

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69313; File No. SR-NSCC-2013-02)

April 4, 2013

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 21, 2013, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

To enhance its ability to meet its liquidity requirements, NSCC is proposing to amend its Rules & Procedures (“Rules”) to provide for a supplemental liquidity funding obligation, as described below.

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

In its filing with the Commission, NSCC 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

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<sup>1</sup> 15 U.S.C. 78s(b)(1). Defined terms that are not defined in this notice are defined in Exhibit 5 of the proposed rule change filing, available at <http://www.sec.gov/rules/sro/nscc.shtml> under File No. SR-NSCC-2013-02, Additional Materials.

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

below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>3</sup>

(A) Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Proposal Overview

As a central counterparty (“CCP”), NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions, thereby reducing the risk faced by its Members and contributing to global financial stability. Further, pursuant to the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”),<sup>4</sup> NSCC has been designated a systemically important financial market utility (“SFMU”) by the Financial Stability Oversight Council, obliging NSCC to meet certain risk management regulatory standards related to, among other things, maintaining adequate financial resources to meet its obligations to its Members in the event of the default of the Member or family of affiliated Members (“Affiliated Family”) that would generate the largest aggregate payment obligation to NSCC in stressed conditions. In this regard and to enhance its ability to meet its liquidity requirements, NSCC is proposing to amend its Rules to provide for a supplemental liquidity funding obligation.

A substantial proportion of the liquidity needed by NSCC is attributable to the exposure presented by those unaffiliated Members and Affiliated Families that regularly incur the largest gross settlement debits over a settlement cycle during trading activity on business days other than periods coinciding with quarterly triple options expiration dates (“Regular Activity Periods”), as

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<sup>3</sup> The Commission has modified the text of the summaries prepared by NSCC.

<sup>4</sup> 12 U.S.C. 5465(e)(1).

well as during times of increased trading activity that arise around quarterly triple options expiration dates (“Options Expiration Activity Periods”).

With the goal of ensuring that NSCC has sufficient liquidity to meet its obligations during Regular Activity Periods, as well as during Options Expiration Activity Periods, it is appropriate that those unaffiliated Members and Affiliated Families provide additional liquidity to NSCC. Under proposed Rule 4(A), this will take the form of supplemental liquidity deposits to the Clearing Fund (i) in an amount based on the largest liquidity need NSCC would have in the event of the default of an unaffiliated Member or Affiliated Family during a Regular Activity Period (“Regular Activity Supplemental Deposit”), and (ii) an additional amount to cover the largest liquidity need NSCC would have in the event of the default of an unaffiliated Member or Affiliated Family during an Options Expiration Activity Period (“Special Activity Supplemental Deposit”) (collectively with Regular Activity Supplemental Deposit, “Supplemental Deposit”).

The obligation of an unaffiliated Member or the Members of an Affiliated Family to make a Regular Activity Supplemental Deposit (“Regular Activity Liquidity Obligation”) or a Special Activity Supplemental Deposit (“Special Activity Liquidity Obligation”) would be imposed on the thirty (30) unaffiliated Members and/or Affiliated Families who generate the largest aggregate liquidity needs over a settlement cycle that would apply in the event of a closeout (i.e., over a period from date of default through the following three (3) settlement days), based upon a lookback period. The Regular Activity Liquidity Obligation of an unaffiliated Member or the Members of an Affiliated Family to make a Regular Activity Supplemental Deposit will be reduced by any liquidity such Members or their affiliates may provide in the form of commitments under NSCC’s committed liquidity facility (“Credit Facility”).

The calculations for both the Regular Activity Liquidity Obligation and the Special Activity Liquidity Obligation are designed so that NSCC has adequate liquidity resources to enable it to settle transactions, notwithstanding the default of an unaffiliated Member and/or Affiliated Family during Regular Activity Periods, as well as during Options Expiration Activity Periods. The Liquidity Obligations imposed on Affiliated Families would be allocated among the Family Members in proportion to the liquidity risk (or peak exposure) they present to NSCC.

#### Regulatory Background

As both a CCP and a designated SFMU, NSCC adheres to strict risk management processes that are regularly reviewed against applicable regulatory and industry standards. This includes the securities laws and rulemaking promulgated by the Commission, such as Rule 17Ad-22(b)(3), which requires registered clearing agencies to maintain sufficient financial resources to withstand, at a minimum, a default by the participant (defined in Rule 17Ad-22(a)(3) to include a participant family) to which it has the largest exposure.

NSCC is also mindful of the standards set forth in the Principles for Financial Market Infrastructures (“PFMI”) of the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions. Key Consideration 4 of PFMI Principle 7, addressing liquidity risk, provides that a CCP should maintain sufficient liquidity resources to meet its payment obligations under a wide range of stress scenarios including the default of the participant and its affiliates that would generate the largest aggregate payment obligation to the CCP.

NSCC believes the proposed rule change should assist NSCC in securing adequate liquidity resources to meet its settlement obligations during both Regular Activity Periods and Options Expiration Activity Periods, notwithstanding the default of one of its unaffiliated

Members and/or Affiliated Families that pose the largest aggregate liquidity need over the four day settlement cycle.

*Supplemental Liquidity Providers*

Every business day NSCC measures the liquidity obligations of its unaffiliated Members and Affiliated Families by taking the sum of their purchase obligations on that day in securities that are eligible for processing in NSCC's Continuous Net Settlement ("CNS") system and for the following three (3) settlement days (which equates to the period from the date of default through the remaining settlement cycle). NSCC then takes into account certain adjustments, assumptions and offsets, and assumes the occurrence of certain stressed conditions.

