members on the date of default.

Pursuant to current Section 5 of Rule 4, if, as a result of applying the Clearing Fund deposit of a Member, the Member's actual Clearing Fund deposit is less than its Required Deposit, it will be required to eliminate such deficiency in order to satisfy its Required Deposit amount. Pursuant to current Section 4 of Rule 4, Members can also be assessed for non-default losses incident to the operation of the clearance and settlement business of NSCC. Pursuant to current Section 8 of Rule 4, Members may withdraw from membership within specified timeframes after a loss allocation charge to limit their obligation for future assessments.

Overview of the Proposed Rule Changes

A. Changes to Enhance Resiliency of NSCC's Loss Allocation Process

In order to enhance the resiliency of NSCC's loss allocation process, NSCC proposes to change the manner in which each of the aspects of the loss allocation waterfall described above would be employed. NSCC would retain the current core loss allocation process following the application of the defaulting Member's resources, i.e., first, by applying NSCC's corporate contribution, and second, by pro rata allocations to Members. However, NSCC would clarify or adjust certain elements and introduce certain new loss allocation concepts, as further discussed below. In addition, the

proposed rule change would address the loss allocation process as it relates to losses arising from or relating to multiple default or non-default events in a short period of time, also as described below.

Accordingly, NSCC is proposing five (5) key changes to enhance NSCC's loss allocation process:

- (1) Changing the calculation and application of NSCC's corporate contribution.

As stated above, Addendum E currently provides that NSCC will contribute no less than 25% of its retained earnings (or such higher amount as the Board of Directors shall determine) to a loss or liability that is not satisfied by the impaired Member's Clearing Fund deposit. Under the proposal, NSCC would amend the calculation of its corporate contribution from a percentage of its retained earnings to a mandatory amount equal to 50% of the NSCC General Business Risk Capital Requirement.⁸ NSCC's General Business Risk Capital Requirement, as defined in NSCC's Clearing Agency Policy on Capital Requirements,⁹ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.¹⁰

⁸ NSCC calculates its General Business Risk Capital Requirement as the amount equal to the greatest of (i) an amount determined based on its general business profile, (ii) an amount determined based on the time estimated to execute a recovery or orderly wind-down of NSCC's critical operations, and (iii) an amount determined based on an analysis of NSCC's estimated operating expenses for a six (6) month period.

⁹ See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-NSCC-2017-004).

¹⁰ 17 CFR 240.17Ad-22(e)(15).

The proposed Corporate Contribution (as defined in the proposed rule change) would be held in addition to NSCC's General Business Risk Capital Requirement.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than those from Member impairments. Under the proposal, NSCC would apply its corporate contribution to non-default losses as well. The proposed Corporate Contribution would apply to losses arising from Defaulting Member Events and Declared Non-Default Loss Events (as such terms are defined below and in the proposed rule change), and would be a mandatory contribution by NSCC prior to any allocation of the loss among NSCC's Members.¹¹ As proposed, if the Corporate Contribution is fully or partially used against a loss or liability relating to an Event Period, the Corporate Contribution would be reduced to the remaining unused amount, if any, during the following two hundred fifty (250) business days¹² in order to permit NSCC to replenish the Corporate Contribution.¹³ To ensure transparency, Members would receive notice of any such reduction to the Corporate Contribution.

¹¹ The proposed rule change would not require a Corporate Contribution with respect to the use of the Clearing Fund as a liquidity resource; however, if NSCC uses the Clearing Fund as a liquidity resource for more than 30 calendar days, as set forth in proposed Section 2 of Rule 4, then NSCC would have to consider the amount used as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and allocate the loss pursuant to proposed Section 4 of Rule 4, which would then require the application of a Corporate Contribution.

¹² Rule 1 defines "business day" as "any day on which the Corporation is open for business. However, on any business day that banks or transfer agencies in New York State are closed or a Qualified Securities Depository is closed, no deliveries of securities and no payments of money shall be made through the facilities of the Corporation." Supra note 5.

¹³ NSCC believes that two hundred and fifty (250) business days would be a reasonable estimate of the time frame that NSCC would require to replenish the Corporate Contribution by equity in accordance with NSCC's Clearing Agency

As compared to the current approach of applying “no less than” a percentage of retained earnings to defaulting Member losses, the proposed Corporate Contribution would be a fixed percentage of NSCC’s General Business Risk Capital Requirement, which would provide greater transparency and accessibility to Members. The proposed Corporate Contribution would apply not only towards losses and liabilities arising out of or relating to Defaulting Member Events but also those arising out of or relating to Declared Non-Default Loss Events, which is consistent with the current industry guidance that “a CCP should identify the amount of its own resources to be applied towards losses arising from custody and investment risk, to bolster confidence that participants’ assets are prudently safeguarded.”¹⁴

Under the current Addendum E, NSCC has the discretion to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as result of a Member’s impairment. This option would be retained and expanded under the proposal so that it would be clear that NSCC can voluntarily apply amounts greater than the Corporate Contribution against any loss or liability (including non-default losses) of NSCC, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Policy on Capital Requirements, including a conservative additional period to account for any potential delays and/or unknown exigencies in times of distress.

¹⁴ See Resilience of central counterparties (CCPs): Further guidance on the PFMI, issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, at 42 (July 2017), available at www.bis.org/cpmi/publ/d163.pdf.

The proposed rule changes relating to the calculation and application of the Corporate Contribution are set forth in proposed Sections 4 and 5 of Rule 4, as further described below.

(2) Introducing an Event Period.

In order to clearly define the obligations of NSCC and its Members regarding loss allocation and to balance the need to manage the risk of sequential loss events against Members' need for certainty concerning their maximum loss allocation exposures, NSCC is proposing to introduce the concept of an "Event Period" to the Rules to address the losses and liabilities that may arise from or relate to multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Specifically, the proposal would group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days ("Event Period") for purposes of allocating losses to Members in one or more rounds (as described below), subject to the limitations of loss allocation set forth in the proposed rule change and as explained below.¹⁵ In the case of a loss or liability arising from or relating to a Defaulting Member Event, an Event Period would begin on the day NSCC notifies Members that it has ceased to act¹⁶ for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a loss or liability arising from or relating to a Declared Non-

¹⁵ NSCC believes that having a ten (10) business day Event Period would provide a reasonable period of time to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or a severe market dislocation episode, while still providing appropriate certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

¹⁶ Supra note 7.

Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period. An Event Period may include both Defaulting Member Events and Declared Non-Default Loss Events, and there would not be separate Event Periods for Defaulting Member Events or Declared Non-Default Loss Events occurring during overlapping ten (10) business day periods.

The amount of losses that may be allocated by NSCC, subject to the required Corporate Contribution, and to which a Loss Allocation Cap would apply for any Member that elects to withdraw from membership in respect of a loss allocation round, would include any and all losses from any Defaulting Member Events and any Declared Non-Default Loss Events during the Event Period, regardless of the amount of time, during or after the Event Period, required for such losses to be crystallized and allocated.¹⁷

¹⁷ As discussed below, each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period.

The proposed rule changes relating to the implementation of an Event Period are set forth in proposed Section 4 of Rule 4, as further described below.

(3) Introducing the concept of “rounds” and Loss Allocation Notice.

Pursuant to the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

Each loss allocation would be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.¹⁸ The “Loss Allocation Cap” of a Member would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

¹⁸ Pursuant to the current Section 8 of Rule 4, the time period for a participant to give notice of its election to terminate its business with NSCC in respect of a pro rata charge is ten (10) business days after receiving notice of a pro rata charge. Supra note 5.

NSCC believes that it is appropriate to shorten such time period from ten (10) business days to five (5) business days because NSCC needs timely notice of which Members would remain in its membership for purposes of calculating the loss allocation for any subsequent round. NSCC believes that five (5) business days would provide Members with sufficient time to decide whether to cap their loss allocation obligations by withdrawing from their membership in NSCC.

The amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

For example, for illustrative purposes only, after the required Corporate Contribution, if NSCC has a \$5 billion loss determined with respect to an Event Period and the sum of Loss Allocation Caps for all Members subject to the loss allocation is \$4 billion, the first round would begin when NSCC issues the first Loss Allocation Notice for that Event Period. NSCC could issue one or more Loss Allocation Notices for the first round until the sum of losses allocated equals \$4 billion. Once the \$4 billion is allocated, the first round would end and NSCC would need a second round in order to allocate the remaining \$1 billion of loss. NSCC would then issue a Loss Allocation Notice for the \$1 billion and this notice would be the first Loss Allocation Notice for the second round. The issuance of the Loss Allocation Notice for the \$1 billion would begin the second round.

The proposed rule change would link the Loss Allocation Cap to a round in order to provide Members the option to limit their loss allocation exposure at the beginning of each round. As proposed and as described further below, a Member could limit its loss allocation exposure to its Loss Allocation Cap by providing notice of its election to withdraw from membership within five (5) business days after the issuance of the first Loss Allocation Notice in any round.

The proposed rule changes relating to the implementation of “rounds” and Loss Allocation Notices are set forth in proposed Section 4 of Rule 4, as further described below.

- (4) Implementing a “look-back” period to calculate a Member’s loss allocation pro rata share and its Loss Allocation Cap.

Currently, the Rules calculate a Member’s pro rata share for purposes of loss allocation based on the Member’s “allocation for a System,” which in turn is based on settlement dollar amounts. Therefore, a Member’s loss allocation obligations are currently based on the Member’s activity in each of the various services or “Systems” offered by NSCC.¹⁹ The Rules do not anticipate the possibility of more than one Defaulting Member Event or Declared Non-Default Loss Event in quick succession.

Given NSCC’s risk-based margining methodology, NSCC believes that it would be more appropriate to determine a Member’s pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC, which is represented by the Member’s Required Deposit (NSCC is proposing that “Required Deposits” be renamed “Required Fund Deposits,” as described below). Accordingly, NSCC is proposing to calculate each Member’s pro rata share of losses and liabilities to be allocated in any round (as described above and in the proposed rule change) to be equal to (i) the Member’s Average RFD divided by (ii) the sum of Average RFD amounts for all Members that are subject to loss allocation in such round.

¹⁹ NSCC’s current loss allocation rules pre-date NSCC’s move to a risk-based margining methodology.

Additionally, as described above and in the proposed rule change, if a Member withdraws from membership pursuant to proposed Section 6 of Rule 4, NSCC is proposing that the Member's Loss Allocation Cap be equal to the greater of (i) its Required Fund Deposit on the first day of the applicable Event Period or (ii) its Average RFD.

NSCC believes that employing a backward-looking average to calculate a Member's loss allocation pro rata share and Loss Allocation Cap would disincentivize Member behavior that could heighten volatility or reduce liquidity in markets in the midst of a financial crisis. Specifically, the proposed look-back period would discourage a Member from reducing its settlement activity during a time of stress primarily to limit its loss allocation pro rata share, which, as proposed, would now be based on the Member's average settlement activity over the look-back period rather than its settlement activity at a point in time that the Member may not be able to estimate. Similarly, NSCC believes that taking a backward-looking average into consideration when determining a Member's Loss Allocation Cap would also deter a Member from reducing its settlement activity during a time of stress primarily to limit its Loss Allocation Cap.

NSCC believes that having a look-back period of seventy (70) business days is appropriate, because it would be long enough to enable NSCC to capture a full calendar quarter of a Member's activities, including quarterly option expirations, and smooth out the impact from any abnormalities and/or arbitrariness that may have occurred, but not too long that the Member's business strategy and outlook could have shifted significantly, resulting in material changes to the size of its portfolios.

The proposed rule changes relating to the implementation of a look-back period are set forth in proposed Section 4 of Rule 4, as further described below.

(5) Capping withdrawing Members' loss allocation exposure and related changes.

NSCC's current loss allocation rules allow a Member to withdraw if the Member notifies NSCC, within ten (10) business days after receipt of notice of a pro rata charge, of its election to terminate its membership and thereby avail itself of a cap on loss allocation, which is its Required Deposit as fixed immediately prior to the time of the pro rata charge. As discussed above, the proposed rule change would continue providing Members the opportunity to limit their loss allocation exposure by offering withdrawal options; however, the cap on loss allocation would be calculated differently and the associated withdrawal process would also be modified as it relates to withdrawals associated with the loss allocation process. In particular, the proposed rule change would shorten the withdrawal notification period from ten (10) business days to five (5) business days, and would also change the beginning of such notification period from the receipt of the notice of a pro rata charge to the issuance of the notice, as further described below.

As proposed, if a Member timely provides notice of its withdrawal from membership in respect of a loss allocation round, the maximum amount of losses it would be responsible for would be its Loss Allocation Cap,²⁰ provided that the Member complies with the requirements of the withdrawal process in proposed Section 6 of Rule 4.²¹

Currently, NSCC's loss allocation provisions provide that if a pro rata charge is made against a Member's actual Clearing Fund deposit, and as result thereof the Member's deposit is less than its Required Deposit, the Member will, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. To increase transparency of the timeframe under which NSCC would require funds from Members to satisfy their loss allocation obligations, NSCC is proposing that Members would receive two (2) business days' notice of a loss allocation, and Members would be required to pay the requisite amount no later than the second business day following issuance of such notice.²² Members would have five (5) business

²⁰ If a Member's Loss Allocation Cap exceeds the Member's then-current Required Fund Deposit, it must still cover the excess amount.

²¹ For the avoidance of doubt, pursuant to Section 13(d) of Rule 4(A) (Supplemental Liquidity Deposits), a Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any pro rata charge pursuant to Section 4 of Rule 4. Supra note 5.

²² NSCC believes that allowing Members two (2) business days to satisfy their loss allocation obligations would provide Members sufficient notice to arrange funding, if necessary, while allowing NSCC to address losses in a timely manner.

days²³ from the issuance of the first Loss Allocation Notice in any round of an Event Period to decide whether to withdraw from membership.²⁴

Each round would allow a Member the opportunity to notify NSCC of its election to withdraw from membership after satisfaction of the losses allocated in such round. Multiple Loss Allocation Notices may be issued with respect to each round to allocate losses up to the round cap.

Specifically, the first round and each subsequent round of loss allocation would allocate losses up to a round cap of the aggregate of all Loss Allocation Caps of those Members included in the round. If a Member provides notice of its election to withdraw from membership, it would be subject to loss allocation in that round, up to its Loss Allocation Cap. If the first round of loss allocation does not fully cover NSCC's losses, a second round will be noticed to those Members that did not elect to withdraw from membership in the previous round; however, as noted above, the amount of any second or subsequent round cap may differ from the first or preceding round cap because there may be fewer Members in a second or subsequent round if Members elect to withdraw from membership with NSCC as provided in proposed Section 6 of Rule 4 following the first Loss Allocation Notice in any round.

²³ Supra note 18.

²⁴ NSCC believes that setting the start date of the withdrawal notification period to the date of issuance of a notice would provide a single withdrawal timeframe that would be consistent across the Members.

Pursuant to the proposed rule change, in order to avail itself of its Loss Allocation Cap, a Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member must: (i) specify in its Loss Allocation Withdrawal Notice (as defined below and in the proposed rule change) an effective date of withdrawal, which date shall be no later than ten (10) business days following the last day of the applicable Loss Allocation Withdrawal Notification Period (as defined below and in the proposed rule change) (i.e., no later than ten (10) business days after the 5th business day following the first Loss Allocation Notice in that round of loss allocation),²⁵ (ii) cease all activity that would result in transactions being submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member's withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully and finally settled by the effective date of the Member's withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

As proposed, a Member that withdraws in compliance with proposed Section 6 of Rule 4 would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under Rule 4; however, its aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

²⁵ NSCC believes that having an effective date of withdrawal that is not later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period would provide Members with a reasonable period of time to wind down their activities at NSCC while minimizing any uncertainty typically associated with a longer withdrawal period.

The proposed rule changes are designed to enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated. To the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

The proposed rule changes relating to capping withdrawing Members' loss allocation exposure and related changes to the withdrawal process are set forth in proposed Sections 4 and 6 of Rule 4, as further described below.

B. Changes to Align Loss Allocation Rules

The proposed rule changes would align the loss allocation rules, to the extent practicable and appropriate, of the three DTCC Clearing Agencies so as to provide consistent treatment, especially for firms that are participants of two or more DTCC Clearing Agencies. As proposed, the loss allocation waterfall and certain related provisions, e.g., returning a former Member's Clearing Fund, would be consistent across the DTCC Clearing Agencies to the extent practicable and appropriate. The proposed rule changes of NSCC that would align loss allocation rules of the DTCC Clearing Agencies are set forth in proposed Sections 1, 2, 7, and 12 of Rule 4, as further described below.

C. Clarifying Changes Relating to Loss Allocation

The proposed rule changes are intended to make the provisions in the Rules governing loss allocation more transparent and accessible to Members. In particular,

NSCC is proposing the following changes relating to loss allocation to clarify Members' obligations for Declared Non-Default Loss Events.

Aside from losses that NSCC might face as a result of a Defaulting Member Event, NSCC could incur non-default losses incident to its clearance and settlement business.²⁶ The Rules currently permit NSCC to apply Clearing Fund to non-default losses. Specifically, pursuant to Section 2(b) of Rule 4,²⁷ NSCC can use the Clearing Fund to satisfy losses or liabilities of NSCC incident to the operation of the clearance and settlement business of NSCC. Section II of Addendum K provides additional details regarding the application of the Clearing Fund to losses outside of a System.

If there is a failure of NSCC following a non-default loss, such occurrence would affect Members in much the same way as a failure of NSCC following a Defaulting Member Event. Accordingly, NSCC is proposing rule changes to enhance the provisions relating to non-default losses by clarifying Members' obligations for such losses.

Specifically, NSCC is proposing enhancement of the governance around non-default losses that would trigger loss allocation to Members by specifying that the Board of Directors would have to determine that there is a non-default loss that may be a significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among the Members in order to ensure that NSCC may

²⁶ Non-default losses may arise from events such as damage to physical assets, a cyber-attack, or custody and investment losses.

²⁷ Section 2(b) of Rule 4 provides that "the use of the Clearing Fund...shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses and liabilities of a System." Supra note 5.

continue to offer clearance and settlement services in an orderly manner. The proposed rule change would provide that NSCC would then be required to promptly notify Members of this determination, which is referred to in the proposed rule as a Declared Non-Default Loss Event. In addition, NSCC is proposing to better align the interests of NSCC with those of its Members by stipulating a mandatory Corporate Contribution apply to a Declared Non-Default Loss Event prior to any allocation of the loss among Members, as described above. Additionally, NSCC is proposing language to clarify Members' obligations for Declared Non-Default Loss Events.

The proposed rule changes relating to Declared Non-Default Loss Events and Members' obligations for such events are set forth in proposed Section 4 of Rule 4, as further described below.

D. Reduce the time within which NSCC is required to return a former Member's Clearing Fund deposit

The proposed rule change would reduce the time period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.

NSCC believes that shortening the time period for the return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they

could have use of the deposits sooner than under the current Rules while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied, which would include both matured as well as contingent obligations.

The proposed rule changes relating to the reduced time period in which NSCC is required to return the Clearing Fund deposit of a former Member are set forth in proposed Section 7 of Rule 4, as further described below.

The foregoing changes as well as other changes (including a number of conforming and technical changes) that NSCC is proposing in order to improve the transparency and accessibility of the Rules are described in detail below.

E. Loss Allocation Waterfall Comparison

The following example²⁸ illustrates the differences between the current and proposed loss allocation provisions:

Assumptions:

- (i) Member A defaults on a business day (Day 1). On the same day, NSCC ceases to act for Member A and notifies Members of the cease to act. After liquidating Member A's portfolio and applying Member A's Clearing Fund deposit, NSCC has a loss of \$350 million.

²⁸ For purposes of this example, NSCC has assumed that the losses occurred with guaranteed CNS activity of Members, and NSCC allocated all such Members' deposits to the Clearing Fund to CNS activity (which is typically more than 99% of the NSCC daily gross settlement amount).

- (ii) Member X voluntarily retires from membership five (5) business days after NSCC ceases to act for Member A (Day 6).
- (iii) Member B defaults seven (7) business days after NSCC ceases to act for Member A (Day 8). On the same day, NSCC ceases to act for Member B and notifies Members of the cease to act. After liquidating Member B's portfolio and applying Member B's Clearing Fund deposit, NSCC has a loss of \$350 million.
- (iv) The current NSCC loss provisions require NSCC to contribute no less than 25% of its retained earnings as a corporate contribution. For the purposes of this example, it is assumed that NSCC will contribute 25% of its retained earnings. The amount of NSCC's retained earnings is \$416 million.
- (v) NSCC's General Business Risk Capital Requirement is \$154 million.

Current Loss Allocation:

Under the current loss allocation provisions, with respect to the losses arising out of Member A's default, NSCC will contribute \$104 million ($\$416 \text{ million} * 25\%$) from retained earnings and then allocate the remaining loss of \$246 million ($\$350 \text{ million} - \104 million) to Members.

With respect to losses arising out of Member B's default, NSCC will contribute \$78 million ($(\$416 \text{ million} - \$104 \text{ million}) * 25\%$) from retained earnings and then

allocate the remaining loss of \$272 million (\$350 million - \$78 million) to Members. Because Member X voluntarily retired before NSCC ceased to act for Member B, Member X is not subject to loss allocation with respect to losses arising out of Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC will contribute \$182 million of retained earnings and will allocate losses of \$518 million to Members.

Proposed Loss Allocation:

Under the proposed loss allocation provisions, a Defaulting Member Event with respect to Member A's default would have occurred on Day One, and a Defaulting Member Event with respect to Member B's default would have occurred on Day 8. Because the Defaulting Member Events occurred during a 10-business day period, they would be grouped together into an Event Period for purposes of allocating losses to Members. The Event Period would begin on the 1st business day and end on the 10th business day.

With respect to losses arising out of Member A's default, NSCC would apply a Corporate Contribution of \$77 million ($\$154 \text{ million} * 50\%$) and then allocate the remaining loss of \$273 million ($\$350 \text{ million} - \77 million) to Members. With respect to losses arising out of Member B's default, NSCC would not apply a Corporate Contribution since it would have already contributed the maximum Corporate Contribution of 50% of its General Business Risk Capital Requirement. NSCC would allocate the losses of \$350 million arising out of Member B's default to Members. Because Member X was a Member on the first day of the Event Period, Member X would

be subject to loss allocation with respect to all events occurring during the Event Period, even if the event occurred after its retirement. Therefore, Member X would be subject to loss allocation with respect to Member B's default.

Altogether, with respect to losses arising out of defaults of Member A and Member B, NSCC would apply a Corporate Contribution of \$77 million and would allocate losses of \$623 million to Members. The principal differences in the above example are due to (i) the proposed changes to the calculation and application of the Corporate Contribution and (ii) the proposed introduction of an Event Period.

(ii) Detailed Description of the Proposed Rule Changes Related to Loss Allocation

A. Proposed Changes to Rule 4 (Clearing Fund)

Overview of Rule 4 (Clearing Fund)

Rule 4 currently addresses Clearing Fund requirements and loss allocation obligations. While Procedure XV addresses the various Clearing Fund calculations, Rule 4 sets forth rights, obligations and other aspects associated with the Clearing Fund, as well as the loss allocation process. Rule 4 is currently organized into 12 sections. NSCC is proposing changes to each section, and consolidating provisions in Rule 4 relating to Mutual Fund Services and Insurance and Retirement Processing Services into new sections, as described below.

Section 1

Section 1 of Rule 4 currently sets forth the requirement that each Member and Mutual Fund/Insurance Services Member shall, and each Fund Member and Insurance Carrier/Retirement Services Member may, be required to make a deposit to the Clearing Fund. Section 1 currently provides that each participant's Required Deposit is based on

one or more formulas specified by NSCC's Board of Directors. The basis of each such formula is participants' usage of NSCC's facilities. Section 1 also currently sets forth the minimum amount of each participant category's Required Deposit.

Current Section 1 allows a portion of a participant's Clearing Fund deposit to be evidenced by an open account indebtedness secured by Eligible Clearing Fund Securities, subject to certain limitations set forth in Procedure XV, and sets forth the various requirements associated with the deposit of Eligible Clearing Fund Securities. Current Section 1 also permits NSCC to require participants to post a letter of credit where NSCC believes the participants present legal risk.

Current Section 1 also provides that NSCC allocate the Clearing Fund by types of service (e.g., Mutual Fund Services) as well as by Systems (e.g., CNS), and divide the Clearing Fund into separate "Allocations" for each such service and separate "Funds" for each such System.

Under the proposed rule change, NSCC is proposing to add a subheading of "Required Fund Deposits" to Section 1 and restructure Section 1 so that it applies to Members only and delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Section 1.²⁹ Provisions of Rule 4 regarding Mutual Fund/Insurance Services Members and Fund Members would be covered in a new proposed Section 13 to Rule 4, discussed below.

²⁹ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members from Sections 2, 3, 4, 5, 6, 7, 8, 9, and 12 of Rule 4.

Provisions of Rule 4 regarding Insurance Carrier/Retirement Services Members would be covered in a new proposed Section 14 to Rule 4, discussed below.

Under the proposed rule change, Section 1 would continue to have the same provisions as they relate to Members except for the following: (i) the language throughout the section would be reorganized, streamlined and clarified, (ii) “Required Deposits” would be renamed “Required Fund Deposits,”³⁰ which is a more descriptive term to refer to Members’ deposits required for the Clearing Fund, and would harmonize with the rules of FICC/GSD and FICC/MBSD³¹ and the term used in such rules,³² (iii) a sentence would be added regarding additional deposits maintained by the Members at NSCC, (iv) the provision regarding the Clearing Fund being allocated by Systems and services would be deleted,³³ and (v) change “Rules” to “Rules and Procedures” to better reflect the name of NSCC’s rulebook.³⁴

The proposed sentence regarding additional deposits to the Clearing Fund would permit Members to post such additional deposits at their discretion and would make clear

³⁰ In addition to Section 1 of Rule 4, NSCC is proposing to rename “Required Deposits” to “Required Fund Deposits” in Sections 2, 3, 4, 8, 9, and 11 of Rule 4.

³¹ FICC/GSD Rulebook (“FICC/GSD Rules”), available at http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf and FICC/MBSD Clearing Rules (“FICC/MBSD Rules”), available at http://dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf.

³² See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 31.

³³ In addition to Section 1 of Rule 4, NSCC is proposing to delete references to the Clearing Fund being allocated by Systems and services from Sections 2, 3, and 4 of Rule 4.

³⁴ In addition to Section 1 of Rule 4, NSCC is proposing to change “Rules” to “Rules and Procedures” in Sections 9 and 12 of Rule 4.

that such additional deposits would be deemed to be part of the Clearing Fund and the Member's Actual Deposit (as discussed below and as defined in the proposed rule change) but would not be deemed to be part of the Member's Required Fund Deposit.

NSCC proposes to add language in Section 1 to make it clear that each Member would grant NSCC a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure the Member's open account indebtedness or placed by the Member in NSCC's possession (or its agents acting on its behalf) to secure all such Member's obligations to NSCC, and that NSCC would be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The additional language would further harmonize the Rules with language used in the FICC/GSD Rules and FICC/MBSD Rules,³⁵ thus providing consistent treatment of pledged resources for firms that are members of both NSCC and FICC.

NSCC proposes to clarify the language in footnote 2 of Section 1. In addition, NSCC proposes to add "Eligible Letter of Credit" as a defined term to refer to letters of credit posted by participants if required by NSCC,³⁶ which would harmonize the term

³⁵ See Section 4 of FICC/GSD Rule 4 and Section 4 of FICC/MBSD Rule 4, supra note 31.

³⁶ In addition to Section 1 of Rule 4, NSCC is also proposing to rename "Letter of Credit" to "Eligible Letter of Credit" in Sections 2 and 12 of Rule 4.

with the term used in the FICC/GSD Rules and FICC/MBSD Rules,³⁷ thus providing consistent terminology for firms that are members of both NSCC and FICC.

Similarly, NSCC proposes to add “Actual Deposit” as a defined term in Section 1 to refer to Eligible Clearing Fund Securities, funds and assets pledged to NSCC to secure a Member’s open account indebtedness or placed by a Member in the possession of NSCC (or its agents acting on its behalf) and any Eligible Letters of Credit issued on behalf of a Member in favor of NSCC.

Instead of requiring participants to pledge Eligible Clearing Fund Securities to NSCC’s account at a Qualified Securities Depository designated by the participants, NSCC proposes to clarify and streamline Section 1 of proposed Rule 4 to provide that Eligible Clearing Fund Securities pledged to secure a Member’s open account indebtedness would be delivered to NSCC’s account at DTC.

NSCC would delete the provision regarding allocation of the Clearing Fund by Systems and services, as this provision is no longer relevant under the proposed rule change. Provisions relating to Mutual Fund Services and Insurance and Retirement Processing Services in Section 1 (as well as other sections in Rule 4) would be consolidated in the proposed new Sections 13 and 14, entitled “Mutual Fund Deposits” and “Insurance Deposits,” respectively.

To consolidate provisions regarding the maintenance, investment and permitted use of Clearing Fund, NSCC would move the last paragraph of Section 1 about

³⁷ See FICC/GSD Rule 1 (Definitions) and FICC/MBSD Rule 1 (Definitions), supra note 31.

segregation and maintenance of Clearing Fund (again, in terms of “Fund,” “System,” and “Allocation,” as discussed above) to Section 2.

In addition, NSCC proposes to correct a typographical error in the reference to a footnote in Section 1 of Rule 4. Specifically, there is an incorrect reference to footnote 22 in the second paragraph of Section 1 in current Rule 4. NSCC is proposing to change this reference to reflect the correct footnote, which is footnote 2.

Section 2

Section 2 of Rule 4 currently covers the permitted uses of the Clearing Fund (again by “Fund” and “Allocation,” as set forth in current Section 1), including the investment of Clearing Fund Cash and Cash Receipts, as well as participants’ rights to any interest earned or paid on pledged Eligible Clearing Fund Securities or cash deposits.

NSCC is proposing to add a subheading of “Permitted Use, Investment, and Maintenance of Clearing Fund Assets” to Section 2 and restructure Section 2 so that it applies to Members only. NSCC is also proposing to restructure Section 2 so that the permitted use of Clearing Fund appears first, then the investment of Clearing Fund, followed by maintenance of Clearing Fund.

Under the proposed rule change, the permitted use of Clearing Fund paragraph would continue to have the same provisions as they relate to how the Clearing Fund can be used by NSCC, except the provisions would be streamlined and clarified. Specifically, in order to be consistent with the proposed change in Section 4 (as described below) regarding NSCC requiring Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact), NSCC is proposing to modify the permitted use of Clearing Fund to make it clear that the Clearing Fund can be used by NSCC to secure

each Member's performance of obligations to NSCC, including each Member's obligations with respect to any loss allocations as set forth in Section 4 of Rule 4. NSCC is also proposing to delete the defined term of Cash Receipts and related provisions from Rule 4 because, unlike the Clearing Fund, Cash Receipts are money payments received from participants and payable to others; therefore, NSCC believes that continuing to include Cash Receipts in Rule 4 is no longer necessary and may cause confusion among Members.

NSCC is proposing to add a paragraph that provides that each time NSCC uses any part of the Clearing Fund to provide liquidity to NSCC to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity for more than thirty (30) calendar days, NSCC, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, would consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with proposed Section 4 of Rule 4. NSCC believes that this proposed change would increase transparency and accessibility of the Rules for Members by specifying a point in time by which NSCC would need to replenish the Clearing Fund through loss allocation if NSCC uses the Clearing Fund to provide or secure liquidity to NSCC to meet its settlement obligations. NSCC believes that a period of thirty (30) calendar days would be appropriate because it would provide sufficient time for NSCC to determine whether it would be able to obtain the necessary funds from liquidation of the portfolio of the Defaulting Member to repay the used Clearing Fund

amount. In addition, this proposed change would also harmonize this section with the comparable section in the FICC/GSD Rules and FICC/MBSD Rules,³⁸ so as to provide consistent treatment for firms that are members of both NSCC and FICC.

Proposed Section 2 would continue to have the same provisions concerning the investment and maintenance of the Clearing Fund, except these provisions would also be streamlined and clarified. Specifically, NSCC is proposing language to make it clear that it may invest cash in the Clearing Fund in accordance with the Clearing Agency Investment Policy adopted by NSCC.³⁹ NSCC would revise the relocated sentence from Section 1 which provides that NSCC shall not be required to segregate any Clearing Fund (again, in terms of “Fund,” “System,” and “Allocation,” as discussed above) in order to (i) conform to the proposed deletions in Section 1 and use the newly defined term of “Actual Deposit” as set forth in Section 1 and (ii) make clear that NSCC would not be

³⁸ See Section 5 of FICC/GSD Rule 4 and Section 5 of FICC/MBSD Rule 4, supra note 31.

³⁹ See Securities Exchange Act Release No. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (SR-NSCC-2016-003). The Clearing Agency Investment Policy (the “Policy”) governs the management, custody, and investment of cash deposited to the Clearing Fund, the proprietary liquid net assets (cash and cash equivalents) of NSCC and other funds held by NSCC. The Policy sets forth guiding principles for the investment of those funds, which include adherence to a conservative investment philosophy that places the highest priority on maximizing liquidity and avoiding risk, as well as mandating the segregation and separation of funds. The Policy also addresses the process for evaluating credit ratings of counterparties and identifies permitted investments within specified parameters. In general, assets are required to be held by regulated and creditworthy financial institution counterparties and invested in financial instruments that, with respect to the Clearing Fund, may include deposits with banks, including the Federal Reserve Bank of New York, collateralized reverse-repurchase agreements, direct obligations of the U.S. government and money-market mutual funds.

required to segregate a Member's Actual Deposit but that NSCC would maintain books and records concerning the assets that constitute each Member's Actual Deposit.

Under the proposed rule change, Members would continue to be entitled to any interest earned or paid on Clearing Fund cash deposits and pledged Eligible Clearing Fund Securities; however, NSCC is proposing additional language to make it clear that interest on pledged Eligible Clearing Fund Securities that is received by NSCC would be credited to a Member's cash deposits to the Clearing Fund, except in the event of a default by such Member on any obligations to NSCC, in which case NSCC may exercise its rights under proposed Section 3 of Rule 4.

Section 3

Section 3 of Rule 4 currently provides that NSCC may apply a participant's actual deposit to any obligation the participant has to NSCC that the participant has failed to satisfy and to any Cross-Guaranty Obligation. Participants are required to eliminate any resulting deficiencies in their Required Deposits within such time as NSCC requires. Section 3 also currently provides for the manner in which loss allocation would apply with respect to Off-the-Market Transactions.

Under the proposed rule change, NSCC is proposing to add a subheading of "Application of Clearing Fund Deposits and Other Amounts to Members' Obligations" and to delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into Funds/Allocations by Systems and services. Under the proposed rule change, NSCC would retain the provisions in Section 3 regarding applying the Member's Actual Deposit to satisfy an obligation to NSCC that a Member fails to satisfy and the requirement to replenish the Required Fund Deposit as necessary, but

NSCC proposes to add clarifying language that, in addition to a Member's Actual Deposit, NSCC will also apply any amounts available under a Clearing Agency Cross-Guaranty Agreement and any proceeds therefrom to satisfy the obligation. NSCC also proposes to add language making it clear that NSCC may take any and all actions with respect to the assets and amounts referenced in the prior sentence, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that NSCC determines is appropriate.

Under the proposed rule change, NSCC would move the provision regarding allocation of losses from Off-the-Market Transactions to proposed Section 4 of Rule 4, which addresses allocation of losses to Members. NSCC would streamline and clarify the remaining provisions for transparency and accessibility.

Section 4 and Section 5

Current Section 4 of Rule 4 contains NSCC's current loss allocation waterfall, which would be initiated if NSCC incurs a loss or liability in a System that is not satisfied pursuant to current Section 3. Section 4 currently provides for the following loss allocation waterfall:

- (i) Application of NSCC's existing retained earnings or such lesser part⁴⁰ of the existing retained earnings unless the Board of Directors elects to apply the Fund/Allocation for a particular System or service.

⁴⁰ Addendum E provides that NSCC "will apply no less than twenty-five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability." Supra note 5.

- (ii) If a loss or liability remains after the application of the retained earnings, NSCC would apply the Clearing Fund (this application is subject to the current structure where the Rules provide that the Clearing Fund is allocated to different Systems/services).
 - a. NSCC is required to provide participants and the Commission with 5 business days' prior notice before applying the Clearing Fund.
 - b. Participants (other than those responsible for causing the loss or liability) would be charged pro rata based upon their allocation to the applicable Fund, less any amounts that participants were required to deposit pursuant to Rule 15.

Section 5 of Rule 4 currently states that if a pro rata charge is made pursuant to Rule 4 against a participant's actual Clearing Fund deposit, and as a consequence thereof the participant's remaining deposit is less than its Required Deposit, the participant would, upon demand by NSCC, be required to replenish its deposit to eliminate the deficiency within such time as NSCC shall require. Current Section 5 further provides that if the participant does not take this required action, NSCC may take disciplinary action against the participant, and any disciplinary action taken against the participant or the voluntary or involuntary termination of the participant's membership will not affect the obligations of the participant to NSCC or any remedy to which NSCC may be entitled under applicable law.

Under the proposed rule change, NSCC is proposing to add a subheading of "Loss Allocation Waterfall, Off-the-Market Transactions" to Section 4 and delete provisions that do not apply to Members and/or that reference the Clearing Fund being allocated into

Funds/Allocations by System or service. In addition, NSCC is proposing to restructure its loss allocation waterfall as described below.

Under the proposal, Section 4 would make clear that the loss allocation waterfall applies to any loss and liability incurred by NSCC arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event.

As proposed, Section 4 would provide that, for the purposes of Rule 4, the term “Defaulting Member” would mean a Member for which NSCC has ceased to act pursuant to Rule 46,⁴¹ the term “Defaulting Member Event” would mean the determination by NSCC to cease to act for a Member pursuant to Rule 46, and the term “Declared Non-Default Loss Event” would mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of NSCC may be a significant and substantial loss or liability that may materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner. Proposed Section 4 would establish the concept of an “Event Period” to provide for a clear and transparent way of handling multiple loss events occurring in a period of ten (10) business days, which would be grouped into an Event Period.⁴² As stated above, both

⁴¹ NSCC may cease to act for a Member pursuant to any of the circumstances set forth under Rule 46 (Restrictions on Access to Services), including, but not limited to, in the event the Member is in default of any delivery of funds or securities to NSCC. Supra note 5.

⁴² Supra note 15.

Defaulting Member Events or Declared Non-Default Loss Events could occur within the same Event Period.

Under the proposal, an Event Period with respect to a Defaulting Member Event would begin on the day NSCC notifies participants that it has ceased to act for the Defaulting Member (or the next business day, if such day is not a business day). In the case of a Declared Non-Default Loss Event, an Event Period would begin on the day that NSCC notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day). If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event would be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

As proposed, each Member would be obligated to NSCC for the entire amount of any loss or liability incurred by NSCC arising out of or relating to any Defaulting Member Event with respect to such Member. Under the proposal, to the extent that such loss or liability is not satisfied pursuant to proposed Section 3 of Rule 4, NSCC would apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as provided in proposed Section 4.

Under proposed Section 4, the loss allocation waterfall would begin with a corporate contribution from NSCC (“Corporate Contribution”), as is the case under the current Rules, but in a different form than under the current Section 4 of Rule 4. Today, pursuant to Addendum E, in the event of a Member impairment, NSCC is required to apply at least 25% of its retained earnings existing at the time of a Member impairment;

however, no corporate contribution from NSCC is currently required for losses resulting other than those from Member impairments. Under the proposal, NSCC would amend Section 5 to add a subheading of “Corporate Contribution” and define NSCC’s Corporate Contribution with respect to any loss allocation pursuant to proposed Section 4 of Rule 4, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, as an amount that is equal to fifty (50) percent of the amount calculated by NSCC in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period.⁴³ The proposed rule change would specify that NSCC’s General Business Risk Capital Requirement, as defined in NSCC’s Clearing Agency Policy on Capital Requirements,⁴⁴ is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.⁴⁵

As proposed, if NSCC applies the Corporate Contribution to a loss or liability arising out of or relating to one or more Defaulting Member Events or Declared Non-Default Loss Events relating to an Event Period, then for any subsequent Event Periods that occur during the two hundred fifty (250) business days thereafter,⁴⁶ the Corporate Contribution would be reduced to the remaining unused portion of the Corporate Contribution amount that was applied for the first Event Period. Proposed Section 5

⁴³ Supra note 8.

⁴⁴ Supra note 9.

⁴⁵ Supra note 10.

⁴⁶ Supra note 13.

would require NSCC to notify Members of any such reduction to the Corporate Contribution.

Currently, the Rules do not require NSCC to contribute its retained earnings to losses and liabilities other than from Member impairments. Under the proposal, NSCC would expand the application of its corporate contribution beyond losses and liabilities from Member impairments. The proposed Corporate Contribution would apply to losses or liabilities relating to or arising out of Defaulting Member Events and Declared Non-Default Loss Events, and would be a mandatory loss contribution by NSCC prior to any allocation of the loss among Members.

Addendum E currently provides NSCC the option to contribute amounts higher than the specified percentage of retained earnings, as determined by the Board of Directors, to any loss or liability incurred by NSCC as the result of a Member's impairment. This option would be retained and expanded under the proposal to also cover non-default losses. Proposed Section 5 would provide that nothing in the Rules would prevent NSCC from voluntarily applying amounts greater than the Corporate Contribution against any NSCC loss or liability, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

Proposed Section 4 of Rule 4 would provide that NSCC shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. The proposed rule change also provides that if losses and liabilities with respect

to such Event Period remain unsatisfied following application of the Corporate Contribution, NSCC would allocate such losses and liabilities to Members, as described below.

Proposed Section 4 of Rule 4 would also retain the requirement of loss allocation among Members if a loss or liability remains after the application of the Corporate Contribution, as described above. In contrast to the current Section 4 where NSCC would apply Members' Required Deposits to the mutualized loss allocation amounts, under the proposal, NSCC would require Members to pay their loss allocation amounts (leaving their Required Fund Deposits intact).⁴⁷ Loss allocation obligations would continue to be calculated based upon a Member's pro rata share of losses and liabilities (although the pro rata share would be calculated differently than it is today), and Members would still retain the ability to voluntarily withdraw from membership and cap their loss allocation obligation (although the loss allocation obligation would also be calculated differently than it is today).

⁴⁷ NSCC believes that shifting from the two-step methodology of applying the Clearing Fund and then requiring Members to immediately replenish it, to requiring direct payment would increase efficiency while preserving the right to charge a Member's Clearing Fund deposits in the event the Member does not timely pay. Such a failure to pay would trigger recourse to the Clearing Fund deposits of the Member under proposed Section 3 of Rule 4. In addition, this change would provide greater stability for NSCC in times of stress by allowing NSCC to retain the Clearing Fund, its critical prefunded resource, while charging loss allocations. NSCC believes doing so would allow NSCC to cover its current credit exposures to Members at all times. By retaining the Clearing Fund as proposed, NSCC could use the Clearing Fund to secure the performance obligations of Members to NSCC, including their payment obligation for any loss allocation, while maintaining access to prefunded resources. By being able to manage its current credit exposures throughout the loss allocation process, NSCC would be able to continue to provide its critical operations and services during what would be expected to be a stressful period.

The proposed rule change to Section 4 of Rule 4 would clarify that each Member that is a Member on the first day of an Event Period would be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. The proposal would make it clear that any Member for which NSCC ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

Under the proposed rule change, a loss allocation “round” would mean a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the round cap. When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. NSCC may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4.

As proposed, each loss allocation would be communicated to Members by the issuance of a Loss Allocation Notice. Under the proposal, each Member’s pro rata share of losses and liabilities to be allocated in any round would be equal to (i) the Member’s Average RFD divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice would specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or

subsequent round would expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Withdrawal Notification Period”) to notify NSCC of its election to withdraw from membership with NSCC pursuant to proposed Section 6 of Rule 4, and thereby benefit from its Loss Allocation Cap.⁴⁸ As proposed, the “Loss Allocation Cap” of a Member would be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

NSCC is proposing to clarify that after a first round of loss allocation with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4 would be subject to further loss allocation with respect to that Event Period.

As proposed, Members would have two (2) business days after NSCC issues a first round Loss Allocation Notice to pay the amount specified in any such notice.⁴⁹ On a subsequent round (i.e., if the first round did not cover the entire loss of the Event Period because NSCC was only able to allocate up to the round cap), Members would also have two (2) business days after notice by NSCC to pay their loss allocation amounts (again subject to their Loss Allocation Caps), unless Members have notified (or will timely notify) NSCC of their election to withdraw from membership with respect to a prior loss allocation round pursuant to proposed Section 6 of Rule 4.

⁴⁸ Supra note 18.

⁴⁹ Supra note 22.

As proposed, Section 4 would also provide that, to the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, NSCC may in its discretion retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

Under the proposal, if a Member fails to make its required payment in respect of a Loss Allocation Notice by the time such payment is due, NSCC would have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with proposed Section 3 of Rule 4 described above. Members who wish to withdraw would be required to comply with the requirements in proposed Section 6 of Rule 4, described further below. Specifically, proposed Section 4 of Rule 4 would provide that if, after notifying NSCC of its election to withdraw from membership pursuant to proposed Section 6 of Rule 4, the Member fails to comply with the provisions of proposed Section 6 of Rule 4, its notice of withdrawal would be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

Under the proposal, NSCC would delete the provision in current Section 4 of Rule 4 that requires NSCC to provide Members and the Commission with 5 business days' prior notice before applying the Clearing Fund to a loss or liability because such requirement would no longer be relevant under the proposed rule change. Under the proposed rule change, NSCC would notify Members subject to loss allocation of the amounts being allocated to them in one or more Loss Allocation Notices. As proposed, instead of applying the Clearing Fund, NSCC would require Members to pay their loss allocation amounts (leaving their Clearing Fund deposits intact). In order to conform to

these proposed rule changes, NSCC is proposing to eliminate the required notification to Members regarding the application of Clearing Fund in current Section 4 of Rule 4.

NSCC is also proposing to delete the required notification to the Commission regarding the application of Clearing Fund in the same section. While as a practical matter, NSCC would notify the Commission of a decision to loss allocate, NSCC does not believe such notification needs to be specified in the Rules.

Under the proposed rule change, NSCC would move the provision related to Off-the-Market Transactions from current Section 3 of Rule 4 to proposed Section 4 of Rule 4 and clarify that (i) a loss or liability of NSCC in connection with the close-out or liquidation of an Off-the-Market Transaction would be allocated to the Member that was the counterparty to such transaction and (ii) no allocation would be made if the Defaulting Member satisfied all applicable intraday mark-to-market margin charges assessed by NSCC with respect to the Off-the-Market Transaction prior to its default.⁵⁰

Section 6

Proposed Section 6 of Rule 4 would include the provisions regarding withdrawal from membership currently covered by Section 8 of Rule 4. NSCC believes that relocating the provisions on withdrawal from membership as it pertains to loss allocation, so that it comes right after the section on the loss allocation waterfall, would provide for the better organization of Rule 4. As proposed, the subheading for Section 6 would read “Withdrawal Following Loss Allocation.”

⁵⁰ See Securities Exchange Act Release No. 79598 (December 19, 2016), 81 FR 94462 (December 23, 2016) (SR-NSCC-2016-005), at 94465, and Securities Exchange Act Release No. 79592 (December 19, 2016), 81 FR 94448 (December 23, 2016) (SR-NSCC-2016-803), at 94452.

Currently, Section 8 of Rule 4 provides that participants may notify NSCC within ten (10) business days after receipt of notice of a pro rata charge that they have elected to terminate their membership and thereby avail themselves of a cap on loss allocation, which is currently their Required Deposit as fixed immediately prior to the time of the pro rata charge.

As stated above, under the proposed rule change, a Member who wishes to withdraw from membership in respect of a loss allocation round must provide notice of its election to withdraw (“Loss Allocation Withdrawal Notice”) within five (5) business days from the issuance of the first Loss Allocation Notice in any round.⁵¹ In order to avail itself of its Loss Allocation Cap, the Member would need to follow the requirements in proposed Section 6 of Rule 4, which would provide that the Member must: (i) specify in its Loss Allocation Withdrawal Notice an effective date for withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period (i.e., no later than ten (10) business days after the 5th business day following the first Loss Allocation Notice in that round of loss allocation),⁵² (ii) cease all activity that would result in transactions being submitted to NSCC for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member’s withdrawal, and (iii) ensure that all clearance and settlement activity for which such Member is obligated to NSCC is fully

⁵¹ Supra note 18.

⁵² Supra note 25.

and finally settled by the effective date of the Member's withdrawal, including, without limitation, by resolving by such date all fails and buy-in obligations.

Proposed Section 6 of Rule 4 would provide that a Member that withdraws in compliance with the requirements of proposed Section 6 of Rule 4 would nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated under proposed Rule 4; however, the Member's aggregate obligation would be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

NSCC is proposing to include a sentence in proposed Section 6 of Rule 4 to make it clear that if the Member fails to comply with the requirements set forth in that section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to proposed Section 4 of Rule 4 as if it had not given such notice.

Currently, Section 8 also contains provisions regarding additional pro rata charges that may be made by NSCC for the same loss or liability under the existing loss allocation process and the applicable caps that participants wishing to voluntarily terminate their membership after such additional pro rata charges are noticed may avail themselves of. These provisions would be replaced by the loss allocation process contained in proposed Section 4 described above.

Section 7

As proposed, Section 7 would cover the provisions on the return of a Member's Clearing Fund deposit that are currently covered by Section 6 of Rule 4. Proposed

Section 7's subheading would be "Return of Members' Clearing Fund Deposits" and would apply only to Members.

Currently, with respect to the return of Clearing Fund deposits, Section 6 of Rule 4 states that NSCC will return a participant's Clearing Fund deposit 90 days after 3 conditions are met: (i) the participant ceases to be a participant, (ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund have been closed, and (iii) all obligations of the participant to NSCC have been satisfied or have been deducted from the participant's Clearing Fund deposit by NSCC, provided that the participant has provided NSCC with satisfactory indemnities or guarantees or another participant has been substituted on all transactions and obligations of the participant.

Current Section 6 provides further that in the absence of an acceptable guarantee, indemnity or substitution, NSCC will retain the entire Clearing Fund deposit of a participant if such deposit is less than \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after conditions described in (i), (ii) and (iii) of the paragraph above have occurred. If the participant's Clearing Fund deposit is equal to or greater than \$100,000, NSCC will retain the greater of twenty-five (25) percent of a participant's average Clearing Fund requirement over the twelve (12) months immediately prior to the date the participant ceased to be a participant, or \$100,000 for two (2) years (or four (4) years for Members who have Sponsored Accounts at a Qualified Securities Depository) after conditions described in (i), (ii) and (iii) of the paragraph above have occurred.

Current Section 6 states that if a participant made a deposit with respect to the Mutual Fund Services or Insurance and Retirement Processing Services, the participant will be entitled to the return of this deposit ninety (90) days after all associated transactions in these services have been satisfied.

Finally, Section 6 currently provides that any obligation of a participant to NSCC unsatisfied at the time the participant ceases to be a participant will not be affected by such cessation of membership.

Proposed Section 7 would reduce the period in which NSCC may retain a Member's Clearing Fund deposit. Specifically, NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC will return the Member's Actual Deposit in the form of (i) cash or securities within thirty (30) calendar days and (ii) Eligible Letters of Credit within ninety (90) calendar days, after all of the Member's transactions have settled and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC. NSCC believes that shortening the time periods for the return of a Member's Clearing Fund deposit would be helpful to firms who have exited NSCC so that they could have use of the deposits sooner than under the current Rules, while at the same time protecting NSCC because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. Proposed Section 7 would also harmonize the retention period for a Member's deposits to the Clearing Fund

with the FICC/GSD Rules,⁵³ thus providing consistent treatment for firms that are members of both NSCC and FICC. Similarly, the Clearing Fund deposit retention for Members who have Sponsored Accounts at DTC would be reduced in order to stay consistent with the proposed retention period in the rules of DTC.⁵⁴ In addition, NSCC proposes to make it clear that a Member's obligations to NSCC would include both matured as well as contingent obligations.

Section 8

Proposed Section 8 of Rule 4 would cover the subject matter currently covered in Section 7 of Rule 4. Proposed Section 8's subheading would be "Changes in Members' Required Fund Deposits" and would apply only to Members.

Currently, Section 7 of Rule 4 requires participants to satisfy any increase in their Required Deposit within such time as NSCC requires. At the time the increase becomes effective, the participant's obligations to NSCC will be determined in accordance with the increased Required Deposit whether or not the Member has so increased its deposit.

⁵³ Section 10 of FICC/GSD Rule 4, in relevant part, states that "If a Netting Member gives notice to the Corporation pursuant to Rule 3 of its election to terminate its membership in the Netting System, the Member's deposits to the Clearing Fund in the form of cash or securities shall be returned to it within 30 calendar days thereafter ... provided that all amounts owing to the Corporation by the Member have been paid to the Corporation prior to such return and the Member has no remaining open Net Settlement Position, Fail Net Settlement Position, or Forward Net Settlement Position." Supra note 31.

⁵⁴ On December 18, 2017, DTC submitted a proposed rule change and an advance notice to enhance its rules regarding allocation of losses. See Securities Exchange Act Release Nos. 82426 (January 2, 2018), 83 FR 913 (January 8, 2018) (SR-DTC-2017-022) and 82582 (January 24, 2018), 83 FR 4297 (January 30, 2018) (SR-DTC-2017-804). On June 28, 2018, DTC submitted amendments to the proposed rule change and advance notice. Copies of the amendments to the proposed rule change and the advance notice are available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

NSCC is not proposing any substantive changes to this provision, which will be renumbered as Section 8 of Rule 4 under the proposed rule change, except for streamlining the provision and limiting its application to Members as stated above.

Section 9

Currently, Section 9 of Rule 4 addresses situations where a participant has excess deposits in the Clearing Fund (i.e., amounts above its Required Deposit). The current provision provides that NSCC will, on any day that NSCC has determined and provided notification that an excess deposit exists with respect to a participant, return an excess amount requested by a participant that follows the formats and timeframe established by NSCC for such request. The current provision makes clear that NSCC will not return the requested excess amount (i) until any amount required to be charged against the participant's Required Deposit is paid by the participant to NSCC and/or (ii) if NSCC determines that the participant's current month's use of one or more services is materially different than the previous month's use upon which such excess is based. Section 9 currently makes clear that, notwithstanding any of the foregoing, NSCC may, in its discretion, withhold any or all of a participant's excess deposit if the participant has been placed on the Watch List.⁵⁵ Current Section 9 also makes clear that nothing in this section limits NSCC's rights under Rule 15.⁵⁶

⁵⁵ Pursuant to Section 4 of Rule 2B, a Member could be placed on the Watch List either based on its credit rating of 5, 6 or 7, which can either be generated by the Credit Risk Rating Matrix or from a manual downgrade, or when NSCC deems such placement as necessary to protect NSCC and its Members. Supra note 5.

⁵⁶ Rule 15 permits NSCC to require a Member, Limited Member or any applicant to become either to furnish NSCC adequate assurances of the entity's financial responsibility and operational capability as NSCC may deem necessary. Supra note 5.

Proposed Section 9 would add a subheading “Excess Clearing Fund Deposits” and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except for streamlining the provisions in this section and eliminating the condition described in clause (i) of the paragraph above that limits participants’ ability to request the return of excess amounts on deposit in the Clearing Fund and replacing clause (ii) of the paragraph above with a clause that provides NSCC may, in its discretion, withhold any or all of a participant’s excess deposit if NSCC determines that the Member’s anticipated activities in NSCC in the near future may reasonably be expected to be materially different than its activities of the recent past. NSCC believes that the proposed additional clause would protect NSCC and its participants because the clause would allow NSCC to retain excess deposits to cover an expected near-term increase in a Member’s Required Fund Deposit amount due to the anticipated change in the Member’s activities. The proposed additional clause would also align NSCC’s Rules with that of FICC/GSD and FICC/MBSD,⁵⁷ thus providing consistent treatment for firms that are members of both NSCC and FICC.

Section 10

Current Section 10 of Rule 4 provides for crediting persons against whom losses are charged pursuant to Rule 4 if there is a subsequent recovery of such losses by NSCC. NSCC is not proposing any changes to this section other than (i) making it clear that no loss allocation under proposed Rule 4 would constitute a waiver of any claim NSCC may have against a Member for any losses or liabilities to which the Member is subject under

⁵⁷ See Section 9 of FICC/GSD Rule 4 (Clearing Fund and Loss Allocation) and Section 9 of FICC/MBSD Rule 4 (Clearing Fund and Loss Allocation). Supra note 31.

the Rules, including, without limitation, any loss or liability to which it may be subject under proposed Rule 4, and (ii) adding a subheading “No Waiver; Subsequent Recovery Against Loss Amounts” and replacing “persons” with “Persons,” which is currently defined in Rule 1 (Definitions and Descriptions) to mean “a partnership, corporation, limited liability corporation or other organization, entity or an individual.” NSCC is proposing the change in (i) above to preserve its legal rights and to make it clear to Members that loss allocation under proposed Rule 4 would not be deemed as NSCC waiving any claims it may have against a Member for any losses or liabilities to which the Member is subject under the Rules. With respect to the proposed change in (ii) above, given that NSCC is a corporation, NSCC believes that the term “Person” already includes NSCC; however, for increased clarity, NSCC is proposing to add “including the Corporation” to make it clear to Members that if there is a subsequent recovery of losses charged pursuant to Rule 4, the net amount of the recovery would be credited to Persons, including NSCC, against whom the loss was charged in proportion to the amounts charged against them.

Section 11

Current Section 11 of Rule 4 provides that a participant may withdraw Eligible Clearing Fund Securities from pledge, provided that the participant has deposited cash with, or pledged additional Eligible Clearing Fund Securities to, NSCC that, in the aggregate, secure the open account indebtedness of the participant and/or satisfy the participant’s Required Deposit. Proposed Section 11 would add a subheading “Substitution or Withdrawal of Pledged Securities” and would apply only to Members.

NSCC is not proposing any substantive changes to this provision, except for changes to improve the transparency and accessibility of this section.

Section 12

Current Section 12 of Rule 4 makes it clear that NSCC has certain rights with respect to the Clearing Fund. Proposed Section 12 would add a subheading “Authority of Corporation” and would apply only to Members. NSCC is not proposing any substantive changes to this provision, except to clarify that a reference to 30 days in current Section 12 would mean 30 calendar days.

Section 13

NSCC is proposing to add a new Section 13 to Rule 4 that would be entitled “Mutual Fund Deposits.” Under the proposal, NSCC would consolidate provisions from various sections in the current Rule 4 concerning Mutual Fund/Insurance Services Members and Fund Members and group them into proposed Section 13. Aside from the consolidation, NSCC is not proposing any substantive changes to these provisions, except for changes to (i) reduce NSCC’s retention period of Mutual Fund Deposits when a Mutual Fund Participant (as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with the proposed change in Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

Proposed Section 13 would provide that each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member would, and each Fund Member (collectively with such Members and Mutual Fund/Insurance

Services Members, “Mutual Fund Participants”) may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its “Mutual Fund Deposit” and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit would be a separate and additional component of such Member’s deposit to the Clearing Fund but not part of the Member’s Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to proposed Section 4 of Rule 4.

As in the current Rules, proposed Section 13 would also provide that if any Mutual Fund Participant fails to satisfy any obligation to NSCC relating to Mutual Fund Services, notwithstanding NSCC’s right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, NSCC would first apply such Mutual Fund Participant’s Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated to NSCC, NSCC would apply such Member’s Actual Deposit in accordance with proposed Section 3 of Rule 4. NSCC would next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants, and after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Mutual Fund Participants are Members. If any loss or liability remains

thereafter and there are no continuing Mutual Fund Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 13 would reduce NSCC's retention period of Mutual Fund Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that a Mutual Fund Participant that elects to withdraw from membership would be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Mutual Fund Participant was responsible while a Mutual Fund Participant. NSCC is proposing this change in order to harmonize the retention period of Mutual Fund Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 13 would make it clear that NSCC's rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Mutual Fund Deposits.

Section 14

NSCC is proposing to add a new Section 14 to Rule 4 that would be entitled "Insurance Deposits." Under the proposal, NSCC would consolidate provisions from various sections in current Rule 4 concerning Insurance Carrier/Retirement Services Members and group them into proposed Section 14. Aside from the consolidation, NSCC is not proposing any substantive changes to these provisions, except for changes to (i) reduce NSCC's retention period of Insurance Deposits when an Insurance Participant

(as defined below and in the proposed rule change) elects to withdraw from membership, in order to harmonize it with proposed Section 7, as described above, and (ii) improve the transparency and accessibility of the provisions.

As in the current Rules, proposed Section 14 would provide that each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, “Insurance Participants”) may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules (its “Insurance Deposit” and, unless specified otherwise, for the purposes of the Rules, Required Fund Deposits shall include Insurance Deposits). Proposed Section 14 would also provide that if any Insurance Participant fails to satisfy any obligation to NSCC relating to the Insurance and Retirement Processing Services, NSCC would first apply such Insurance Participant’s Insurance Deposit. If after such application any loss or liability remains, NSCC would allocate the remaining loss or liability to the other Insurance Participants in successive rounds of loss allocations in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants, and after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with proposed Section 6 of Rule 4, following the procedures and timeframes set forth in proposed Sections 4 and 6 of Rule 4 as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, NSCC would proceed with loss allocations to Members for a Defaulting Member Event in accordance with proposed Section 4 of Rule 4.

As proposed, Section 14 would reduce NSCC's retention period of Insurance Deposits from ninety (90) days under the current Section 6 of Rule 4 to thirty (30) calendar days. Specifically, NSCC is proposing that an Insurance Participant that elects to withdraw from membership would be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and it has satisfied all of its matured and contingent obligations to NSCC for which such Insurance Participant was responsible while an Insurance Participant. NSCC is proposing this change in order to harmonize the retention period of Insurance Deposit with the proposed Clearing Fund retention period in proposed Section 7 of Rule 4, as described above.

As proposed, Section 14 would make it clear that NSCC's rights, authority and obligations with respect to deposits to the Clearing Fund as set forth in Rule 4 would apply to Insurance Deposits.

B. Proposed Changes to Addendum E (Statement of Policy Application of Retained Earnings Member Impairments) and Addendum K (Interpretation of the Board of Directors Application of Clearing Fund)

Addendum E is a statement of policy that currently provides that NSCC will apply no less than twenty-five (25) percent of its retained earnings to cover losses or liabilities from a Member's impairment that is not otherwise satisfied by the impaired Member's Clearing Fund deposit. NSCC is proposing to delete Addendum E in its entirety because it would no longer be relevant given the proposed rule change relating to the Corporate Contribution discussed above.

NSCC is proposing to modify Addendum K to delete all provisions associated with loss allocation and application of the Clearing Fund in connection with a loss or liability incurred by NSCC, including modifying the title of Addendum K. These

provisions would no longer be necessary under the proposed rule change because the loss allocation process in its entirety would be governed by Rule 4. In addition, the current language in Addendum K regarding allocation by System would no longer be applicable under the proposed rule change as described above. NSCC would retain the provisions in Addendum K that pertain to NSCC's guaranty and rename Addendum K "The Corporation's Guaranty." NSCC is also proposing to replace "Rules" with "Rules and Procedures" to better reflect the name of NSCC's rulebook.

(iii) Other Proposed Rule Changes

NSCC is proposing changes to Rule 1 (Definitions and Descriptions), Rule 2B (Ongoing Membership Requirements and Monitoring), Rule 4(A) (Supplemental Liquidity Deposits), Rule 13 (Exception Processing), Rule 15 (Assurances of Financial Responsibility and Operational Capability), Rule 42 (Wind-Down of a Member, Fund Member or Insurance Carrier/Retirement Services Member), Procedure III (Trade Recording Service (Interface with Qualified Clearing Agencies)), Procedure XV (Clearing Fund Formula and Other Matters), and Addendum O (Admission of Non-US Entities as Direct NSCC Members). NSCC is proposing changes to these Rules in order to conform them with the proposed changes to Rule 4 as well as to make certain technical changes to these Rules.

Specifically, NSCC is proposing to add the following defined terms to Rule 1, in alphabetical order: Actual Deposit, Average RFD, Clearing Fund Cash, Corporate Contribution, Declared Non-Default Loss Event, Defaulting Member, Defaulting Member Event, Eligible Letter of Credit, Event Period, Insurance Deposit, Insurance Participant, Issuer, Lender, Loss Allocation Cap, Loss Allocation Notice, Loss Allocation

Withdrawal Notice, Loss Allocation Withdrawal Notification Period, Mutual Fund Deposit, Mutual Fund Participant, Required Fund Deposit, Termination Date, and Voluntary Termination Notice.

NSCC is proposing to delete the defined term “The Corporation” in Rule 1 and replace it with “Corporation” in Rule 1. NSCC is proposing to replace “Required Deposits” with “Required Fund Deposits” in Rule 2B, Rule 4(A), Rule 15, Rule 42, Procedure III, and Procedure XV. NSCC is proposing to replace “Rules” with “Rules and Procedures” in Rule 1, Rule 2B, Rule 13, Rule 15, and Procedure III. NSCC is also proposing to replace “Letter of Credit” with “Eligible Letter of Credit” in Rule 42 and Addendum O.

In addition, in Section 5 of Rule 2B, NSCC proposes to change the reference to Section 8 of Rule 4 to reflect the updated section number, which would be to Section 4 of Rule 4. NSCC is also proposing conforming changes to this section to ensure that termination provisions in the Rules, whether voluntary or in response to a loss allocation, are consistent with one another to the extent appropriate.

Currently, Section 5 of Rule 2B provides that participants may elect to voluntarily retire their membership by providing NSCC with written notice of such termination. Such termination will not be effective until accepted by NSCC, which shall be evidenced by a notice to NSCC’s participants announcing the participant’s retirement and the effective date of the retirement, which is defined as the “Retirement Date.” This section also provides that a participant’s voluntary termination of membership shall not affect its obligations to NSCC.

Where appropriate, NSCC is proposing changes to align Section 5 of Rule 2B with the proposed new Section 6 of Rule 4, both of which address termination of membership. Specifically, NSCC is proposing to rename the subheading of Section 5 of Rule 2B to “Voluntary Termination” and to change “retirement” to “termination” and “Retirement Date” to “Termination Date” throughout Section 5 of Rule 2B. NSCC is also proposing to provide that when a participant elects to voluntarily terminate its membership by providing NSCC a written notice of such termination (“Voluntary Termination Notice”), the participant must specify in its Voluntary Termination Notice a desired date for its withdrawal, provided such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to NSCC as of the time such Voluntary Termination Notice is submitted to NSCC, unless otherwise approved by NSCC. NSCC is retaining the provision that makes it clear that the termination will not be effective until accepted by NSCC.⁵⁸ NSCC is also retaining the provision that describes NSCC’s acceptance of the termination; however, NSCC is proposing to make it clear that such acceptance, as evidenced by a notice to NSCC’s participants, would (i) be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from the participant and (ii) announce the last trade date for the participant instead of the Termination Date. In addition, NSCC is proposing to make it clear that the Termination Date would be the final settlement date of all

⁵⁸ Unlike the Voluntary Termination Notice, the Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4 does not require explicit acceptance by NSCC to be effective. NSCC believes that requiring explicit acceptance of the Loss Allocation Withdrawal Notice could complicate the loss allocation process and potentially result in membership withdrawal being delayed as well as detract from the objective to have NSCC know on a timely basis which Members would remain subject to the subsequent rounds of loss allocation.

transactions of the participant. NSCC is proposing these clarifying changes so that the Rules would align more closely with NSCC's current practice.

As an example, Member A submits a Voluntary Termination Notice to NSCC on April 1st indicating its desired termination date is June 15th. NSCC would accept such termination request by issuing a notice to Members within 10 business days from April 1st; such notice would provide that the last trade date for Member A is June 12th, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A. In contrast, if Member A submits a Voluntary Termination Notice on April 1st and indicates its desired termination date is April 5th, NSCC would either (i) accept such termination notice by issuing a notice to Members on or before April 5th; such notice would provide that the last trade date for Member A is April 2nd, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A, or (ii) if NSCC requires additional time to process the termination, NSCC would accept such termination notice by issuing notice to Members after April 5th but still within 10 business days from April 1st; such notice would provide that the last trade date for Member A is a date after April 2nd, and the effective date of Member A's NSCC membership termination would be the final settlement date of all transactions of Member A.

NSCC is also proposing to clarify that after the close of business on the Termination Date,⁵⁹ a participant that terminates its membership shall no longer be

⁵⁹ Account(s) of a terminating participant are generally deactivated after the close of business on the Termination Date.

eligible or required to submit transactions to NSCC for clearance and settlement, unless the Board of Directors determines otherwise in order to ensure an orderly liquidation of the participant's open obligations. If any transaction is submitted to NSCC by such participant that is scheduled to settle after the Termination Date, the participant's Voluntary Termination Notice would be deemed void and the participant would remain subject to the Rules as if it had not given such notice. Furthermore, NSCC is proposing to add a sentence to Section 5 of Rule 2B to refer participants to Sections 7, 13 and 14 of Rule 4, as applicable, regarding provisions on the return of a participant's Clearing Fund deposit and to specify that if an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant would need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, would supersede and void any pending Voluntary Termination Notice previously submitted by the participant. As an example, if an Event Period occurs after submission of the Voluntary Termination Notice by a Member but on or prior to the Termination Date, and the Member does not subsequently submit a Loss Allocation Withdrawal Notice as proposed in Section 6 of Rule 4, then the Member would not benefit from its Loss Allocation Cap, i.e., the Member would remain obligated for its pro rata share of losses and liabilities with respect to any Event Period that commenced on or prior to the Termination Date.

In Rule 4(A), NSCC proposes to amend Section 11 to update a cross-reference to the time period for the refund of deposits to the Clearing Fund when a Member ceases to

be a participant in order to align it with proposed Section 7 of Rule 4, which would reduce the time period from 90 days to 30 calendar days. NSCC is also proposing to add a reference to Section 13 of Rule 4 in clause (c) of Section 13 of Rule 4(A) in order to specify that a Special Activity Supplemental Deposit of a Member may be used to satisfy a loss or liability as provided in such new proposed Section 13. NSCC is also proposing technical changes in Sections 2 and 13 of Rule 4(A) to reflect new proposed defined terms in the Rules.

In Rule 13, NSCC would replace “System” with “system” to reflect the proposed deletion of “System” as a defined term from Rule 4 and Addendum K. In Procedure XV, NSCC would replace “Qualified Securities Depository” with “DTC” to be consistent with the proposed change in Section 1 of Rule 4.

Member Outreach

Beginning in August 2017, NSCC conducted outreach to Members in order to provide them with advance notice of the proposed changes. As of the date of this filing, no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

Implementation Timeframe

Pending Commission approval, NSCC expects to implement this proposal within two (2) business days after approval. Members would be advised of the implementation date of this proposal through issuance of an NSCC Important Notice.

Expected Effect on Risks to the Clearing Agency, its Participants and the Market

NSCC believes that the proposed rule changes to enhance the resiliency of NSCC’s loss allocation process and to shorten the time within which NSCC is required to

return a former Member's Clearing Fund deposit would reduce the risk of uncertainty to NSCC, its Members and the market overall. Specifically, by modifying the calculation of NSCC's corporate contribution, NSCC would apply a mandatory fixed percentage of its General Business Risk Capital Requirement (as compared to the current Rules which provide for "no less than" a percentage of retained earnings), which would provide greater transparency and accessibility to Members as to how much NSCC would contribute in the event of a loss or liability. By modifying the application of NSCC's corporate contribution to apply to Declared Non-Default Loss Events, in addition to Defaulting Member Events, on a mandatory basis, NSCC would expand the application of its corporate contribution beyond losses and liabilities from Member impairments, which would better align the interests of NSCC with those of its Members by stipulating a mandatory application of the Corporate Contribution to a Declared Non-Default Loss Event prior to any allocation of the loss among Members. Taken together, these proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process by enhancing the calculation and application of NSCC's Corporate Contribution, which is one of the key elements of NSCC's loss allocation process. Moreover, by providing greater transparency and accessibility to Members, as stated above, the proposed rule changes regarding the Corporate Contribution, including the proposed replenishment period, would allow Members to better assess the adequacy of NSCC's loss allocation process.

By introducing the concept of an Event Period, NSCC would be able to group Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of ten (10) business days for purposes of allocating losses to Members. NSCC believes

that the Event Period would provide a defined structure for the loss allocation process to encompass potential sequential Defaulting Member Events or Declared Non-Default Loss Events that are likely to be closely linked to an initial event and/or market dislocation episode. Having this structure would enhance the overall resiliency of NSCC's loss allocation process because NSCC would be better equipped to address losses that may arise from multiple Defaulting Member Events and/or Declared Non-Default Loss Events that arise in quick succession. Moreover, the proposed Event Period structure would provide certainty for Members concerning their maximum exposure to mutualized losses with respect to such events.

By introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, NSCC would (i) set forth a defined amount that it would allocate to Members during each round (i.e., the round cap), (ii) advise Members of loss allocation obligation information as well as round information through the issuance of Loss Allocation Notices, and (iii) provide Members with the option to limit their loss allocation exposure after the issuance of the first Loss Allocation Notice in each round. These proposed rule changes would enhance the overall resiliency of NSCC's loss allocation process because they would enable NSCC to continue the loss allocation process in successive rounds until all of NSCC's losses are allocated and enable NSCC to identify continuing Members for purposes of calculating subsequent loss allocation obligations in successive rounds. Moreover, the proposed rule changes would define for Members a clear manner and process in which they could cap their loss allocation exposure to NSCC.

By implementing a “look-back” period to calculate a Member’s loss allocation obligations and its Loss Allocation Cap, NSCC would discourage Members from reducing their settlement activity during a time of stress primarily to limit their loss allocation obligations. By determining a Member’s loss allocation obligations based on the average of its Required Fund Deposit over a look-back period and its Loss Allocation Cap based on the greater of its Required Fund Deposit or the average thereof over a look-back period, NSCC would be able to calculate a Member’s pro rata share of losses and liabilities based on the amount of risk that the Member brings to NSCC. These proposed rule changes would enhance the overall resiliency of NSCC’s loss allocation process because they would deter Members from reducing their settlement activity during a time of stress primarily to limit their Loss Allocation Caps.

By reducing the time within which NSCC is required to return a former Member’s Clearing Fund deposit, NSCC would enable firms that have exited NSCC to have access to their funds sooner than under the current Rules, while at the same time protecting NSCC and its provision of clearance and settlement services because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. As such, NSCC would maintain the requisite level of Clearing Fund deposit to ensure that it can continue to meet its clearance and settlement obligations.

Management of Identified Risks

NSCC is proposing the rule changes as described in detail above in order to enhance the resiliency of NSCC’s loss allocation process and provide transparency and accessibility to Members regarding NSCC’s loss allocation process.

Consistency with the Clearing Supervision Act

The proposed rule change would be consistent with Section 805(b) of the Clearing Supervision Act.⁶⁰ The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.⁶¹

The proposed rule change would enhance the resiliency of NSCC's loss allocation process by (1) modifying the calculation and application of NSCC's corporate contribution, (2) introducing an Event Period, (3) introducing the concept of "rounds" (and accompanying Loss Allocation Notices) and applying this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implementing a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap. Together, these proposed rule changes would (i) create greater certainty for Members regarding NSCC's obligation towards a loss, (ii) more clearly specify NSCC's and Members' obligations toward a loss and balance the need to manage the risk of sequential defaults and other potential loss events against Members' need for certainty concerning their maximum exposures, and (iii) provide Members the opportunity to limit their exposure to NSCC by capping their exposure to loss allocation. Reducing the risk of uncertainty to NSCC, its Members and the market overall would promote robust risk management, promote safety and

⁶⁰ 12 U.S.C. 5464(b).

⁶¹ Id.

soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, NSCC believes that the proposed rule change to enhance the resiliency of NSCC's loss allocation process is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

By reducing the time within which NSCC is required to return a former Member's Clearing Fund deposit, NSCC would enable firms that have exited NSCC to have access to their funds sooner than under the current Rules while at the same time protecting NSCC and its provision of clearance and settlement services because such return would only occur if all obligations of the terminating Member to NSCC have been satisfied. As such, NSCC would maintain the requisite level of Clearing Fund deposit to ensure that it can continue to meet its clearance and settlement obligations. Enabling NSCC to continue to meet its clearance and settlement obligations would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, NSCC believes that this proposed rule change is consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed rule change is also consistent with Rules 17Ad-22(e)(13) and 17Ad-22(e)(23)(i), promulgated under the Act.⁶² Rule 17Ad-22(e)(13) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure NSCC has the authority and operational capacity to take timely action to contain losses and continue to meet its obligations.⁶³ As

⁶² 17 CFR 240.17Ad-22(e)(13) and (e)(23)(i).

⁶³ 17 CFR 240.17Ad-22(e)(13).

described above, the proposed rule changes to (1) modify the calculation and application of NSCC's corporate contribution, (2) introduce an Event Period, (3) introduce the concept of "rounds" (and accompanying Loss Allocation Notices) and apply this concept to the timing of loss allocation payments and the Member withdrawal process in connection with the loss allocation process, and (4) implement a "look-back" period to calculate a Member's loss allocation obligation (which would replace the current calculation of a Member's loss allocation obligation based on the Member's activity in each of the various services or "Systems" offered by NSCC) and its Loss Allocation Cap, taken together, are designed to enhance the resiliency of NSCC's loss allocation process. Having a resilient loss allocation process would help ensure that NSCC can effectively and timely address losses relating to or arising out of either the default of one or more Members or one or more non-default loss events, which in turn would help NSCC contain losses and continue to meet its clearance and settlement obligations. Therefore, NSCC believes that the proposed rule changes to enhance the resiliency of NSCC's loss allocation process are consistent with Rule 17Ad-22(e)(13) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of NSCC's default rules and procedures.⁶⁴ The proposed rule changes to (i) align the loss allocation rules of the DTCC Clearing Agencies, (ii) improve the overall transparency and accessibility of the provisions in the Rules governing loss allocation, and (iii) make conforming and technical changes, would not only ensure that NSCC's loss allocation

⁶⁴ 17 CFR 240.17Ad-22(e)(23)(i).

rules are, to the extent practicable and appropriate, consistent with the loss allocation rules of other DTCC Clearing Agencies, but also would help to ensure that NSCC's loss allocation rules are transparent and clear to Members. Aligning the loss allocation rules of the DTCC Clearing Agencies would provide consistent treatment, to the extent practicable and appropriate, especially for firms that are participants of two or more DTCC Clearing Agencies. Having transparent and clear loss allocation rules would enable Members to better understand the key aspects of NSCC's default rules and procedures and provide Members with increased predictability and certainty regarding their exposures and obligations. As such, NSCC believes that the proposed rule changes to align the loss allocation rules of the DTCC Clearing Agencies as well as to improve the overall transparency and accessibility of NSCC's loss allocation rules are consistent with Rule 17Ad-22(e)(23)(i) under the Act.

Similarly, the proposed rule changes to NSCC's voluntary termination provisions would improve the clarity of the Rules and help to ensure that NSCC's voluntary termination process is transparent and clear to Members. Having clear voluntary termination provisions would enable Members to better understand NSCC's voluntary termination process and provide Members with increased predictability and certainty regarding their rights and obligations with respect to such process. As such, NSCC believes that the proposed rule changes to the voluntary termination provision are also consistent with Rule 17Ad-22(e)(23)(i) under the Act.

III. Date of Effectiveness of the Advance Notice, and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change

was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the Advance Notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NSCC-2017-806 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-2017-806. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Advance Notice that are filed with the Commission, and all written communications relating to the Advance Notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment

submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSCC-2017-806 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary



TEXT OF PROPOSED RULE CHANGE

Bold and underlined text indicates proposed added language

~~**Bold and strikethrough text**~~ indicates proposed deleted language

Bold, double-underlined and italicized text indicates additional language proposed by this Amendment No. 1

~~***Bold, strikethrough and dotted underlined text***~~ indicates deleted language proposed by this Amendment No. 1

RULE 1. DEFINITIONS AND DESCRIPTIONS

Unless the context requires otherwise, the terms defined in this Rule shall, for all purposes of these Rules and Procedures, have the meanings herein specified.

Actual Deposit

The term "Actual Deposit" has the meaning specified in Rule 4.

Average RFD

The term "Average RFD" has the meaning specified in Rule 4.

Clearing Fund Cash

The term "Clearing Fund Cash" has the meaning specified in Rule 4.

Corporate Contribution

The term "Corporate Contribution" has the meaning specified in Rule 4.

Corporation

The term "Corporation" means National Securities Clearing Corporation.

Declared Non-Default Loss Event

The term "Declared Non-Default Loss Event" has the meaning specified in Rule 4.

Defaulting Member

The term "Defaulting Member" has the meaning specified in Rule 4.

Defaulting Member Event

The term "Defaulting Member Event" has the meaning specified in Rule 4.

Eligible Letter of Credit

The term "Eligible Letter of Credit" has the meaning specified in Rule 4.

Event Period

The term "Event Period" has the meaning specified in Rule 4.

Insurance Deposit

The term "Insurance Deposit" has the meaning specified in Rule 4.

Insurance Participant

The term "Insurance Participant" has the meaning specified in Rule 4.

Issuer

The term "Issuer" has the meaning specified in Rule 4.

Lender

The term "Lender" has the meaning specified in Rule 4.

Loss Allocation Cap

The term "Loss Allocation Cap" has the meaning specified in Rule 4.

Loss Allocation Notice

The term "Loss Allocation Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notice

The term "Loss Allocation Withdrawal Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notification Period

The term "Loss Allocation Withdrawal Notification Period" has the meaning specified in Rule 4.

Mutual Fund Deposit

The term "Mutual Fund Deposit" has the meaning specified in Rule 4.

Mutual Fund Participant

The term "Mutual Fund Participant" has the meaning specified in Rule 4.

Required Fund Deposit

The term "Required Fund Deposit" has the meaning specified in Rule 4.

Termination Date

The term "Termination Date" has the meaning specified in Rule 2B.

The Corporation

The term "the Corporation" means the ~~National Securities Clearing Corporation.~~

Voluntary Termination Notice

The term "Voluntary Termination Notice" has the meaning specified in Rule 2B.

RULE 2B. ONGOING MEMBERSHIP REQUIREMENTS AND MONITORING

SEC. 4. ONGOING MONITORING

(e) The Corporation may require a Member or Limited Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Procedure XV (which additional deposit shall constitute a portion of the Member's or Limited Member's Required **Fund** Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member or Limited Member. The Corporation may also retain any deposit in excess of the Required **Fund** Deposit of a Member or Limited Member that has been placed on the Watch List as provided in Section 9 of Rule 4.

SEC. 5. VOLUNTARY ~~RETIREMENT~~TERMINATION

A Member, Fund Member, Insurance Carrier/Retirement Services Member, Municipal Comparison Only Member, Mutual Fund/Insurance Services Member, Data Services Only Member, Investment Manager/Agent Member, AIP Member, Third Party Provider Member or Third Party Administrator Member each may elect to voluntarily ~~retire~~terminate such membership by providing the Corporation with a written notice of such termination (“Voluntary Termination Notice”). The participant shall specify in the Voluntary Termination Notice an effective, a desired date for its withdrawal from membership (the “Termination Date”); provided, however, such Termination Date date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from such participant. The Corporation's acceptance shall be evidenced by a notice to the Corporation's participants announcing the participant's ~~retirement termination~~ and the last trade date for the participant. The effective date of the retirement participant's termination shall be the final settlement date of all transactions of the participant (the “Retirement Termination Date”). After the close of business on As of the Termination Date, a participant that terminates its membership in the Corporation shall no longer be eligible or required to submit transactions to the Corporation for clearance and settlement, unless the Board determines otherwise in order to ensure an orderly liquidation of the

participant's open obligations. If any transaction is submitted to the Corporation by such participant that is scheduled to settle on or after the Termination Date, such participant's Voluntary Termination Notice will be deemed void, and the participant will remain subject to these Rules and Procedures as if it had not given such Voluntary Termination Notice.

A participant's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the **Retirement Termination** Date (including, but not limited to, any pro-rata charge made by the Corporation pursuant to Section **84** of Rule 4). **The return of the participant's Clearing Fund deposit shall be governed by Sections 7, 13 and 14 of Rule 4, as applicable. If an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant will need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the participant.**

RULE 4. CLEARING FUND

SEC. 1. **Required Fund Deposits.** Each Member ~~and Mutual Fund/Insurance Services Member shall, and each Fund Member and each Insurance Carrier/Retirement Services Member may be required to,~~ make and maintain on an ongoing basis a deposit to the Clearing Fund; ~~such deposits to the Clearing Fund shall be held by the Corporation to be applied as provided in this Rule.~~¹ The amount of each ~~such participant's~~ Member's required deposit shall be ~~fixed~~ determined by the Corporation in accordance with ~~one or more formulas specified by the Board of Directors and included in the Procedure XV and other applicable Rules and~~ Procedures (the "Required Fund Deposit"). ~~The basis of each formula shall be use of the Corporation's facilities.~~ The minimum Required Fund Deposit for each Member shall be \$10,000 ~~unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The minimum Required Deposit for a Mutual Fund/Insurance Services Member who uses the Mutual Fund Services shall be \$5,000 ~~unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The Corporation may require any such ~~participant~~ Member to deposit additional amounts to the Clearing Fund pursuant to Rule 15 ~~and such amounts shall be part of the participant's Required Deposit.~~ A Member may in its discretion maintain additional deposits at the Corporation, subject to any Procedures or other requirements the Corporation may establish for such excess amounts. For purposes of these Rules and Procedures, such additional deposits shall be deemed to be part of the Clearing Fund and the Member's Actual Deposit but shall not be deemed to be part of the Member's Required Fund Deposit.

The Corporation, ~~in its discretion,~~ may permit ~~part of a Member's, Insurance Carrier/Retirement Services Member's or Fund Member's deposit to be evidenced by an open account indebtedness secured by Members to satisfy their Required Fund Deposit obligations through a combination of cash and open account indebtedness secured by~~ Eligible Clearing Fund Securities, ~~provided that the percentage of such participant's Required Deposit that may be collateralized with Eligible Clearing Fund Securities and the collateral value of pledged Eligible Clearing Fund Securities shall be as set forth, as further described~~ in Procedure XV². The aggregate of cash deposited, the collateral value of pledged Eligible

¹ Clearing Fund deposits for Sponsored Accounts (as defined in Procedure IX.B.) relative to such Sponsored Accounts' DTC activity will be calculated and held by DTC in accordance with their procedures, and shall not be included in determining the Required Fund Deposit or the minimum cash requirement.

² In addition, the Corporation reserves the right to require participants to post a letter of credit in an instance where the Corporation, in its discretion, believes the participant presents legal risk. In such circumstances the Corporation may require part of a participant's deposit to be evidenced by an open account indebtedness ~~secured~~supported by one or more irrevocable ~~L~~C letters of ~~C~~Credit with a maturity of no more than one year issued on behalf of the participant in favor of the Corporation ~~(i)~~ under which a bank, trust company or United States branch or agency of a foreign bank (hereinafter, an "Issuer"), in each case approved by the Corporation for such purpose, is obligated to honor drafts

Clearing Fund Securities determined in accordance with Section III of Procedure XV, and the face amount of any Eligible Letters of Credit shall not at any time be less than the Member's Required Fund Deposit.

~~The collateral value of the Eligible Clearing Fund Securities and the face amount of Letters of Credit (if any Letters of Credit are required by the Corporation) shall not at any time be less in the aggregate than the amount of the participant's open account indebtedness. Each Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Member's open account indebtedness or placed by a Member in the possession of the Corporation (or its agents acting on its behalf) (collectively with any Eligible Letters of Credit issued on behalf of a Member in favor of the Corporation, the Member's "Actual Deposit"), in each case to secure all such Member's obligations to the Corporation. The Corporation shall be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The Eligible Clearing Fund Securities shall be pledged to secure a Member's open account indebtedness shall be delivered to the Corporation's account at DTC, or on such other terms and conditions as the Corporation shall may require. The Corporation may in its discretion hold pledged Eligible Clearing Fund Securities in its account at a financial institution designated by the Corporation including, in the Corporation's discretion, the pledge by Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members to the Corporation's account at a Qualified Securities Depository designated by such participant. Eligible Clearing Fund Securities that are not pledged at a Qualified Securities Depository shall be held by the Corporation for its account by a bank or trust company (other than the participant) designated by the Corporation.~~

~~Each participant's Required Deposit shall be allocated by the Corporation among the Mutual Fund Services, the Insurance and Retirement Processing Services and the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the~~

up to a specified amount drawn on it by the Corporation, ~~provided that and (ii)~~ the terms and conditions of ~~any such Letter of Credit are deemed which the Corporation determines are~~ acceptable to the Corporation in its sole discretion ~~(each such letter of credit, an "Eligible Letter of Credit")~~. Any amount drawn on any Eligible Letters of Credit shall be deposited into, and constitute an additional cash deposit to, the Clearing Fund and shall reduce the participant's open account indebtedness by a corresponding amount. Within ten **(10)** calendar days prior to the stated expiration date of any such Eligible Letter of Credit or within such time as the Corporation shall direct upon receipt by the Corporation of written notice from an approved bank of an earlier expiration date of any Eligible Letter of Credit ~~securing~~supporting a participant's open account indebtedness, such participant shall make a substitution for the Eligible Letter of Credit, in accordance with the provisions of this Rule, in the amount required, effective upon or prior to the expiration of the Eligible Letter of Credit.

~~participant participates. The allocation for each System, shall bear the same percentage relationship to the participant's Required Deposit as the participant's use of that System bears to his use of all services offered by the Corporation as measured by settlement dollars. The allocation for the Mutual Fund Services and the Insurance and Retirement Processing Services shall be the dollar amount required to be deposited pursuant to the Clearing Fund formula. The portion of the Clearing Fund allocated for the Mutual Fund Services shall be known as the "Mutual Fund Allocation". The portion of the Clearing Fund allocated for the Insurance and Retirement Processing Services shall be known as the "Insurance Allocation". The portion of the Clearing Fund allocated for each System shall be known as the "Fund" for that System. For example, the portion of the Required Deposit of each Member which shall be allocated for the CNS System shall be known as the Member's "CNS Fund Deposit" and the aggregate of the CNS Fund Deposits shall be known as the "CNS Fund."~~

SEC. 2. Permitted Use, Investment, and Maintenance of Clearing Fund Assets. The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including each Member's obligations with respect to any loss allocations as set forth in Section 4 of this Rule, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in this section.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 4 of this Rule.

The Corporation may invest any cash in the Clearing Fund, including (i) cash deposited by a Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, "Clearing Fund Cash"), in accordance with the Clearing Agency Investment Policy adopted by the Corporation.

~~The Corporation shall not be required to segregate any Fund for a System, the Mutual Fund Allocation, or the Insurance Allocation from the Clearing Fund. The Corporation's each Member's Actual Deposit, but shall maintain~~ books and records shall, however, identify the percentage of each Member's Required Deposit which

~~is at any time allocated to a Fund for a System, to the Mutual Fund Allocation, or the Insurance Allocation. That percentage of (a) the participant's actual cash deposit to the Clearing Fund, and (b) each Eligible Clearing Fund Security pledged to the Corporation by the Member and (c) the face amount of each Letter of Credit (if required by the Corporation) issued on behalf of the participant in favor of the Corporation shall be deemed allocated to the Fund for the System concerning the assets that constitute each Member's Actual Deposit.~~

~~SEC. 2. Subject to the limitations contained in this Rule and the use of a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit as provided in Section 3 of this Rule to satisfy his obligations to the Corporation, the use of~~

~~(a) (1) each Fund shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation arising in the System to which the Fund pertains, and~~

~~(2) the Mutual Fund Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Mutual Fund Services, and~~

~~(3) the Insurance Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Insurance and Retirement Processing Services, and~~

~~(b) the Clearing Fund, which consists of all Clearing Fund deposits except for deposits made in respect of the Mutual Fund Services and Insurance and Retirement Processing Services, shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~Any cash in the Clearing Fund may be partially or wholly invested in securities issued or guaranteed as to principal and interest by the United States or agencies or instrumentalities of the United States, repurchase agreements relating to such securities or, certificates of deposit or deposit accounts insured by the Federal Deposit Insurance Corporation, "FDIC", or otherwise pursuant to the investment policy adopted by the Corporation.~~

~~Each participant Member shall be entitled to any interest earned or paid on pledged Eligible Clearing Fund Securities or Clearing Fund cash deposits.³ Any interest on pledged Eligible Clearing Fund Securities that is received by the~~

³ Sponsored Accounts (as defined in Procedure IX.B.) will receive interest earned or paid on their Clearing Fund deposits held at DTC at such rate or rates as DTC pays to its participants.

Corporation shall be credited to the Member's cash deposit to the Clearing Fund, except in the event of a default by such Member on any obligations to the Corporation, in which case the Corporation may exercise its rights under Section 3 of this Rule.

~~No cash in the Clearing Fund and no proceeds of any loans made to the Corporation upon the pledge, by the Corporation, of Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or the assignment or transfer, by the Corporation, of Letters of Credit (if any) (or the proceeds thereof) issued on behalf of such participant in favor of the Corporation, to secure the participant's open account indebtedness ("Clearing Fund Cash") and no money payments received from Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members and payable to others ("Cash Receipts") shall be used by the Corporation for any purpose other than (a) the investment of any Clearing Fund Cash or Cash Receipts in securities issued or guaranteed as to principal and interest by the United States or its agencies or invested in certificates of deposit or similar deposits of FDIC approved banks selected by the Corporation, or deposited by the Corporation in its name in a depository or depositories selected by the Corporation, (b) the payment of Cash Receipts to the persons entitled thereto for the purposes for which such Cash Receipts were received by the Corporation, including the allocation of fees, fines and other charges receivable by the Corporation to the Corporation's general account, (c) the application of Clearing Fund Cash to satisfy (i) any loss or liability of the Corporation to the extent permissible pursuant to this Section and Sections 3 and 4 of this Rule or (ii) the return of the deposit of such a participant pursuant to Sections 6 or 9 of this Rule and (d) the loan of Clearing Fund Cash to the Corporation to permit the Corporation to meet its settlement obligations to its participants.~~

SEC. 3. Application of Clearing Fund Deposits and Other Amounts to Members' Obligations. ~~If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member is obligated to the Corporation pursuant to these Rules and Procedures, other than for a pro rata charge governed by Section 5 of this Rule, and (i) fails to satisfy the obligation or (ii) the obligation is a Cross-Guaranty Obligation, the Corporation shall apply to such obligation the portion, of the participant's amount of such Member's a~~Actual dDeposit, any amounts available under a Clearing Agency Cross-Guaranty Agreement, and any proceeds of any of the foregoing to satisfy necessary to eliminate the obligation. ~~Upon the Corporation's demand the participant shall deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any resulting deficiency in his Required Deposit. and the Corporation may take any and all actions with respect to such assets and amounts, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Member's Actual Deposit as compared~~

to its Required Fund Deposit, the Member shall immediately replenish its Actual Deposit. If the ~~participant Member shall fail~~ to do so, the Corporation may take disciplinary action against such ~~participant Member~~ pursuant to Rule 46 or Rule 48. Any disciplinary action ~~which that~~ the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership ~~by the participant~~ shall not affect the ~~Member's~~ obligations ~~of the participant~~ to the Corporation or any remedy to which the Corporation may be entitled under applicable law.

~~In applying a Member's or Mutual Fund/Insurance Services Member's actual deposit to his obligations to the Corporation, the Corporation shall first apply that portion of his actual deposit which has been allocated to the Mutual Fund Allocation to obligations arising in the Mutual Fund Services, to the Insurance Allocation to obligations arising in the Insurance and Retirement Processing Services and to any Fund to obligations arising in the System to which the Fund pertains. If after such application the participant remains obligated in one or more Systems, the Corporation shall apply any remaining deposit to his remaining obligation to each such System, in the same proportion that each obligation bears to the total remaining obligations to the Systems. If the participant thereafter remains obligated to the Corporation, any remaining deposit shall be applied thereto.~~

~~Notwithstanding the foregoing, to the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the Off the Market Transaction, or on whose behalf the Off the Market Transaction was submitted, to the Corporation; however, no allocation shall be made if such Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures.~~

~~SEC. 4. **Loss Allocation Waterfall, Off-the-Market Transactions.** If the Corporation incurs a loss or liability (i) relating to or arising out of a default of a Member for whom the Corporation has ceased to act pursuant to Rule 46 (such Member being referred to as a "Defaulting Member") that is not satisfied pursuant to Sections 3, 13 or 14 of this Rule (a "Defaulting Member Event") or (ii) otherwise incident to the clearance and settlement business of the Corporation as determined below (a "Declared Non-Default Loss Event") in a System which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Fund for that System. The Corporation shall not apply any other portion of the Clearing Fund to any such loss or liability. Corporation shall address the loss or liability as follows:~~

~~If the Corporation incurs a loss or liability in the Mutual Fund Services or the Insurance and Retirement Processing Services which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the~~

~~Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Mutual Fund Allocation for the Mutual Fund Services or the Allocation for the Insurance and Retirements Processing Service.~~

~~If the Corporation incurs any loss or liability otherwise than in a System which is not satisfied pursuant to Section 3 of this Rule or the second paragraph of Section 4 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Clearing Fund.~~

~~If the retained earnings applied to the loss or liability are insufficient to eliminate the loss or liability, the Fund allocated for the System in which the loss or liability occurred, the Mutual Fund Allocation, the Insurance Allocation or the Clearing Fund, whichever applicable, shall be applied to eliminate the excess loss, provided, however, that if a loss or liability occurs simultaneously in a System, the Insurance and Retirement Processing Services and/or the Mutual Fund Services and any other service whose transactions are not guaranteed and such losses or liabilities are not satisfied by the application of retained earnings, the Fund for the System, the Insurance Allocation and the Mutual Fund Allocation shall be applied before the Clearing Fund is applied. If a Fund or the Mutual Fund Allocation or the Insurance Allocation or the Clearing Fund is applied to a loss or liability, the Corporation shall provide 5 business days' prior notice to each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member and to the Securities and Exchange Commission, stating the amount to be applied and the reasons therefore.~~

~~If a Fund is applied, each Member who participated in the System, other than the Member or Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his or their allocation to the Fund, less the proportion of such allocation attributable to the additional amount the Member was required to deposit pursuant to Rule 15, (as such allocation was fixed at the time the loss or liability is discovered). If the Mutual Fund Allocation or the Insurance Allocation, as the case may be, is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member who participated in the Mutual Fund Services or Insurance and Retirement Processing Services, as the case may be, other than the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or Members, Insurance Carrier/Retirement Services Members or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based on his or their allocation to the Mutual Fund Allocation or Insurance Allocation, as the case may be.~~

~~If the Clearing Fund is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member, other than the Member or Members, Mutual Fund/Insurance Services~~

~~Member or Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Member or Insurance Carriers Members, or Fund Member or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his Required Deposit, less the amount of his Mutual Fund Services deposit, or Insurance and Retirement Processing Services deposit, as the case may be, and less the additional amount he was required to deposit pursuant to Rule 15 (as such Required Deposit was fixed at the time the loss or liability is discovered), without regard for any allocation to a Fund for a System.~~

~~SEC. 5. Except as provided in Section 8 of this Rule, if a pro rata charge is made pursuant to Section 4 of this Rule against a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit, and as a consequence such participant's remaining deposit to the Clearing Fund is less than his Required Deposit, the participant shall, upon the Corporation's demand, deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any deficiency in his Required Deposit. If the participant shall fail to do so, the Corporation may take disciplinary action against the participant pursuant to Rule 46 or Rule 48. Any disciplinary action which the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership by the participant shall not affect the obligations of the participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law.~~

For the purposes of this Rule, the following terms shall have the following meanings:

"Defaulting Member" shall mean a Member for which the Corporation has ceased to act pursuant to Rule 46.

"Defaulting Member Event" shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 46.

"Declared Non-Default Loss Event" shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

If the Corporation incurs a loss or liability arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation shall address the loss or liability as follows:

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) business days (an “Event Period”) shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for a *the* Defaulting Member (or the next business day, if such day is not a business day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the ~~determination by the Board of Directors that the applicable loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.~~ *Declared Non-Default Loss Event* (or the next business day, if such day is not a business day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 3 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

The Corporation shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.

In the case of losses and liabilities relating to or arising out of a Declared Non-Default Loss Event, all Members shall be subject to loss allocation. In the case of losses and liabilities relating to or arising out of a Defaulting Member Event, only non-defaulting Members shall be subject to loss allocation. After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with

Section 6 of this Rule shall be subject to loss allocation with respect to that Event Period. The Corporation shall notify Members subject to loss allocation of the amounts being allocated to them (“Loss Allocation Notice”) in successive rounds of loss allocations.

Each Member that is a Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Member for which the Corporation ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule.

Each loss allocation shall be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.
Loss Allocation Notice.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Withdrawal Notification Period”) to notify the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, and thereby benefit from its Loss Allocation Cap. The “Loss Allocation Cap” of a Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule shall be subject to further loss allocation with respect to that Event Period.

Each Member's pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member's "Average RFD"), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round. Each Member's maximum payment obligation with respect to any loss allocation round shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period or (y) its Average RFD (such amount shall be each Member's "Loss Allocation Cap").

Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second business day after the Corporation issues any such notice. Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second business day after the Corporation issues such notice, unless the Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round pursuant to Section 6 of this Rule.

Notwithstanding Section 9 of this Rule, to the extent that a Member's Loss Allocation Cap exceeds the Member's Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Member, up to the Member's Loss Allocation Cap.

If a Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with Section 3 of this Rule.

If a Member notifies the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member shall comply with the provisions of Section 6 of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member fails to comply with the provisions of Section 6 of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction; however, no allocation shall be made if the Defaulting Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures, prior to its default.

SEC. 5. Corporate Contribution. For any loss allocation pursuant to Section 4 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) business days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution.

Nothing in these Rules and Procedures shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether *arising out of or relating to a* Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

SEC. 6. Withdrawal Following Loss Allocation. If a Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss allocation *round* as set forth in Section 4 of this Rule ("Loss Allocation Withdrawal Notice"), the Member shall:

(i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period,

(ii) cease all activity that would result in transactions being submitted to the Corporation for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member's withdrawal, and

(iii) ensure that all clearance and settlement activity for which such Member is obligated to the Corporation is fully and finally settled by the effective date of the Member's withdrawal from membership, including, without limitation, by resolving by such date all fails and buy-in obligations.

A Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

If the Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to Section 4 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.

~~SEC. 67. Return of Members' Clearing Fund Deposits. A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member or his successor in interest shall be entitled to the return of his actual deposit 90 days after:~~

~~(i) the participant ceases to be a participant and~~

~~(ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund or any Fund have been closed, and~~

~~(iii) all obligations to the Corporation for which the participant was responsible while a participant have been satisfied or, at the discretion of the Corporation, have been deducted by the Corporation from the participant's actual deposit; provided, however, that the participant has presented to the Corporation such indemnities or guarantees as the Corporation deems satisfactory or another participant has been substituted on all transactions and obligations of the participant.~~

~~In the absence of an acceptable guarantee, indemnity or substitution, the greater of:~~

~~(a) 25% of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's average clearing fund requirement over the 12 months immediately prior to the date the participant ceases to be such, or~~

~~(b) \$100,000,~~

~~or, if the participant's actual clearing fund deposit is less than \$100,000, the entire deposit, shall be returned no later than 2 years (4 years for Members who have Sponsored Accounts at a Qualified Securities Depository) after (i), (ii) and (iii) above have occurred.~~

~~A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member shall be entitled to the return of his Mutual Fund Services deposit or Insurance and Retirement Processing Services deposit, as the case may be, ninety (90) days after all Mutual Fund Services transactions or Insurance and Retirement Processing Services transactions, as the case may be, for which he was responsible have been satisfied.~~

~~Any obligation of participant to the Corporation unsatisfied at the time he ceases to be a participant shall not be affected by such cessation of membership.~~

If a Member gives notice to the Corporation of its election to withdraw from membership, the Member's Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied. Notwithstanding the foregoing, the Corporation may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.

SEC. 78. Changes in Members' Required Fund Deposits. ~~Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members~~ Each Member shall deposit in the Clearing Fund such amount ~~which that~~ is necessary to satisfy any increase in ~~his its~~ Required **Fund** Deposit within such time as the Corporation shall require. At the time the increase becomes effective, the ~~participant's Member's~~ obligations to the Corporation shall be determined in accordance with the increased Required **Fund** Deposit whether or not the ~~increase in his Required Deposit has been made~~ Member has satisfied such increased amount.

SEC. 89. Excess Clearing Fund Deposits. ~~If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~

~~or Fund Member, within 10 business days after receipt of notice of a pro rata charge pursuant to Section 4 of this Rule, gives notice to the Corporation of his election to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, he shall nevertheless remain obligated for the pro rata charge; however, his obligation in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Required Deposit less the portion of this deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, and his obligation in respect of a pro rata charge from the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Mutual Fund Services deposit or the Insurance and Retirement Processing Services deposit, as the case may be, as fixed immediately prior to the time of the pro rata charge. The Corporation may make additional pro rata charges attributable to the same loss or liability. In such instance, notwithstanding the foregoing limitation, the obligation of a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, who after receipt of notice of an additional charge elects to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, to the greater of (a) his Required Deposit less the portion of his deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge, or (b) the amount of all prior pro rata charges, attributable to the same loss or liability in respect of which his right to limit such obligation, as provided above, has not been timely exercised, and in respect of a Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, pro rata charge to the greater of (a) the deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge or (b) the amount of all prior pro rata charges in respect of which his right to limit such obligations, as provided above, has not been timely exercised. If the amount of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member or Fund Member's actual deposit is less than his Required Deposit and, accordingly, his actual deposit is insufficient to satisfy the pro rata charge as limited by this Section 8, he shall be obligated to make up the deficiency in his Required Deposit notwithstanding the fact that he subsequently ceases to be a participant, or terminates his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be.~~

~~**SEC. 9.**—The Corporation shall determine with such frequency as it shall, from time to time to specify, whether the amount deposited by each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~

~~or Fund Member~~ to the Clearing Fund may be in excess of such Member's participant's Required Fund Deposit. On any day that the Corporation has determined that an excess deposit exists with respect to any Member, the Corporation will, in the form and manner required by the Corporation, notify each such Member of such excess. ~~and provided notification that the Clearing Fund deposit of a participant exceeds its Required Deposit, then upon such participant's request, provided in such form and within such timeframe as determined by the Corporation from time to time, the Corporation shall cause to be returned to the participant cash on deposit (in excess of the minimum amount of cash required to be maintained in the Clearing Fund) and/or Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) securing such participant's open account indebtedness in an aggregate amount equal to such excess or such lesser amount as the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member may request; provided, however, that such excess shall not be returned (a) until any amount which is required to be charged against the participant's Required Deposit is paid by the participant to the Corporation and/or (b) if the Corporation determines that the participant's current month's use of one or more services is materially different than the previous month's use of such service(s) upon which such excess deposit is based.~~ Subject to the Corporation's rights under these Rules and Procedures to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value in accordance with Section III of Procedure XV on the day of such withdrawal) as the Member requests. Notwithstanding the foregoing, the Corporation may, in its discretion, determine to withhold all or part of any excess deposit of a ~~Member~~participant if such ~~Member~~participant has been placed on the Watch List pursuant to these Rules and Procedures ~~or if the Corporation determines that the Member's anticipated activities in the Corporation in the near future may reasonably be expected to be materially different than its activities of the recent past.~~

The provisions of this Section 9 of Rule 4 shall not limit the rights or remedies of the Corporation as provided by Rule 15 of the Rules and Procedures of the Corporation.

SEC. 10. No waiver; Subsequent Recovery Against Loss Amounts. No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules and Procedures. If a loss charged pro rata is afterward recovered by the Corporation, in whole or in part, the net amount of the recovery shall be credited to the ~~p~~Persons, including the Corporation, against whom the loss was charged in proportion to the amounts charged against them.

SEC. 11. **Substitution or Withdrawal of Pledged Securities.** Upon notice to the Corporation provided in such form and within such timeframe as determined by the Corporation from time to time, a **participant Member** may withdraw **or substitute pledged** Eligible Clearing Fund Securities ~~from pledge~~, provided that the **participant Member continues to has, effective simultaneously with such withdrawal, deposited cash with, or pledged additional Eligible Clearing Fund Securities to, the Corporation which in the aggregate, secure the open account indebtedness of the participant and/or satisfy his at all times its Required Fund Deposit.**

SEC. 12. **Authority of Corporation.** In furtherance of the rights of the Corporation pursuant to these Rules **and Procedures**, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign ~~(each, a "Pledge")~~ any or all ~~a~~Actual ~~d~~Deposits ~~of Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members and Fund Members to the Clearing Fund which shall consist of (i) Clearing Fund Cash, (ii) securities, repurchase agreements, deposits or other instruments in which Clearing Fund Cash is invested and (iii) Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member, or Letters of Credit issued on behalf of any such participant in favor of the Corporation (if any such Letters of Credit are required by the Corporation), in each case to secure the participant's obligations to the Corporation under these Rules, together with the proceeds of any of the foregoing, and any proceeds thereof~~ for the purpose of securing loans made to the Corporation (the party making any such loan to the Corporation hereinafter referred to as the "Lender"); provided that the proceeds of such loans are used for a purpose permissible under Section 2 of this Rule. Such loans shall be on terms and conditions deemed necessary or advisable by the Corporation (including collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ to the Corporation for which such property and **Eligible** ~~l~~Letters of ~~e~~Credit (if any) were pledged to or deposited with the Corporation; provided, however, that if any such loan is made as a result of a loss or liability suffered by the Corporation, the Corporation will promptly, but in no event later than 30 **calendar** days from the day the loan is made, repay the loan in full. No Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ shall have any right, claim or action against any secured Lender (or any collateral agent of such secured Lender) for the return, or otherwise in respect, of any such collateral ~~P~~ledged by the Corporation to such secured Lender (or its collateral agent), so long as any loans made by such Lender to the Corporation or other obligations, secured by such collateral, are unpaid and outstanding. Subject to the foregoing and to the terms and conditions of such loan, the Corporation shall remain obligated to each such **participant Member** to return, and to allow substitution for or withdrawal of, cash, and Eligible Clearing Fund Securities, and **Eligible** ~~l~~Letters of ~~e~~Credit (if any) pledged or deposited by such **participant Member** as a Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund~~, or otherwise to collateralize such **participant's Member's** obligations to the Corporation,

under the circumstances and within the time frames specified in these Rules and Procedures. In the event of any conflict or inconsistency between this Rule 4 and any agreement between the Corporation and any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member~~, this Rule 4 shall govern and prevail.

SEC. 13. Mutual Fund Deposits. Each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member shall, and each Fund Member (collectively with such Members and Mutual Fund/Insurance Services Members, "Mutual Fund Participants") may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Mutual Fund Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit shall be a separate and additional component of such Member's deposit to the Clearing Fund but shall not constitute part of such Member's Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to Section 4 of this Rule.

If any Mutual Fund Participant fails to satisfy any obligation to the Corporation relating to the Mutual Fund Services, notwithstanding the Corporation's right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, the Corporation shall first apply such Mutual Fund Participant's Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated to the Corporation, the Corporation shall apply such Member's Actual Deposit in accordance with Section 3 of this Rule. The Corporation shall next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations, in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants and, after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Mutual Fund Participants are Members. If any loss or liability remains thereafter and there are no continuing Mutual Fund Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any participant's Mutual Fund Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

A Mutual Fund Participant that elects to withdraw from membership shall be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Mutual Fund Participant was responsible while a Mutual Fund Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Mutual Fund Deposits.

SEC. 14. Insurance Deposits. Each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, "Insurance Participants") may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Insurance Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Insurance Deposits).

If any Insurance Participant fails to satisfy any obligation to the Corporation relating to the Insurance and Retirement Processing Services, the Corporation shall first apply such Insurance Participant's Insurance Deposit. If after such application any loss or liability remains, the Corporation shall next allocate such remaining loss or liability to the other Insurance Participants in successive rounds of loss allocations, in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants and, after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any Insurance Participant's Insurance Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

An Insurance Participant that elects to withdraw from membership shall be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Insurance Participant was responsible while an Insurance Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Insurance Deposits.

RULE 4(A). SUPPLEMENTAL LIQUIDITY DEPOSITS

SEC. 2. *Defined Terms.* The following terms shall have the meanings specified:

“Special Activity Prefund Deposit” means a cash deposit of a Member to the Clearing Fund made by wire transfer to an account designated by the Corporation:

- a. that is in excess of the Required **Fund** Deposit of the Member;

“Special Activity Supplemental Liquidity Need” means, on any Special Activity Business Day, the amount by which the Special Activity Daily Liquidity Need of the Corporation exceeds the sum of all Required **Fund** Deposits.

SEC. 11. *Ceasing to be a Participant.* Special Activity Supplemental Deposits shall not be subject to the provisions of Section ~~67~~ of Rule 4 relating to the ~~90~~**thirty (30)** **calendar** day deferral of refunds of deposits to the Clearing Fund when a Member ceases to be a participant.

SEC. 13. *Application of Special Activity Supplemental Deposits.*

- a. A Special Activity Supplemental Deposit of a Member may not be withdrawn by the Member unless it is entitled to a return of such deposit pursuant to Sections 9 or 10 above.
- b. A Special Activity Supplemental Deposit of a Member shall form a part of the ~~a~~**Actual d**Deposit of the Member to the Clearing Fund but shall be in addition to, and separate from, (i) the Required **Fund** Deposit of the Member and (ii) any other deposit of the Member to the Clearing Fund.
- c. A Special Activity Supplemental Deposit of a Member (i) may be invested, paid, applied and loaned as provided in Section 2 of Rule 4 and (ii) may be used to satisfy a loss or liability as provided in Sections ~~3~~ **or 13** of Rule 4.
- d. A Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any *pro rata* charge pursuant to Section 4 of Rule 4.

RULE 13. EXCEPTION PROCESSING

Notwithstanding any provisions in these Rules **and Procedures** to the contrary, in the event that a security may not otherwise be eligible for processing through the CNS, Balance Order or other ~~S~~system, the Corporation, in its sole discretion, may adopt, from time to time, procedures deemed appropriate for the processing of such security. Any such procedures shall be promptly communicated to Members by the Corporation and the Members shall be bound by the procedures set forth in such notice as fully as though such procedures were now a part of the Rules **and Procedures** of the Corporation. Each such notice shall be effective only for the security covered therein.

RULE 15. ASSURANCES OF FINANCIAL RESPONSIBILITY AND OPERATIONAL CAPABILITY

SEC. 2. (a) Each Member or Limited Member, or any applicant to become such, shall furnish to the Corporation such adequate assurances of its financial responsibility and operational capability as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation, its participants, creditors or investors, to safeguard securities and funds in the custody or control of the Corporation and for which the Corporation is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions. Upon the request of a participant or applicant, or otherwise, the Corporation may choose to confer with the participant or applicant before or after requiring it to furnish adequate assurances pursuant to this Rule.

(b) Adequate assurances of the financial responsibility or operational capability of a participant or applicant to become such, as may be required pursuant to these Rules and Procedures, may include, but shall not be limited to, as appropriate under the context of the participant's use of the Corporation's services:

- (i) additional reporting by the participant (or by the entity providing a guarantee) of its financial or operational condition at such intervals and in such detail as the Corporation shall determine;
- (ii) entering into agreements concerning the provision of operational support services by an entity acceptable to the Corporation;
- (iii) restrictions on the participant's use of the Corporation's services;
- (iv) increased Clearing Fund deposits (including additional amounts required in respect of trade activity received by the Corporation after calculation of the applicable Required **Fund** Deposit);
- (v) additional payments to the Corporation in such amounts as may be determined by the Corporation each morning reflecting a percentage of up to 100 percent of the participant's (i) average amount of total daily net debit positions or (ii) morning gross debit activity;
- (vi) delivering securities to the Member only against immediate payment by the Member to the Corporation; and

- (vii) assurances as may be required pursuant to the Corporation's Guidelines and/or Procedures.

RULE 42. WIND-DOWN OF A MEMBER, FUND MEMBER OR INSURANCE
CARRIER/RETIREMENT SERVICES MEMBER

The Corporation may, in its discretion, impose conditions on, or take actions with respect to, the Wind-Down Member as appropriate to mitigate risk the Corporation perceives may be presented by the Wind-Down Member, including but not limited to, the following:

- (i) Permitting the Wind-Down Member to submit to the Corporation only transactions that serve to support the wind-down;
- (ii) Permitting the Wind-Down Member to continue use of one or more of the Corporation's services, notwithstanding that it may not meet some or all of the financial or operational requirements for continuance as a Member or Limited Member, as applicable;
- (iii) Restricting or modifying the Wind-Down Member's use of any or all of the Corporation's services (whether generally, or with respect to certain transactions);
- (iv) Requiring additional assurances of the financial responsibility or operational capability of the Wind-Down Member through, for example, submission of a guaranty of the Wind-Down Member's obligations to the Corporation by an entity acceptable to the Corporation and/or additional reporting by the Wind-Down Member;
- (v) Agreeing to complete one or more trades to which the Wind-Down Member is a party prior to the time the Corporation's guaranty otherwise would become effective pursuant to these Rules and Procedures;
- (vi) Requiring the Wind-Down Member to post increased Clearing Fund deposits and/or to post its Required **Fund** Deposit all in cash or in proportions of cash, qualifying bonds and **e**Eligible Letters of Credit different from those permitted under Rule 4;
- (vii) Prohibiting the Wind-Down Member from withdrawing Clearing Fund on deposit in excess of its Required **Fund** Deposit;
- (viii) Calculating the Required **Fund** Deposit of the Wind-Down Member in a manner different from the applicable formulae provided in the Procedures, in order to more appropriately reflect the risk presented by the Wind-Down Member to the Corporation, such as for example, not applying certain components of such calculation; or

- (ix) Liquidating by buying-in or selling-out, as applicable, any open positions of the Wind-Down Member, for the benefit of such Wind-Down Member with any profit or loss resulting therefrom being debited or credited, as applicable, to the settlement account of the Wind-Down Member.

PROCEDURE III. TRADE RECORDING SERVICE (INTERFACE WITH QUALIFIED CLEARING AGENCIES)

B. Settlement of Option Exercises and Assignments and Settlement of Stock Futures Reaching Maturity

Unless otherwise agreed between OCC and the Corporation, E&A/Delivery Transactions are received by the Corporation from OCC each day on which both the Corporation and OCC are open for accepting trades for clearance. Subject to the paragraph below, the Corporation's guarantee pursuant to Addendum K shall become effective for each E&A/Delivery Transaction when the Required **Fund** Deposits to the Clearing Fund, after taking into account that E&A/Delivery Transaction, are received by the Corporation from all Participating Members.

If (i) a Participating Member has failed to satisfy its Clearing Fund obligations to the Corporation pursuant to Procedure XV, or (ii) the Corporation has declined or ceased to act for a Participating Member pursuant to these Rules **and Procedures** prior to the time that the Corporation's guarantee of such Participating Member's E&A/Delivery Transactions become effective (such Participating Member, a "Defaulting Participating Member"), then none of the E&A/Delivery Transactions involving such defaulting Participating Member for which the Corporation's guarantee pursuant to Addendum K has not yet become effective shall be guaranteed by the Corporation, and all such E&A/Delivery Transactions shall be exited out of the CNS Accounting Operation or the Balance Order Accounting Operation, as applicable, unless otherwise agreed between OCC and the Corporation. The Corporation shall have no further obligation regarding the settlement of the exited E&A/Delivery Transactions, other than such obligations as the Corporation may have pursuant to its arrangement with OCC, and the non-defaulting Participating Members' Required **Fund** Deposit to the Clearing Fund will be recalculated excluding the exited E&A/Delivery Transactions.

PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS¹

I.(B) Additional Clearing Fund Formula

(4) Bank Holiday Charge

For purposes of this section, “Holiday” means any day on which equities markets are open for trading, but the Board of Governors of the Federal Reserve System observes a holiday and banks are closed.

On the business day prior to any Holiday, the Corporation may require each Member to make an additional Clearing Fund deposit (“Bank Holiday Charge”). The Bank Holiday Charge approximates the exposure that a Member’s trading activity on the applicable Holiday could pose to the Corporation. Since the Corporation cannot collect margin on the Holiday, the Bank Holiday Charge is due on the business day prior to the applicable Holiday.

The methodology for calculating a Bank Holiday Charge shall be determined by the Corporation in advance of each applicable Holiday. The Bank Holiday Charge approximates each Member’s Required **Fund** Deposit to address the exposure that such Member’s trading activity on the Holiday could pose to the Corporation. The Corporation shall have the discretion to calculate the Bank Holiday Charge based on its assessment of market conditions at the time the Bank Holiday Charge is calculated (such as, for example, significant market occurrences that could impact market price volatility). The Corporation shall inform Members of the methodology it will use to calculate the Bank Holiday Charge by an Important Notice issued no later than 10 business days prior to the day on which the applicable Bank Holiday Charge is applied. Examples of potential methodologies for the Bank Holiday Charge may include, but shall not be limited to, time scaling of the volatility charge or a stress scenario that reflects potential market price volatility on the Holiday.

II. Minimum Clearing Fund and Additional Deposit Requirements

- (A) Each Member of the Corporation shall be required to contribute a minimum of \$10,000 (the “minimum contribution”). The first 40% (but no less than \$10,000) of a Member’s Required **Fund** Deposit must be in cash and the remaining amount, may be evidenced by open account indebtedness secured by the pledge of Eligible Clearing Fund Securities, which shall be valued, for collateral

¹ All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

purposes, as set forth in subsection III below. A Mutual Fund/Insurance Services Member's entire deposit is required to be in cash.

1. Special Provisions Related to Eligible Clearing Fund Securities:

- (a) Any deposits of Eligible Clearing Fund Agency Securities⁷ or Eligible Clearing Fund Mortgage-Backed Securities⁸, respectively, in excess of 25 percent of the Member's Required **Fund Deposit** will be subject to an additional haircut equal to twice the percentage as specified in the proposed haircut schedule detailed in subsection III below, and
 - (b) No more than 20 percent of a Member's Required **Fund Deposit** secured by pledged Eligible Agency Securities may be of a single issuer.
- (B) All Clearing Fund requirements and other deposit requirements shall be made by Members and Mutual Fund/Insurance Services Members, within one hour of demand unless otherwise determined by the Corporation; provided, however, that to the extent the Member and Mutual Fund/Insurance Services Member is meeting such obligation with a (1) deposit of cash, such deposit shall be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire, and (2) delivery of eligible securities, such delivery shall be received within the deadlines established by ~~a Qualified Securities Depository~~ **DTC**. At the discretion of the Corporation, cash deposits may be included as part of the Member's or Mutual Fund/Insurance Services Member's, daily settlement obligation.
- (C) Additional Clearing Fund deposits shall not be requested unless they exceed such threshold as determined by the Corporation from time to time; provided that the affected Member or Limited Member is not on the Watch List.
- (D) Where the amount of a Member's and Mutual Fund/Insurance Services Member's deficiency is in excess of \$1,000 but less than \$5,000, the Corporation may require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000, the Corporation may require payment in multiples of \$5,000.

⁷ A Member that is an Agency may not pledge Eligible Clearing Fund Agency Securities of which it is the issuer.

⁸ With regard to a Member that pledges Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, such securities will be subject to a premium haircut, as set forth in subsection III below.

ADDENDUM E

~~STATEMENT OF POLICY~~

~~APPLICATION OF RETAINED EARNINGS – MEMBER IMPAIRMENTS~~

~~Under Rule 4, Section 4, if the Corporation suffers a loss or liability by reason of a Member's impairment, and such loss or liability is not satisfied or otherwise made good from the impaired Member's Clearing Fund deposit, the Corporation, in its discretion, may either satisfy such loss or liability or any part thereof out of its then existing retained earnings or, after appropriate notice to both the membership and the Securities and Exchange Commission, directly from the Clearing Fund deposits of all other Members on a pro rata basis.~~

~~While neither the Corporation nor its three predecessor clearing agencies have ever subjected their memberships to such a pro rata assessment, the ability exists for the Corporation to bypass completely its retained earnings. Since the Board of Directors of the Corporation is desirous of clarifying its intentions with respect to the usage of retained earnings in Member impairment situations, the Board has adopted this Policy Statement.~~

~~The Board of Directors of the Corporation hereby advises the membership of the Corporation that pursuant to Rule 4, Section 4 of the Rules of the Corporation, the Corporation will apply no less than twenty five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability.~~

~~Nothing herein, however, shall prevent the Corporation from applying more than twenty five percent (25%) of its then existing retained earnings, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time of the Member impairment.~~

~~This Policy Statement may not be changed, modified or altered, without thirty days prior written notice to the membership and to the Securities and Exchange Commission. Any such change, modification or alteration shall only be prospective in effect, and shall not be applicable to any losses or liability previously incurred as a result of prior Member impairments.~~

(ADDENDUM LETTER RESERVED FOR FUTURE USE)

ADDENDUM K

**~~INTERPRETATION OF THE BOARD OF DIRECTORS
APPLICATION OF CLEARING FUND~~THE CORPORATION'S GUARANTY**

~~Pursuant to Rule 47, the Board of Directors has the authority to interpret the Rules of the Corporation. The purpose of this interpretation is to clarify certain provisions of Rule 4 and the extent to which the Clearing Fund may be applied to a loss or liability of the Corporation.~~

~~I. APPLICATION OF THE CLEARING FUND TO LOSSES SUSTAINED BY A SYSTEM~~

- ~~1. Section 1 of Rule 4 provides that each Member's Required Deposit shall be allocated by the Corporation among the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the Member participates.~~
- ~~2. The Corporation has in practice assumed responsibility for completion of transactions in each of the following services, and has deemed each of these services to be a System, even though the Corporation has not previously made a formal designation of each such service as a System within the definition of Section 1 of Rule 4:~~

The Corporation guarantees the completion of compared and locked-in CNS and balance orders transactions from a fixed point in the clearance and settlement process.¹ CNS transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures. Balance order transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures through the close of business on T+2. If the contra party to a same day or one day settling trade is a member of an interfacing clearing corporation, such guarantee shall not be applicable unless an agreement to guarantee such trade exists between the Corporation and the interfacing clearing corporation. The Corporation has also adopted a policy of guaranteeing the completion of when-issued and when-distributed trades, as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures and will consider all when-issued and when-

¹ The trade guarantee of obligations arising out of the exercise or assignment of options that are settled at the Corporation is addressed in a separate arrangement between NSCC and Options Clearing Corporation, as referred to in Procedure III of the Rules and Procedures, and is not addressed in these Rules and Procedures.

distributed trades of Members as if they were CNS transactions for surveillance purposes regardless of the accounting operation in which they ultimately settle.

~~3. In connection with the expansion by the Corporation of its clearance and settlement business, it has become desirable for the Corporation to make formal designations of the services constituting Systems within the definition of Section 1 of Rule 4. Accordingly, the Board hereby designates the services referred to in paragraph 1.2. above as services for which the Corporation assumes the responsibility for the completion of transactions, and therefore as Systems within the Rule 4, Section 1 definition. These services are the only services so designated as of this date.~~

~~II. APPLICATION OF THE CLEARING FUND TO EXCESS LOSSES AND LOSSES OUTSIDE OF A SYSTEM~~

~~1. Section 2(b) of Rule 4 provides that the use of the Clearing Fund in its entirety (which consists in part of all the Funds) shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~2. Pursuant to Section 2(b) of Rule 4, the entire Clearing Fund must be available to satisfy losses arising outside of a System.~~

~~There are various circumstances pursuant to which the entire Clearing Fund may be available to satisfy losses outside of a System:~~

- ~~• One circumstance arises out of the Mutual Fund Services. Members that do not participate in the Mutual Fund Services are shielded from exposures to the Mutual Fund Services losses as long as the Corporation continues to have active participants in Mutual Fund Services.~~

~~If the Corporation were to have an unsatisfied Mutual Fund Services loss, such loss may be satisfied from the entire Clearing Fund (less the amounts paid in respect of the Mutual Fund Services).~~

- ~~• An additional circumstance arises out of the Insurance and Retirement Processing Services. If the Corporation were to have an unsatisfied loss due to a Member's, Mutual Fund/Insurance Services Member's or Insurance Carrier/Retirement Services Member's use of the Insurance and Retirement Processing Services, such loss may be satisfied from the entire Clearing Fund.~~

ADDENDUM O
ADMISSION OF NON-US ENTITIES AS DIRECT NSCC MEMBERS

Admission of Non-US Entities¹

- Foreign Legal Opinion – obtain an opinion of reputable foreign counsel satisfactory to NSCC providing, among other things, that the agreements described above may be enforced against the foreign entity in the courts of its home country or other jurisdictions where the entity or its property may be found.²

¹ This policy statement excludes Non-U.S. entities that are insurance companies.

² NSCC reserves the right to require the entity to deposit additional amounts to the Clearing Fund and to post an **Eligible Letter of Credit** in an instance where NSCC, in its sole discretion, believes the entity presents legal risk.



NATIONAL
SECURITIES
CLEARING
CORPORATION

RULES & PROCEDURES

TEXT OF PROPOSED RULE CHANGE

Bold and underlined text indicates proposed added language

~~Bold and strikethrough text~~ indicates proposed deleted language

RULE 1. DEFINITIONS AND DESCRIPTIONS

Unless the context requires otherwise, the terms defined in this Rule shall, for all purposes of these Rules **and Procedures**, have the meanings herein specified.

Actual Deposit

The term "Actual Deposit" has the meaning specified in Rule 4.

Average RFD

The term "Average RFD" has the meaning specified in Rule 4.

Clearing Fund Cash

The term "Clearing Fund Cash" has the meaning specified in Rule 4.

Corporate Contribution

The term "Corporate Contribution" has the meaning specified in Rule 4.

Corporation

The term "Corporation" means National Securities Clearing Corporation.

Declared Non-Default Loss Event

The term "Declared Non-Default Loss Event" has the meaning specified in Rule 4.

Defaulting Member

The term "Defaulting Member" has the meaning specified in Rule 4.

Defaulting Member Event

The term "Defaulting Member Event" has the meaning specified in Rule 4.

Eligible Letter of Credit

The term "Eligible Letter of Credit" has the meaning specified in Rule 4.

Event Period

The term "Event Period" has the meaning specified in Rule 4.

Insurance Deposit

The term "Insurance Deposit" has the meaning specified in Rule 4.

Insurance Participant

The term "Insurance Participant" has the meaning specified in Rule 4.

Issuer

The term "Issuer" has the meaning specified in Rule 4.

Lender

The term "Lender" has the meaning specified in Rule 4.

Loss Allocation Cap

The term "Loss Allocation Cap" has the meaning specified in Rule 4.

Loss Allocation Notice

The term "Loss Allocation Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notice

The term "Loss Allocation Withdrawal Notice" has the meaning specified in Rule 4.

Loss Allocation Withdrawal Notification Period

The term "Loss Allocation Withdrawal Notification Period" has the meaning specified in Rule 4.

Mutual Fund Deposit

The term "Mutual Fund Deposit" has the meaning specified in Rule 4.

Mutual Fund Participant

The term "Mutual Fund Participant" has the meaning specified in Rule 4.

Required Fund Deposit

The term "Required Fund Deposit" has the meaning specified in Rule 4.

Termination Date

The term "Termination Date" has the meaning specified in Rule 2B.

The Corporation

The term "the Corporation" means the ~~National Securities Clearing Corporation.~~

Voluntary Termination Notice

The term "Voluntary Termination Notice" has the meaning specified in Rule 2B.

RULE 2B. ONGOING MEMBERSHIP REQUIREMENTS AND MONITORING

SEC. 4. ONGOING MONITORING

(e) The Corporation may require a Member or Limited Member that has been placed on the Watch List to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Procedure XV (which additional deposit shall constitute a portion of the Member's or Limited Member's Required **Fund** Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member or Limited Member. The Corporation may also retain any deposit in excess of the Required **Fund** Deposit of a Member or Limited Member that has been placed on the Watch List as provided in Section 9 of Rule 4.

SEC. 5. VOLUNTARY ~~RETIREMENT~~TERMINATION

A Member, Fund Member, Insurance Carrier/Retirement Services Member, Municipal Comparison Only Member, Mutual Fund/Insurance Services Member, Data Services Only Member, Investment Manager/Agent Member, AIP Member, Third Party Provider Member or Third Party Administrator Member each may elect to voluntarily ~~retire~~terminate such membership by providing the Corporation with a written notice of such termination ("**Voluntary Termination Notice**"). The participant shall specify in the Voluntary Termination Notice a desired date for its withdrawal from membership; provided, however, such date shall not be prior to the scheduled final settlement date of any remaining obligation owed by the participant to the Corporation as of the time such Voluntary Termination Notice is submitted to the Corporation, unless otherwise approved by the Corporation.

Such termination will not be effective until accepted by the Corporation, which shall be no later than ten (10) business days after the receipt of the Voluntary Termination Notice from such participant. The Corporation's acceptance shall be evidenced by a notice to the Corporation's participants announcing the participant's ~~retirement~~termination and the last trade date for the participant. The effective date of the ~~retirement~~ participant's termination shall be the final settlement date of all transactions of the participant (the "**Retirement Termination Date**"). After the close of business on the Termination Date, a participant that terminates its membership in the Corporation shall no longer be eligible or required to submit transactions to the Corporation for clearance and settlement, unless the Board determines otherwise in order to ensure an orderly liquidation of the participant's open obligations. If any transaction is submitted to the Corporation by such

participant that is scheduled to settle after the Termination Date, such participant's Voluntary Termination Notice will be deemed void, and the participant will remain subject to these Rules and Procedures as if it had not given such Voluntary Termination Notice.

A participant's voluntary termination of membership shall not affect its obligations to the Corporation, or the rights of the Corporation, with respect to transactions submitted to the Corporation before the **Retirement Termination** Date (including, but not limited to, any pro-rata charge made by the Corporation pursuant to Section **84** of Rule 4). **The return of the participant's Clearing Fund deposit shall be governed by Sections 7, 13 and 14 of Rule 4, as applicable. If an Event Period were to occur after a participant has submitted its Voluntary Termination Notice but on or prior to the Termination Date, in order for such participant to benefit from its Loss Allocation Cap pursuant to Section 4 of Rule 4, the participant will need to comply with the provisions of Section 6 of Rule 4 and submit a Loss Allocation Withdrawal Notice, which notice, upon submission, shall supersede and void any pending Voluntary Termination Notice previously submitted by the participant.**

RULE 4. CLEARING FUND

SEC. 1. **Required Fund Deposits.** Each Member ~~and Mutual Fund/Insurance Services Member shall, and each Fund Member and each Insurance Carrier/Retirement Services Member may be required to,~~ make and maintain on an ongoing basis a deposit to the Clearing Fund; ~~such deposits to the Clearing Fund shall be held by the Corporation to be applied as provided in this Rule.~~¹ The amount of each ~~such participant's~~ Member's required deposit shall be fixed determined by the Corporation in accordance with ~~one or more formulas specified by the Board of Directors and included in the Procedure XV and other applicable Rules and~~ Procedures (the "Required Fund Deposit"). ~~The basis of each formula shall be use of the Corporation's facilities.~~ The minimum Required Fund Deposit for each Member shall be \$10,000 ~~unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The minimum Required Deposit for a ~~Mutual Fund/Insurance Services Member who uses the Mutual Fund Services shall be \$5,000 unless changed by the Board of Directors and shall be in cash unless changed by the Board of Directors.~~ The Corporation may require any such ~~participant~~ Member to deposit additional amounts to the Clearing Fund pursuant to Rule 15 ~~and such amounts shall be part of the participant's Required Deposit.~~ A Member may in its discretion maintain additional deposits at the Corporation, subject to any Procedures or other requirements the Corporation may establish for such excess amounts. For purposes of these Rules and Procedures, such additional deposits shall be deemed to be part of the Clearing Fund and the Member's Actual Deposit but shall not be deemed to be part of the Member's Required Fund Deposit.

The Corporation, ~~in its discretion,~~ may permit ~~part of a Member's, Insurance Carrier/Retirement Services Member's or Fund Member's deposit to be evidenced by an open account indebtedness secured by Members to satisfy their Required Fund Deposit obligations through a combination of cash and open account indebtedness secured by~~ Eligible Clearing Fund Securities, ~~provided that the percentage of such participant's Required Deposit that may be collateralized with Eligible Clearing Fund Securities and the collateral value of pledged Eligible Clearing Fund Securities shall be as set forth, as further described~~ in Procedure XV². The aggregate of cash deposited, the collateral value of pledged Eligible

¹ Clearing Fund deposits for Sponsored Accounts (as defined in Procedure IX.B.) relative to such Sponsored Accounts' DTC activity will be calculated and held by DTC in accordance with their procedures, and shall not be included in determining the Required Fund Deposit or the minimum cash requirement.

² In addition, the Corporation reserves the right to require participants to post a letter of credit in an instance where the Corporation, in its discretion, believes the participant presents legal risk. In such circumstances the Corporation may require part of a participant's deposit to be evidenced by an open account indebtedness ~~secured~~supported by one or more irrevocable ~~L~~C letters of ~~C~~Credit with a maturity of no more than one year issued on behalf of the participant in favor of the Corporation (i) under which a bank, trust company or United States branch or agency of a foreign bank (hereinafter, an "Issuer"), in each case approved by the Corporation for such purpose, is obligated to honor drafts

Clearing Fund Securities determined in accordance with Section III of Procedure XV, and the face amount of any Eligible Letters of Credit shall not at any time be less than the Member's Required Fund Deposit.

~~The collateral value of the Eligible Clearing Fund Securities and the face amount of Letters of Credit (if any Letters of Credit are required by the Corporation) shall not at any time be less in the aggregate than the amount of the participant's open account indebtedness. Each Member grants to the Corporation a first priority perfected security interest in its right, title and interest in and to any Eligible Clearing Fund Securities, funds and assets pledged to the Corporation to secure the Member's open account indebtedness or placed by a Member in the possession of the Corporation (or its agents acting on its behalf) (collectively with any Eligible Letters of Credit issued on behalf of a Member in favor of the Corporation, the Member's "Actual Deposit"), in each case to secure all such Member's obligations to the Corporation. The Corporation shall be entitled to exercise the rights of a pledgee under common law and a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such assets. The Eligible Clearing Fund Securities shall be pledged to secure a Member's open account indebtedness shall be delivered to the Corporation's account at DTC, or on such other terms and conditions as the Corporation shall may require. The Corporation may in its discretion hold pledged Eligible Clearing Fund Securities in its account at a financial institution designated by the Corporation including, in the Corporation's discretion, the pledge by Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members to the Corporation's account at a Qualified Securities Depository designated by such participant. Eligible Clearing Fund Securities that are not pledged at a Qualified Securities Depository shall be held by the Corporation for its account by a bank or trust company (other than the participant) designated by the Corporation.~~

~~Each participant's Required Deposit shall be allocated by the Corporation among the Mutual Fund Services, the Insurance and Retirement Processing Services and the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the~~

up to a specified amount drawn on it by the Corporation, ~~provided that and (ii)~~ the terms and conditions of ~~any such Letter of Credit are deemed which the Corporation determines are~~ acceptable to the Corporation in its sole discretion (each such letter of credit, an "Eligible Letter of Credit"). Any amount drawn on any Eligible Letters of Credit shall be deposited into, and constitute an additional cash deposit to, the Clearing Fund and shall reduce the participant's open account indebtedness by a corresponding amount. Within ten (10) calendar days prior to the stated expiration date of any such Eligible Letter of Credit or within such time as the Corporation shall direct upon receipt by the Corporation of written notice from an approved bank of an earlier expiration date of any Eligible Letter of Credit securing supporting a participant's open account indebtedness, such participant shall make a substitution for the Eligible Letter of Credit, in accordance with the provisions of this Rule, in the amount required, effective upon or prior to the expiration of the Eligible Letter of Credit.

~~participant participates. The allocation for each System, shall bear the same percentage relationship to the participant's Required Deposit as the participant's use of that System bears to his use of all services offered by the Corporation as measured by settlement dollars. The allocation for the Mutual Fund Services and the Insurance and Retirement Processing Services shall be the dollar amount required to be deposited pursuant to the Clearing Fund formula. The portion of the Clearing Fund allocated for the Mutual Fund Services shall be known as the "Mutual Fund Allocation". The portion of the Clearing Fund allocated for the Insurance and Retirement Processing Services shall be known as the "Insurance Allocation". The portion of the Clearing Fund allocated for each System shall be known as the "Fund" for that System. For example, the portion of the Required Deposit of each Member which shall be allocated for the CNS System shall be known as the Member's "CNS Fund Deposit" and the aggregate of the CNS Fund Deposits shall be known as the "CNS Fund."~~

SEC. 2. Permitted Use, Investment, and Maintenance of Clearing Fund Assets. The Clearing Fund shall only be used by the Corporation (i) to secure each Member's performance of obligations to the Corporation, including each Member's obligations with respect to any loss allocations as set forth in Section 4 of this Rule, (ii) to provide liquidity to the Corporation to meet its settlement obligations, including, without limitation, through the direct use of cash in the Clearing Fund or through the pledge or rehypothecation of pledged Eligible Clearing Fund Securities in order to secure liquidity, and (iii) for investment as set forth in this section.

Each time the Corporation uses any part of the Clearing Fund pursuant to clause (ii) in the preceding paragraph for more than 30 calendar days, the Corporation, at the close of business on the 30th calendar day (or on the first business day thereafter) from the day of such use, shall consider the amount used but not yet repaid as a loss to the Clearing Fund incurred as a result of a Defaulting Member Event and immediately allocate such loss in accordance with Section 4 of this Rule.

The Corporation may invest any cash in the Clearing Fund, including (i) cash deposited by a Member as part of its Actual Deposit, (ii) the proceeds of (x) any loans made to the Corporation secured by the pledge by the Corporation of Eligible Clearing Fund Securities pledged to the Corporation or (y) any sales of Eligible Clearing Fund Securities pledged to the Corporation, (iii) cash receipts from any investment of, repurchase or reverse repurchase agreements relating to, or liquidation of, Clearing Fund assets, and (iv) cash payments on Eligible Letters of Credit (collectively, "Clearing Fund Cash"), in accordance with the Clearing Agency Investment Policy adopted by the Corporation.

~~The Corporation shall not be required to segregate any Fund for a System, the Mutual Fund Allocation, or the Insurance Allocation from the Clearing Fund. The Corporation's each Member's Actual Deposit, but shall maintain~~ books and records shall, however, identify the percentage of each Member's Required Deposit which

~~is at any time allocated to a Fund for a System, to the Mutual Fund Allocation, or the Insurance Allocation. That percentage of (a) the participant's actual cash deposit to the Clearing Fund, and (b) each Eligible Clearing Fund Security pledged to the Corporation by the Member and (c) the face amount of each Letter of Credit (if required by the Corporation) issued on behalf of the participant in favor of the Corporation shall be deemed allocated to the Fund for the System concerning the assets that constitute each Member's Actual Deposit.~~

~~SEC. 2. Subject to the limitations contained in this Rule and the use of a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit as provided in Section 3 of this Rule to satisfy his obligations to the Corporation, the use of~~

~~(a) (1) each Fund shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation arising in the System to which the Fund pertains, and~~

~~(2) the Mutual Fund Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Mutual Fund Services, and~~

~~(3) the Insurance Allocation shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of Insurance and Retirement Processing Services, and~~

~~(b) the Clearing Fund, which consists of all Clearing Fund deposits except for deposits made in respect of the Mutual Fund Services and Insurance and Retirement Processing Services, shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~Any cash in the Clearing Fund may be partially or wholly invested in securities issued or guaranteed as to principal and interest by the United States or agencies or instrumentalities of the United States, repurchase agreements relating to such securities or, certificates of deposit or deposit accounts insured by the Federal Deposit Insurance Corporation, "FDIC", or otherwise pursuant to the investment policy adopted by the Corporation.~~

~~Each participant Member shall be entitled to any interest earned or paid on pledged Eligible Clearing Fund Securities or Clearing Fund cash deposits.³ Any interest on pledged Eligible Clearing Fund Securities that is received by the~~

³ Sponsored Accounts (as defined in Procedure IX.B.) will receive interest earned or paid on their Clearing Fund deposits held at DTC at such rate or rates as DTC pays to its participants.

Corporation shall be credited to the Member's cash deposit to the Clearing Fund, except in the event of a default by such Member on any obligations to the Corporation, in which case the Corporation may exercise its rights under Section 3 of this Rule.

~~No cash in the Clearing Fund and no proceeds of any loans made to the Corporation upon the pledge, by the Corporation, of Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or the assignment or transfer, by the Corporation, of Letters of Credit (if any) (or the proceeds thereof) issued on behalf of such participant in favor of the Corporation, to secure the participant's open account indebtedness ("Clearing Fund Cash") and no money payments received from Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members and payable to others ("Cash Receipts") shall be used by the Corporation for any purpose other than (a) the investment of any Clearing Fund Cash or Cash Receipts in securities issued or guaranteed as to principal and interest by the United States or its agencies or invested in certificates of deposit or similar deposits of FDIC approved banks selected by the Corporation, or deposited by the Corporation in its name in a depository or depositories selected by the Corporation, (b) the payment of Cash Receipts to the persons entitled thereto for the purposes for which such Cash Receipts were received by the Corporation, including the allocation of fees, fines and other charges receivable by the Corporation to the Corporation's general account, (c) the application of Clearing Fund Cash to satisfy (i) any loss or liability of the Corporation to the extent permissible pursuant to this Section and Sections 3 and 4 of this Rule or (ii) the return of the deposit of such a participant pursuant to Sections 6 or 9 of this Rule and (d) the loan of Clearing Fund Cash to the Corporation to permit the Corporation to meet its settlement obligations to its participants.~~

SEC. 3. Application of Clearing Fund Deposits and Other Amounts to Members' Obligations. ~~If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member is obligated to the Corporation pursuant to these Rules and Procedures, other than for a pro rata charge governed by Section 5 of this Rule, and (i) fails to satisfy the obligation or (ii) the obligation is a Cross-Guaranty Obligation, the Corporation shall apply to such obligation the portion, of the participant's amount of such Member's a~~Actual dDeposit, any amounts available under a Clearing Agency Cross-Guaranty Agreement, and any proceeds of any of the foregoing to satisfy necessary to eliminate the obligation. ~~Upon the Corporation's demand the participant shall deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any resulting deficiency in his Required Deposit. and the Corporation may take any and all actions with respect to such assets and amounts, including assignment, transfer, and sale of any Eligible Clearing Fund Securities, that the Corporation determines is appropriate. If such application results in any deficiency in the Member's Actual Deposit as compared~~

to its Required Fund Deposit, the Member shall immediately replenish its Actual Deposit. If the ~~participant Member shall fails~~ to do so, the Corporation may take disciplinary action against such ~~participant Member~~ pursuant to Rule 46 or Rule 48. Any disciplinary action ~~which that~~ the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership ~~by the participant~~ shall not affect the ~~Member's~~ obligations ~~of the participant~~ to the Corporation or any remedy to which the Corporation may be entitled under applicable law.

~~In applying a Member's or Mutual Fund/Insurance Services Member's actual deposit to his obligations to the Corporation, the Corporation shall first apply that portion of his actual deposit which has been allocated to the Mutual Fund Allocation to obligations arising in the Mutual Fund Services, to the Insurance Allocation to obligations arising in the Insurance and Retirement Processing Services and to any Fund to obligations arising in the System to which the Fund pertains. If after such application the participant remains obligated in one or more Systems, the Corporation shall apply any remaining deposit to his remaining obligation to each such System, in the same proportion that each obligation bears to the total remaining obligations to the Systems. If the participant thereafter remains obligated to the Corporation, any remaining deposit shall be applied thereto.~~

~~Notwithstanding the foregoing, to the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with an Off-the-Market Transaction, it shall be allocated directly and entirely to the Member that submitted the Off the Market Transaction, or on whose behalf the Off the-Market Transaction was submitted, to the Corporation; however, no allocation shall be made if such Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures.~~

SEC. 4. **Loss Allocation Waterfall, Off-the-Market Transactions.** ~~If the Corporation incurs a loss or liability in a System which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Fund for that System. The Corporation shall not apply any other portion of the Clearing Fund to any such loss or liability.~~

~~If the Corporation incurs a loss or liability in the Mutual Fund Services or the Insurance and Retirement Processing Services which is not satisfied pursuant to Section 3 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Mutual Fund Allocation for the Mutual Fund Services or the Allocation for the Insurance and Retirements Processing Service.~~

~~If the Corporation incurs any loss or liability otherwise than in a System which is not satisfied pursuant to Section 3 of this Rule or the second paragraph of Section 4 of this Rule, the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines shall be applied to the loss or liability unless the Board of Directors elects instead to apply the Clearing Fund.~~

~~If the retained earnings applied to the loss or liability are insufficient to eliminate the loss or liability, the Fund allocated for the System in which the loss or liability occurred, the Mutual Fund Allocation, the Insurance Allocation or the Clearing Fund, whichever applicable, shall be applied to eliminate the excess loss, provided, however, that if a loss or liability occurs simultaneously in a System, the Insurance and Retirement Processing Services and/or the Mutual Fund Services and any other service whose transactions are not guaranteed and such losses or liabilities are not satisfied by the application of retained earnings, the Fund for the System, the Insurance Allocation and the Mutual Fund Allocation shall be applied before the Clearing Fund is applied. If a Fund or the Mutual Fund Allocation or the Insurance Allocation or the Clearing Fund is applied to a loss or liability, the Corporation shall provide 5 business days' prior notice to each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member and to the Securities and Exchange Commission, stating the amount to be applied and the reasons therefore.~~

~~If a Fund is applied, each Member who participated in the System, other than the Member or Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his or their allocation to the Fund, less the proportion of such allocation attributable to the additional amount the Member was required to deposit pursuant to Rule 15, (as such allocation was fixed at the time the loss or liability is discovered). If the Mutual Fund Allocation or the Insurance Allocation, as the case may be, is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member who participated in the Mutual Fund Services or Insurance and Retirement Processing Services, as the case may be, other than the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, or Members, Insurance Carrier/Retirement Services Members or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based on his or their allocation to the Mutual Fund Allocation or Insurance Allocation, as the case may be.~~

~~If the Clearing Fund is applied, each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member and Fund Member, other than the Member or Members, Mutual Fund/Insurance Services Member or Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Member or Insurance Carriers Members, or Fund Member or Fund Members, if any, responsible for causing the loss or liability, shall be charged pro rata based upon his Required Deposit, less the amount of his Mutual Fund Services deposit, or Insurance and Retirement Processing~~

~~Services deposit, as the case may be, and less the additional amount he was required to deposit pursuant to Rule 15 (as such Required Deposit was fixed at the time the loss or liability is discovered), without regard for any allocation to a Fund for a System.~~

~~SEC. 5. Except as provided in Section 8 of this Rule, if a pro rata charge is made pursuant to Section 4 of this Rule against a Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's actual deposit, and as a consequence such participant's remaining deposit to the Clearing Fund is less than his Required Deposit, the participant shall, upon the Corporation's demand, deposit in the Clearing Fund, within such time as the Corporation shall require, that which is necessary to eliminate any deficiency in his Required Deposit. If the participant shall fail to do so, the Corporation may take disciplinary action against the participant pursuant to Rule 46 or Rule 48. Any disciplinary action which the Corporation takes pursuant to Rule 46 or Rule 48 or the voluntary or involuntary cessation of membership by the participant shall not affect the obligations of the participant to the Corporation or any remedy to which the Corporation may be entitled under applicable law.~~

For the purposes of this Rule, the following terms shall have the following meanings:

"Defaulting Member" shall mean a Member for which the Corporation has ceased to act pursuant to Rule 46.

"Defaulting Member Event" shall mean the determination by the Corporation to cease to act for a Member pursuant to Rule 46.

"Declared Non-Default Loss Event" shall mean the determination by the Board of Directors that a loss or liability incident to the clearance and settlement business of the Corporation may be a significant and substantial loss or liability that may materially impair the ability of the Corporation to provide clearance and settlement services in an orderly manner and will potentially generate losses to be mutualized among Members in order to ensure that the Corporation may continue to offer clearance and settlement services in an orderly manner.

If the Corporation incurs a loss or liability arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation shall address the loss or liability as follows:

Defaulting Member Events and/or Declared Non-Default Loss Events that occur within a period of ten (10) business days (an "Event Period") shall be grouped together for purposes of applying the limits on loss allocation set forth in this Rule.

In the case of a Defaulting Member Event, an Event Period begins on the day the Corporation notifies Members that it has ceased to act for the Defaulting Member (or the next business day, if such day is not a business day).

In the case of a Declared Non-Default Loss Event, an Event Period begins on the day that the Corporation notifies Members of the Declared Non-Default Loss Event (or the next business day, if such day is not a business day), which notification shall be issued promptly following any such determination. If a subsequent Defaulting Member Event or Declared Non-Default Loss Event occurs during an Event Period, any losses or liabilities arising out of or relating to any such subsequent event shall be resolved as losses or liabilities that are part of the same Event Period, without extending the duration of such Event Period.

Each Member shall be obligated to the Corporation for the entire amount of any loss or liability incurred by the Corporation arising out of or relating to any Defaulting Member Event with respect to such Member. To the extent that such loss or liability is not satisfied pursuant to Section 3 of this Rule 4, the Corporation shall apply a Corporate Contribution thereto and charge the remaining amount of such loss or liability ratably to other Members, as further provided below.

The Corporation shall apply the Corporate Contribution to losses and liabilities that arise out of or relate to one or more Defaulting Member Events and/or Declared Non-Default Loss Events that occur within an Event Period. If losses and liabilities with respect to such Event Period remain unsatisfied following application of the Corporate Contribution, the Corporation shall allocate such losses and liabilities to Members, subject to the requirements and limitations below.

Each Member that is a Member on the first day of an Event Period shall be obligated to pay its pro rata share of losses and liabilities arising out of or relating to each Defaulting Member Event (other than a Defaulting Member Event with respect to which it is the Defaulting Member) and each Declared Non-Default Loss Event occurring during the Event Period. Any Member for which the Corporation ceases to act on a non-business day, triggering an Event Period that commences on the next business day, shall be deemed to be a Member on the first day of that Event Period.

A loss allocation “round” means a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members (a “round cap”). When the aggregate amount of losses allocated in a round equals the round cap, any additional losses relating to the applicable Event Period would be allocated in one or more subsequent rounds, in each case subject to a round cap for that round. The Corporation may continue the loss allocation process in successive rounds until all losses from the Event Period are allocated among Members that have not

submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule.

Each loss allocation shall be communicated to Members by the issuance of a notice that advises the Members of the amount being allocated to them (“Loss Allocation Notice”). Each Member’s pro rata share of losses and liabilities to be allocated in any round shall be equal to (i) the average of its Required Fund Deposit for the seventy (70) business days preceding the first day of the applicable Event Period or such shorter period of time that the Member has been a Member (each Member’s “Average RFD”), divided by (ii) the sum of Average RFD amounts of all Members subject to loss allocation in such round.

Each Loss Allocation Notice shall specify the relevant Event Period and the round to which it relates. The first Loss Allocation Notice in any first, second, or subsequent round shall expressly state that such Loss Allocation Notice reflects the beginning of the first, second, or subsequent round, as the case may be, and that each Member in that round has five (5) business days from the issuance of such first Loss Allocation Notice for the round (such period, a “Loss Allocation Withdrawal Notification Period”) to notify the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, and thereby benefit from its Loss Allocation Cap. The “Loss Allocation Cap” of a Member shall be equal to the greater of (x) its Required Fund Deposit on the first day of the applicable Event Period and (y) its Average RFD.

After a first round of loss allocations with respect to an Event Period, only Members that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule shall be subject to further loss allocation with respect to that Event Period.

Members shall pay to the Corporation the amount specified in any first round Loss Allocation Notice on the second business day after the Corporation issues any such notice. Members shall pay to the Corporation the amount specified in any subsequent round Loss Allocation Notice on the second business day after the Corporation issues such notice, unless the Member has timely notified (or will timely notify) the Corporation of its election to withdraw from membership with respect to a prior loss allocation round pursuant to Section 6 of this Rule.

To the extent that a Member’s Loss Allocation Cap exceeds the Member’s Required Fund Deposit on the first day of the applicable Event Period, the Corporation may, in its discretion, retain any excess amounts on deposit from the Member, up to the Member’s Loss Allocation Cap.

If a Member fails to make payment to the Corporation in respect of a Loss Allocation Notice by the time such payment is due, the Corporation shall have the right to proceed against such Member as a Member that has failed to satisfy an obligation in accordance with Section 3 of this Rule.

If a Member notifies the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member shall comply with the provisions of Section 6 of this Rule. If, after notifying the Corporation of its election to withdraw from membership pursuant to Section 6 of this Rule, the Member fails to comply with the provisions of Section 6 of this Rule, its notice of withdrawal shall be deemed void and any further losses resulting from the applicable Event Period may be allocated against it as if it had not given such notice.

To the extent that a loss or liability of the Corporation is determined by the Corporation to arise in connection with the close-out or liquidation of an Off-the-Market Transaction in the portfolio of a Defaulting Member, it shall be allocated directly and entirely to the Member that was the counterparty to such Off-the-Market Transaction; however, no allocation shall be made if the Defaulting Member has satisfied all applicable intraday mark-to-market margin charges assessed by the Corporation with respect to the Off-the-Market Transaction, as permitted by these Rules and Procedures, prior to its default.

SEC. 5. Corporate Contribution. For any loss allocation pursuant to Section 4 of this Rule, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporation's corporate contribution to losses or liabilities that are incurred by the Corporation with respect to an Event Period ("Corporate Contribution") shall be an amount that is equal to fifty (50) percent of the amount calculated by the Corporation in respect of its General Business Risk Capital Requirement as of the end of the calendar quarter immediately preceding the Event Period. The Corporation's General Business Risk Capital Requirement, as defined in its Clearing Agency Policy on Capital Requirements, is, at a minimum, equal to the regulatory capital that the Corporation is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Securities Exchange Act of 1934, as amended. If the Corporate Contribution is applied by the Corporation against a loss or liability relating to an Event Period, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, the Corporate Contribution for any subsequent Event Periods occurring during the two hundred fifty (250) business days thereafter shall be reduced to the remaining unused portion of the Corporate Contribution amount that applied for the first Event Period. The Corporation shall notify Members of any such reduction to the Corporate Contribution.

Nothing in these Rules and Procedures shall prevent the Corporation from voluntarily applying amounts greater than the Corporate Contribution against any loss or liability of the Corporation, whether arising out of or relating to a Defaulting Member Event or a Declared Non-Default Loss Event, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time.

SEC. 6. Withdrawal Following Loss Allocation. If a Member timely notifies the Corporation of its election to withdraw from membership in respect of a loss

allocation round as set forth in Section 4 of this Rule (“Loss Allocation Withdrawal Notice”), the Member shall:

(i) specify in the Loss Allocation Withdrawal Notice an effective date for its withdrawal from membership, which date shall not be later than ten (10) business days following the last day of the Loss Allocation Withdrawal Notification Period,

(ii) cease all activity that would result in transactions being submitted to the Corporation for clearance and settlement for which such Member would be obligated to perform, where the scheduled final settlement date would be later than the effective date of the Member’s withdrawal, and

(iii) ensure that all clearance and settlement activity for which such Member is obligated to the Corporation is fully and finally settled by the effective date of the Member’s withdrawal from membership, including, without limitation, by resolving by such date all fails and buy-in obligations.

A Member that withdraws in compliance with the requirements of this section shall nevertheless remain obligated for its pro rata share of losses and liabilities with respect to any Event Period for which it is otherwise obligated hereunder; however, its aggregate obligation shall be limited to the amount of its Loss Allocation Cap (as fixed in the round for which it withdrew).

If the Member fails to comply with the requirements in this section, its Loss Allocation Withdrawal Notice will be deemed void, and the Member will remain subject to further loss allocations pursuant to Section 4 of this Rule as if it had not given such Loss Allocation Withdrawal Notice.

~~SEC. 67. *Return of Members’ Clearing Fund Deposits.* A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member or his successor in interest shall be entitled to the return of his actual deposit 90 days after:~~

~~(i) the participant ceases to be a participant and~~

~~(ii) all transactions open at the time the participant ceases to be a participant which could result in a charge to the Clearing Fund or any Fund have been closed, and~~

~~(iii) all obligations to the Corporation for which the participant was responsible while a participant have been satisfied or, at the discretion of the Corporation, have been deducted by the Corporation from the participant’s actual deposit; provided, however, that the participant has presented to the Corporation such indemnities or guarantees as the Corporation deems satisfactory or another participant has been substituted on all transactions and obligations of the participant.~~

~~In the absence of an acceptable guarantee, indemnity or substitution, the greater of:~~

~~(a) 25% of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member's or Fund Member's average clearing fund requirement over the 12 months immediately prior to the date the participant ceases to be such, or~~

~~(b) \$100,000,~~

~~or, if the participant's actual clearing fund deposit is less than \$100,000, the entire deposit, shall be returned no later than 2 years (4 years for Members who have Sponsored Accounts at a Qualified Securities Depository) after (i), (ii) and (iii) above have occurred.~~

~~A Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member shall be entitled to the return of his Mutual Fund Services deposit or Insurance and Retirement Processing Services deposit, as the case may be, ninety (90) days after all Mutual Fund Services transactions or Insurance and Retirement Processing Services transactions, as the case may be, for which he was responsible have been satisfied.~~

~~Any obligation of participant to the Corporation unsatisfied at the time he ceases to be a participant shall not be affected by such cessation of membership.~~

~~If a Member gives notice to the Corporation of its election to withdraw from membership, the Member's Actual Deposit in the form of (i) cash or securities shall be returned to it within thirty (30) calendar days and (ii) Eligible Letters of Credit shall be returned to it within ninety (90) calendar days, after all of its transactions have settled and all matured and contingent obligations to the Corporation for which the Member was responsible while a Member have been satisfied. Notwithstanding the foregoing, the Corporation may retain for up to two (2) years the Actual Deposits from Members who have Sponsored Accounts at DTC.~~

~~SEC. 78. Changes in Members' Required Fund Deposits. Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members or Fund Members Each Member shall deposit in the Clearing Fund such amount ~~which~~ that is necessary to satisfy any increase in ~~his~~ its Required Fund Deposit within such time as the Corporation shall require. At the time the increase becomes effective, the ~~participant's~~ Member's obligations to the Corporation shall be determined in accordance with the increased Required Fund Deposit whether or not the ~~increase in his Required Deposit has been made~~ Member has satisfied such increased amount.~~

~~SEC. 89. Excess Clearing Fund Deposits. If a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~

~~or Fund Member, within 10 business days after receipt of notice of a pro rata charge pursuant to Section 4 of this Rule, gives notice to the Corporation of his election to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, he shall nevertheless remain obligated for the pro rata charge; however, his obligation in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Required Deposit less the portion of this deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, and his obligation in respect of a pro rata charge from the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited to the amount of his Mutual Fund Services deposit or the Insurance and Retirement Processing Services deposit, as the case may be, as fixed immediately prior to the time of the pro rata charge. The Corporation may make additional pro rata charges attributable to the same loss or liability. In such instance, notwithstanding the foregoing limitation, the obligation of a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member, who after receipt of notice of an additional charge elects to terminate his business with the Corporation, or his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, shall be limited in respect of any pro rata charge other than a pro rata charge arising from losses in the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, to the greater of (a) his Required Deposit less the portion of his deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge, or (b) the amount of all prior pro rata charges, attributable to the same loss or liability in respect of which his right to limit such obligation, as provided above, has not been timely exercised, and in respect of a Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, pro rata charge to the greater of (a) the deposit attributable to the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be, as fixed immediately prior to the time of the first pro rata charge or (b) the amount of all prior pro rata charges in respect of which his right to limit such obligations, as provided above, has not been timely exercised. If the amount of the Member's, Mutual Fund/Insurance Services Member's, Insurance Carrier/Retirement Services Member or Fund Member's actual deposit is less than his Required Deposit and, accordingly, his actual deposit is insufficient to satisfy the pro rata charge as limited by this Section 8, he shall be obligated to make up the deficiency in his Required Deposit notwithstanding the fact that he subsequently ceases to be a participant, or terminates his use of the Mutual Fund Services or the Insurance and Retirement Processing Services, as the case may be.~~

~~**SEC. 9.**—The Corporation shall determine with such frequency as it shall, from time to time to specify, whether the amount deposited by each Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member~~

~~or Fund Member~~ to the Clearing Fund may be in excess of such Member's participant's Required Fund Deposit. On any day that the Corporation has determined that an excess deposit exists with respect to any Member, the Corporation will, in the form and manner required by the Corporation, notify each such Member of such excess. ~~and provided notification that the Clearing Fund deposit of a participant exceeds its Required Deposit, then upon such participant's request, provided in such form and within such timeframe as determined by the Corporation from time to time, the Corporation shall cause to be returned to the participant cash on deposit (in excess of the minimum amount of cash required to be maintained in the Clearing Fund) and/or Eligible Clearing Fund Securities (valued at their collateral value on the day of such withdrawal) securing such participant's open account indebtedness in an aggregate amount equal to such excess or such lesser amount as the Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member may request; provided, however, that such excess shall not be returned (a) until any amount which is required to be charged against the participant's Required Deposit is paid by the participant to the Corporation and/or (b) if the Corporation determines that the participant's current month's use of one or more services is materially different than the previous month's use of such service(s) upon which such excess deposit is based.~~ Subject to the Corporation's rights under these Rules and Procedures to require additional amounts to be deposited by a Member, upon a Member's request, and in accordance with such procedures as the Corporation may set forth from time to time, the Corporation shall return to the Member such amount of its excess cash on deposit (subject to the minimum amount of cash required to be maintained in the Clearing Fund) and/or pledged Eligible Clearing Fund Securities (valued at their collateral value in accordance with Section III of Procedure XV on the day of such withdrawal) as the Member requests. Notwithstanding the foregoing, the Corporation may, in its discretion, determine to withhold all or part of any excess deposit of a Memberparticipant if such Memberparticipant has been placed on the Watch List pursuant to these Rules and Procedures or if the Corporation determines that the Member's anticipated activities in the Corporation in the near future may reasonably be expected to be materially different than its activities of the recent past.

The provisions of this Section 9 of Rule 4 shall not limit the rights or remedies of the Corporation as provided by Rule 15 of the Rules and Procedures of the Corporation.

SEC. 10. No waiver; Subsequent Recovery Against Loss Amounts. No loss allocation under this Rule shall constitute a waiver of any claim the Corporation may have against a Member for any losses or liabilities, including, without limitation, any loss or liability to which the Member is subject under these Rules and Procedures. If a loss charged pro rata is afterward recovered by the Corporation, in whole or in part, the net amount of the recovery shall be credited to the persons, including the Corporation, against whom the loss was charged in proportion to the amounts charged against them.

SEC. 11. **Substitution or Withdrawal of Pledged Securities.** Upon notice to the Corporation provided in such form and within such timeframe as determined by the Corporation from time to time, a ~~participant Member~~ may withdraw **or substitute pledged** Eligible Clearing Fund Securities ~~from pledge~~, provided that the ~~participant Member continues to has, effective simultaneously with such withdrawal, deposited cash with, or pledged additional Eligible Clearing Fund Securities to, the Corporation which in the aggregate, secure the open account indebtedness of the participant and/or~~ satisfy **his at all times its** Required **Fund** Deposit.

SEC. 12. **Authority of Corporation.** In furtherance of the rights of the Corporation pursuant to these Rules **and Procedures**, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign ~~(each, a "Pledge")~~ any or all ~~a~~**Actual** ~~d~~**Deposits of Members, Mutual Fund/Insurance Services Members, Insurance Carrier/Retirement Services Members and Fund Members to the Clearing Fund which shall consist of (i) Clearing Fund Cash, (ii) securities, repurchase agreements, deposits or other instruments in which Clearing Fund Cash is invested and (iii) Eligible Clearing Fund Securities pledged by a Member, Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member, or Letters of Credit issued on behalf of any such participant in favor of the Corporation (if any such Letters of Credit are required by the Corporation), in each case to secure the participant's obligations to the Corporation under these Rules, together with the proceeds of any of the foregoing, and any proceeds thereof** for the purpose of securing loans made to the Corporation (the party making any such loan to the Corporation hereinafter referred to as the "Lender"); provided that the proceeds of such loans are used for a purpose permissible under Section 2 of this Rule. Such loans shall be on terms and conditions deemed necessary or advisable by the Corporation (including collateralization thereof) in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ to the Corporation for which such property and **Eligible** ~~l~~**Letters of e****Credit** (if any) were pledged to or deposited with the Corporation; provided, however, that if any such loan is made as a result of a loss or liability suffered by the Corporation, the Corporation will promptly, but in no event later than 30 **calendar** days from the day the loan is made, repay the loan in full. No Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or Fund Member~~ shall have any right, claim or action against any secured Lender (or any collateral agent of such secured Lender) for the return, or otherwise in respect, of any such collateral ~~P~~**pledged** by the Corporation to such secured Lender (or its collateral agent), so long as any loans made by such Lender to the Corporation or other obligations, secured by such collateral, are unpaid and outstanding. Subject to the foregoing and to the terms and conditions of such loan, the Corporation shall remain obligated to each such ~~participant Member~~ to return, and to allow substitution for or withdrawal of, cash, and Eligible Clearing Fund Securities, and **Eligible l****Letters of e****Credit** (if any) pledged or deposited by such ~~participant Member~~ as a Clearing Fund deposit ~~or to secure an open account indebtedness to the Clearing Fund,~~ or otherwise to collateralize such ~~participant's~~ **Member's** obligations to the Corporation,

under the circumstances and within the time frames specified in these Rules and Procedures. In the event of any conflict or inconsistency between this Rule 4 and any agreement between the Corporation and any Member, ~~Mutual Fund/Insurance Services Member, Insurance Carrier/Retirement Services Member or a Fund Member~~, this Rule 4 shall govern and prevail.

SEC. 13. Mutual Fund Deposits. Each Member that uses the Mutual Fund Services to submit mutual fund purchases, redemptions, or exchanges to any Fund Member or another Member and each Mutual Fund/Insurance Services Member shall, and each Fund Member (collectively with such Members and Mutual Fund/Insurance Services Members, "Mutual Fund Participants") may, be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Mutual Fund Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Mutual Fund Deposits). In the case of a Member, its Mutual Fund Deposit shall be a separate and additional component of such Member's deposit to the Clearing Fund but shall not constitute part of such Member's Required Fund Deposit for purposes of calculating pro rata loss allocations pursuant to Section 4 of this Rule.

If any Mutual Fund Participant fails to satisfy any obligation to the Corporation relating to the Mutual Fund Services, notwithstanding the Corporation's right to reverse in whole or in part any credit previously given to the contra side to any outstanding Mutual Fund Services transaction of the Mutual Fund/Insurance Services Member, the Corporation shall first apply such Mutual Fund Participant's Mutual Fund Deposit. If after such application any loss or liability remains and if such Mutual Fund Participant is a Member that is not otherwise obligated to the Corporation, the Corporation shall apply such Member's Actual Deposit in accordance with Section 3 of this Rule. The Corporation shall next allocate any further remaining loss or liability to the other Mutual Fund Participants in successive rounds of loss allocations, in each case up to the aggregate of Mutual Fund Deposits from non-defaulting Mutual Fund Participants and, after the first such round, Mutual Fund Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Mutual Fund Participants are Members. If any loss or liability remains thereafter and there are no continuing Mutual Fund Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any participant's Mutual Fund Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

A Mutual Fund Participant that elects to withdraw from membership shall be entitled to the return of its Mutual Fund Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Mutual Fund Participant was responsible while a Mutual Fund Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Mutual Fund Deposits.

SEC. 14. *Insurance Deposits.* Each Mutual Fund/Insurance Services Member that uses the Insurance and Retirement Processing Services and each Insurance Carrier/Retirement Services Member (collectively, "Insurance Participants") may be required to make a cash deposit to the Clearing Fund in the amounts determined in accordance with Procedure XV and other applicable Rules and Procedures (its "Insurance Deposit" and, unless specified otherwise, for the purposes of these Rules and Procedures, Required Fund Deposits shall include Insurance Deposits).

If any Insurance Participant fails to satisfy any obligation to the Corporation relating to the Insurance and Retirement Processing Services, the Corporation shall first apply such Insurance Participant's Insurance Deposit. If after such application any loss or liability remains, the Corporation shall next allocate such remaining loss or liability to the other Insurance Participants in successive rounds of loss allocations, in each case up to the aggregate of Insurance Deposits from non-defaulting Insurance Participants and, after the first such round, Insurance Participants that have not submitted a Loss Allocation Withdrawal Notice in accordance with Section 6 of this Rule, following the procedures and subject to the timeframes set forth in Sections 4 and 6 of this Rule as if such Insurance Participants are Members. If any loss or liability remains thereafter and there are no continuing Insurance Participants, the Corporation shall proceed with loss allocations to Members for a Defaulting Member Event as set forth in Section 4 of this Rule. The application of any Insurance Participant's Insurance Deposit shall not affect any other right or remedy of the Corporation under these Rules and Procedures or under applicable law.

An Insurance Participant that elects to withdraw from membership shall be entitled to the return of its Insurance Deposit no later than thirty (30) calendar days after all of its transactions have settled and all matured and contingent obligations to the Corporation for which such Insurance Participant was responsible while an Insurance Participant have been satisfied.

Without limitation of the specific provisions set forth in this section, the Corporation's rights, authority and obligations with respect to deposits to the Clearing Fund that are set forth in this Rule 4, including, without limitation, the treatment of Clearing Fund Cash, shall apply to Insurance Deposits.

RULE 4(A). SUPPLEMENTAL LIQUIDITY DEPOSITS

SEC. 2. *Defined Terms.* The following terms shall have the meanings specified:

“Special Activity Prefund Deposit” means a cash deposit of a Member to the Clearing Fund made by wire transfer to an account designated by the Corporation:

- a. that is in excess of the Required **Fund** Deposit of the Member;

“Special Activity Supplemental Liquidity Need” means, on any Special Activity Business Day, the amount by which the Special Activity Daily Liquidity Need of the Corporation exceeds the sum of all Required **Fund** Deposits.

SEC. 11. *Ceasing to be a Participant.* Special Activity Supplemental Deposits shall not be subject to the provisions of Section ~~67~~ of Rule 4 relating to the ~~90~~**thirty (30)** **calendar** day deferral of refunds of deposits to the Clearing Fund when a Member ceases to be a participant.

SEC. 13. *Application of Special Activity Supplemental Deposits.*

- a. A Special Activity Supplemental Deposit of a Member may not be withdrawn by the Member unless it is entitled to a return of such deposit pursuant to Sections 9 or 10 above.
- b. A Special Activity Supplemental Deposit of a Member shall form a part of the ~~a~~**Actual d**Deposit of the Member to the Clearing Fund but shall be in addition to, and separate from, (i) the Required **Fund** Deposit of the Member and (ii) any other deposit of the Member to the Clearing Fund.
- c. A Special Activity Supplemental Deposit of a Member (i) may be invested, paid, applied and loaned as provided in Section 2 of Rule 4 and (ii) may be used to satisfy a loss or liability as provided in Sections ~~3~~ **or 13** of Rule 4.
- d. A Special Activity Supplemental Deposit of a Member may not be used to calculate or be applied to satisfy any *pro rata* charge pursuant to Section 4 of Rule 4.

RULE 13. EXCEPTION PROCESSING

Notwithstanding any provisions in these Rules and Procedures to the contrary, in the event that a security may not otherwise be eligible for processing through the CNS, Balance Order or other ~~S~~system, the Corporation, in its sole discretion, may adopt, from time to time, procedures deemed appropriate for the processing of such security. Any such procedures shall be promptly communicated to Members by the Corporation and the Members shall be bound by the procedures set forth in such notice as fully as though such procedures were now a part of the Rules and Procedures of the Corporation. Each such notice shall be effective only for the security covered therein.

RULE 15. ASSURANCES OF FINANCIAL RESPONSIBILITY AND OPERATIONAL CAPABILITY

SEC. 2. (a) Each Member or Limited Member, or any applicant to become such, shall furnish to the Corporation such adequate assurances of its financial responsibility and operational capability as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation, its participants, creditors or investors, to safeguard securities and funds in the custody or control of the Corporation and for which the Corporation is responsible, or to promote the prompt and accurate clearance, settlement and processing of securities transactions. Upon the request of a participant or applicant, or otherwise, the Corporation may choose to confer with the participant or applicant before or after requiring it to furnish adequate assurances pursuant to this Rule.

(b) Adequate assurances of the financial responsibility or operational capability of a participant or applicant to become such, as may be required pursuant to these Rules **and Procedures**, may include, but shall not be limited to, as appropriate under the context of the participant's use of the Corporation's services:

- (i) additional reporting by the participant (or by the entity providing a guarantee) of its financial or operational condition at such intervals and in such detail as the Corporation shall determine;
- (ii) entering into agreements concerning the provision of operational support services by an entity acceptable to the Corporation;
- (iii) restrictions on the participant's use of the Corporation's services;
- (iv) increased Clearing Fund deposits (including additional amounts required in respect of trade activity received by the Corporation after calculation of the applicable Required **Fund** Deposit);
- (v) additional payments to the Corporation in such amounts as may be determined by the Corporation each morning reflecting a percentage of up to 100 percent of the participant's (i) average amount of total daily net debit positions or (ii) morning gross debit activity;
- (vi) delivering securities to the Member only against immediate payment by the Member to the Corporation; and

- (vii) assurances as may be required pursuant to the Corporation's Guidelines and/or Procedures.

RULE 42. WIND-DOWN OF A MEMBER, FUND MEMBER OR INSURANCE
CARRIER/RETIREMENT SERVICES MEMBER

The Corporation may, in its discretion, impose conditions on, or take actions with respect to, the Wind-Down Member as appropriate to mitigate risk the Corporation perceives may be presented by the Wind-Down Member, including but not limited to, the following:

- (i) Permitting the Wind-Down Member to submit to the Corporation only transactions that serve to support the wind-down;
- (ii) Permitting the Wind-Down Member to continue use of one or more of the Corporation's services, notwithstanding that it may not meet some or all of the financial or operational requirements for continuance as a Member or Limited Member, as applicable;
- (iii) Restricting or modifying the Wind-Down Member's use of any or all of the Corporation's services (whether generally, or with respect to certain transactions);
- (iv) Requiring additional assurances of the financial responsibility or operational capability of the Wind-Down Member through, for example, submission of a guaranty of the Wind-Down Member's obligations to the Corporation by an entity acceptable to the Corporation and/or additional reporting by the Wind-Down Member;
- (v) Agreeing to complete one or more trades to which the Wind-Down Member is a party prior to the time the Corporation's guaranty otherwise would become effective pursuant to these Rules and Procedures;
- (vi) Requiring the Wind-Down Member to post increased Clearing Fund deposits and/or to post its Required **Fund** Deposit all in cash or in proportions of cash, qualifying bonds and **e**Eligible Letters of Credit different from those permitted under Rule 4;
- (vii) Prohibiting the Wind-Down Member from withdrawing Clearing Fund on deposit in excess of its Required **Fund** Deposit;
- (viii) Calculating the Required **Fund** Deposit of the Wind-Down Member in a manner different from the applicable formulae provided in the Procedures, in order to more appropriately reflect the risk presented by the Wind-Down Member to the Corporation, such as for example, not applying certain components of such calculation; or

- (ix) Liquidating by buying-in or selling-out, as applicable, any open positions of the Wind-Down Member, for the benefit of such Wind-Down Member with any profit or loss resulting therefrom being debited or credited, as applicable, to the settlement account of the Wind-Down Member.

PROCEDURE III. TRADE RECORDING SERVICE (INTERFACE WITH QUALIFIED CLEARING AGENCIES)

B. Settlement of Option Exercises and Assignments and Settlement of Stock Futures Reaching Maturity

Unless otherwise agreed between OCC and the Corporation, E&A/Delivery Transactions are received by the Corporation from OCC each day on which both the Corporation and OCC are open for accepting trades for clearance. Subject to the paragraph below, the Corporation's guarantee pursuant to Addendum K shall become effective for each E&A/Delivery Transaction when the Required **Fund** Deposits to the Clearing Fund, after taking into account that E&A/Delivery Transaction, are received by the Corporation from all Participating Members.

If (i) a Participating Member has failed to satisfy its Clearing Fund obligations to the Corporation pursuant to Procedure XV, or (ii) the Corporation has declined or ceased to act for a Participating Member pursuant to these Rules **and Procedures** prior to the time that the Corporation's guarantee of such Participating Member's E&A/Delivery Transactions become effective (such Participating Member, a "Defaulting Participating Member"), then none of the E&A/Delivery Transactions involving such defaulting Participating Member for which the Corporation's guarantee pursuant to Addendum K has not yet become effective shall be guaranteed by the Corporation, and all such E&A/Delivery Transactions shall be exited out of the CNS Accounting Operation or the Balance Order Accounting Operation, as applicable, unless otherwise agreed between OCC and the Corporation. The Corporation shall have no further obligation regarding the settlement of the exited E&A/Delivery Transactions, other than such obligations as the Corporation may have pursuant to its arrangement with OCC, and the non-defaulting Participating Members' Required **Fund** Deposit to the Clearing Fund will be recalculated excluding the exited E&A/Delivery Transactions.

PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS¹

I.(B) Additional Clearing Fund Formula

(4) Bank Holiday Charge

For purposes of this section, “Holiday” means any day on which equities markets are open for trading, but the Board of Governors of the Federal Reserve System observes a holiday and banks are closed.

On the business day prior to any Holiday, the Corporation may require each Member to make an additional Clearing Fund deposit (“Bank Holiday Charge”). The Bank Holiday Charge approximates the exposure that a Member’s trading activity on the applicable Holiday could pose to the Corporation. Since the Corporation cannot collect margin on the Holiday, the Bank Holiday Charge is due on the business day prior to the applicable Holiday.

The methodology for calculating a Bank Holiday Charge shall be determined by the Corporation in advance of each applicable Holiday. The Bank Holiday Charge approximates each Member’s Required **Fund** Deposit to address the exposure that such Member’s trading activity on the Holiday could pose to the Corporation. The Corporation shall have the discretion to calculate the Bank Holiday Charge based on its assessment of market conditions at the time the Bank Holiday Charge is calculated (such as, for example, significant market occurrences that could impact market price volatility). The Corporation shall inform Members of the methodology it will use to calculate the Bank Holiday Charge by an Important Notice issued no later than 10 business days prior to the day on which the applicable Bank Holiday Charge is applied. Examples of potential methodologies for the Bank Holiday Charge may include, but shall not be limited to, time scaling of the volatility charge or a stress scenario that reflects potential market price volatility on the Holiday.

II. Minimum Clearing Fund and Additional Deposit Requirements

- (A) Each Member of the Corporation shall be required to contribute a minimum of \$10,000 (the “minimum contribution”). The first 40% (but no less than \$10,000) of a Member’s Required **Fund** Deposit must be in cash and the remaining amount, may be evidenced by open account indebtedness secured by the pledge of Eligible Clearing Fund Securities, which shall be valued, for collateral

¹ All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

purposes, as set forth in subsection III below. A Mutual Fund/Insurance Services Member's entire deposit is required to be in cash.

1. Special Provisions Related to Eligible Clearing Fund Securities:

- (a) Any deposits of Eligible Clearing Fund Agency Securities⁷ or Eligible Clearing Fund Mortgage-Backed Securities⁸, respectively, in excess of 25 percent of the Member's Required **Fund** Deposit will be subject to an additional haircut equal to twice the percentage as specified in the proposed haircut schedule detailed in subsection III below, and
 - (b) No more than 20 percent of a Member's Required **Fund** Deposit secured by pledged Eligible Agency Securities may be of a single issuer.
- (B) All Clearing Fund requirements and other deposit requirements shall be made by Members and Mutual Fund/Insurance Services Members, within one hour of demand unless otherwise determined by the Corporation; provided, however, that to the extent the Member and Mutual Fund/Insurance Services Member is meeting such obligation with a (1) deposit of cash, such deposit shall be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire, and (2) delivery of eligible securities, such delivery shall be received within the deadlines established by ~~a Qualified Securities Depository~~ **DTC**. At the discretion of the Corporation, cash deposits may be included as part of the Member's or Mutual Fund/Insurance Services Member's, daily settlement obligation.
- (C) Additional Clearing Fund deposits shall not be requested unless they exceed such threshold as determined by the Corporation from time to time; provided that the affected Member or Limited Member is not on the Watch List.
- (D) Where the amount of a Member's and Mutual Fund/Insurance Services Member's deficiency is in excess of \$1,000 but less than \$5,000, the Corporation may require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000, the Corporation may require payment in multiples of \$5,000.

⁷ A Member that is an Agency may not pledge Eligible Clearing Fund Agency Securities of which it is the issuer.

⁸ With regard to a Member that pledges Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, such securities will be subject to a premium haircut, as set forth in subsection III below.

ADDENDUM E

~~STATEMENT OF POLICY~~

~~APPLICATION OF RETAINED EARNINGS – MEMBER IMPAIRMENTS~~

~~Under Rule 4, Section 4, if the Corporation suffers a loss or liability by reason of a Member's impairment, and such loss or liability is not satisfied or otherwise made good from the impaired Member's Clearing Fund deposit, the Corporation, in its discretion, may either satisfy such loss or liability or any part thereof out of its then existing retained earnings or, after appropriate notice to both the membership and the Securities and Exchange Commission, directly from the Clearing Fund deposits of all other Members on a pro rata basis.~~

~~While neither the Corporation nor its three predecessor clearing agencies have ever subjected their memberships to such a pro rata assessment, the ability exists for the Corporation to bypass completely its retained earnings. Since the Board of Directors of the Corporation is desirous of clarifying its intentions with respect to the usage of retained earnings in Member impairment situations, the Board has adopted this Policy Statement.~~

~~The Board of Directors of the Corporation hereby advises the membership of the Corporation that pursuant to Rule 4, Section 4 of the Rules of the Corporation, the Corporation will apply no less than twenty five percent (25%) of its retained earnings, existing at the time of a Member impairment which gives rise to a loss or liability not satisfied by the impaired Member's Clearing Fund deposit, to such loss or liability.~~

~~Nothing herein, however, shall prevent the Corporation from applying more than twenty five percent (25%) of its then existing retained earnings, if the Board of Directors, in its sole discretion, believes such to be appropriate under the factual situation existing at the time of the Member impairment.~~

~~This Policy Statement may not be changed, modified or altered, without thirty days prior written notice to the membership and to the Securities and Exchange Commission. Any such change, modification or alteration shall only be prospective in effect, and shall not be applicable to any losses or liability previously incurred as a result of prior Member impairments.~~

(ADDENDUM LETTER RESERVED FOR FUTURE USE)

ADDENDUM K

**~~INTERPRETATION OF THE BOARD OF DIRECTORS
APPLICATION OF CLEARING FUND~~THE CORPORATION'S GUARANTY**

~~Pursuant to Rule 47, the Board of Directors has the authority to interpret the Rules of the Corporation. The purpose of this interpretation is to clarify certain provisions of Rule 4 and the extent to which the Clearing Fund may be applied to a loss or liability of the Corporation.~~

~~I. APPLICATION OF THE CLEARING FUND TO LOSSES SUSTAINED BY A SYSTEM~~

- ~~1. Section 1 of Rule 4 provides that each Member's Required Deposit shall be allocated by the Corporation among the services for which the Corporation assumes responsibility for completion of transactions and which are designated as such by the Corporation (collectively the "Systems" and individually a "System") and in which the Member participates.~~
- ~~2. The Corporation has in practice assumed responsibility for completion of transactions in each of the following services, and has deemed each of these services to be a System, even though the Corporation has not previously made a formal designation of each such service as a System within the definition of Section 1 of Rule 4:~~

The Corporation guarantees the completion of compared and locked-in CNS and balance orders transactions from a fixed point in the clearance and settlement process.¹ CNS transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures. Balance order transactions are guaranteed as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures through the close of business on T+2. If the contra party to a same day or one day settling trade is a member of an interfacing clearing corporation, such guarantee shall not be applicable unless an agreement to guarantee such trade exists between the Corporation and the interfacing clearing corporation. The Corporation has also adopted a policy of guaranteeing the completion of when-issued and when-distributed trades, as of the point they have: (i) for bilateral submissions by Members, been validated and compared by the Corporation pursuant to these Rules and Procedures, and (ii) for locked-in submissions, been validated by the Corporation pursuant to these Rules and Procedures and will consider all when-issued and when-

¹ The trade guarantee of obligations arising out of the exercise or assignment of options that are settled at the Corporation is addressed in a separate arrangement between NSCC and Options Clearing Corporation, as referred to in Procedure III of the Rules **and Procedures**, and is not addressed in these Rules **and Procedures**.

distributed trades of Members as if they were CNS transactions for surveillance purposes regardless of the accounting operation in which they ultimately settle.

~~3. In connection with the expansion by the Corporation of its clearance and settlement business, it has become desirable for the Corporation to make formal designations of the services constituting Systems within the definition of Section 1 of Rule 4. Accordingly, the Board hereby designates the services referred to in paragraph 1.2. above as services for which the Corporation assumes the responsibility for the completion of transactions, and therefore as Systems within the Rule 4, Section 1 definition. These services are the only services so designated as of this date.~~

~~II. APPLICATION OF THE CLEARING FUND TO EXCESS LOSSES AND LOSSES OUTSIDE OF A SYSTEM~~

~~1. Section 2(b) of Rule 4 provides that the use of the Clearing Fund in its entirety (which consists in part of all the Funds) shall be limited to satisfaction of losses or liabilities of the Corporation incident to the operation of the clearance and settlement business of the Corporation other than losses or liabilities of a System.~~

~~2. Pursuant to Section 2(b) of Rule 4, the entire Clearing Fund must be available to satisfy losses arising outside of a System.~~

~~There are various circumstances pursuant to which the entire Clearing Fund may be available to satisfy losses outside of a System:~~

- ~~• One circumstance arises out of the Mutual Fund Services. Members that do not participate in the Mutual Fund Services are shielded from exposures to the Mutual Fund Services losses as long as the Corporation continues to have active participants in Mutual Fund Services.~~

~~If the Corporation were to have an unsatisfied Mutual Fund Services loss, such loss may be satisfied from the entire Clearing Fund (less the amounts paid in respect of the Mutual Fund Services).~~

- ~~• An additional circumstance arises out of the Insurance and Retirement Processing Services. If the Corporation were to have an unsatisfied loss due to a Member's, Mutual Fund/Insurance Services Member's or Insurance Carrier/Retirement Services Member's use of the Insurance and Retirement Processing Services, such loss may be satisfied from the entire Clearing Fund.~~

ADDENDUM O
ADMISSION OF NON-US ENTITIES AS DIRECT NSCC MEMBERS

Admission of Non-US Entities¹

- Foreign Legal Opinion – obtain an opinion of reputable foreign counsel satisfactory to NSCC providing, among other things, that the agreements described above may be enforced against the foreign entity in the courts of its home country or other jurisdictions where the entity or its property may be found.²

¹ This policy statement excludes Non-U.S. entities that are insurance companies.

² NSCC reserves the right to require the entity to deposit additional amounts to the Clearing Fund and to post an **Eligible Letter of Credit** in an instance where NSCC, in its sole discretion, believes the entity presents legal risk.