The stressed market conditions NSCC assumes in this calculation include, but are not limited to, (i) the simultaneous default, without prior warning, of all Members of the Affiliated Family with the largest aggregate four (4) day settlement obligations; (ii) that on the day of such default, the Members of such Affiliated Family are trading at peak historical trading levels and no market participants curtail their activity with any Members of the Family; and (iii) leading up to or after the default, there is no increased volatility in the market that would result in a significant increase in Clearing Fund requirements, mark-to-market collections, or other risk-based premiums that would have the result of increasing NSCC's liquidity resources. NSCC believes that these conditions simulate the impact of significant credit risk and market risk stresses on NSCC's liquidity need across both Regular Activity Periods and Options Expiration Activity Periods.

NSCC then identifies the largest Member liquidity need on each day and determines if the available liquidity resources, consisting of the aggregate Required Deposits, any Supplemental Deposits, and any Prefund Deposits in the Clearing Fund on the day the liquidity need was

observed, are adequate to cover that liquidity need, or if there is a calculated liquidity shortfall under the assumed stressed market conditions described above.

The Regular Activity Supplemental Deposits will be calculated to address those daily liquidity shortfalls that fall on any business day included in a Regular Activity Period (“Regular Activity Supplemental Liquidity Need”), and the Special Activity Supplemental Deposits will be calculated to address those additional daily liquidity shortfalls that fall on any business day included in an Options Expiration Activity Period (“Special Activity Supplemental Liquidity Need”).

*Regular Activity Supplemental Deposits*

Under this proposal, every six (6) months, NSCC will determine (i) its largest Regular Activity Supplemental Liquidity Need (“Regular Activity Peak Liquidity Need”) over the preceding twelve (12) month period and (ii) those unaffiliated Members and Affiliated Families that presented the largest aggregate liquidity exposures to NSCC over the preceding six-month period. NSCC will then rank the aggregate liquidity exposures presented by the unaffiliated Members and/or Affiliated Families (“Regular Activity Peak Liquidity Exposures”) during the lookback period to determine which thirty (30) such unaffiliated Members and Affiliated Families presented the largest respective Regular Activity Peak Liquidity Exposures within the lookback period. NSCC’s Regular Activity Peak Liquidity Need will then be allocated to these thirty (30) unaffiliated Members and Affiliated Families (“Regular Activity Liquidity Providers”), in proportion to the Regular Activity Peak Liquidity Exposures they presented to NSCC during the lookback period.

The first of these semi-annual calculations of the Regular Activity Liquidity Obligations will be made to coincide with NSCC’s annual renewal of the Credit Facility each year (“Regular

Activity First Tranche Liquidity Obligations”) and the second calculation each year will be made six (6) months thereafter (“Regular Activity Second Tranche Liquidity Obligations”).

*Special Activity Supplemental Deposits*

Special Activity Supplemental Deposits are deposits made in addition to Regular Activity Supplemental Deposits, designed to cover the additional liquidity exposure that occurs over an Options Expiration Activity Period. Each calendar quarter, on a day that is no later than the fifth business day preceding any Options Expiration Activity Period, NSCC will also determine (i) its largest Special Activity Supplemental Liquidity Need (“Special Activity Peak Liquidity Need”) over the preceding twenty-four (24) months (i.e., the eight prior Options Expiration Activity Periods, or a longer lookback period as determined by NSCC) and (ii) those unaffiliated Members and Affiliated Families that presented the largest aggregate Special Activity liquidity exposures to NSCC over the same period. NSCC will then rank the aggregate Special Activity liquidity exposures presented by such unaffiliated Members and/or Affiliated Families (referred to as their respective “Special Activity Peak Liquidity Exposures”) during the lookback period to determine which thirty (30) such unaffiliated Members and Affiliated Families presented the largest respective Special Activity Peak Liquidity Exposures within the lookback period. NSCC’s Special Activity Supplemental Peak Need will then be allocated to these thirty (30) Members and Affiliated Families (“Special Activity Liquidity Providers”), in proportion to the Special Activity Peak Liquidity Exposures they presented to NSCC during the lookback period.

*Interim Adjustments and Calls*

With the goal of ensuring that NSCC’s liquidity resources remain adequate between the specified calculation dates, if either current liquidity needs increase significantly over those liquidity needs used for the regular calculations (or Special Activity Calculations), or the amount

of liquidity resources is significantly reduced, the proposal permits NSCC to make interim recalibrations and liquidity calls: if between the semi-annual calculations of the Regular Activity Liquidity Obligations, the aggregate amount of Regular Activity Supplemental Deposits decreases by an amount that exceeds a threshold as determined by NSCC (whether as a result of the retirement of Members, a cease to act, or otherwise), then NSCC will recalculate its Regular Activity Peak Liquidity Need and allocate it among the unaffiliated Members and Affiliated Families that then comprise the applicable thirty (30) largest Regular Activity Liquidity Providers, in the same manner such calculations and allocations would be made at each semi-annual calculation of Regular Activity Liquidity Obligations.<sup>5</sup>

Conversely, if on any business day between regular semi-annual calculation dates NSCC observes an increase in its Regular Activity Liquidity Needs that exceeds a predetermined threshold amount, or between the dates on which it calculates Special Activity Liquidity Obligations it observes an increase in its Special Activity Liquidity Needs that exceeds a predetermined threshold amount, NSCC shall be entitled to call for an additional deposit from the Member whose increase in activity levels caused (or was the primary cause of) such increased liquidity need (“Liquidity Call”). Liquidity Call amounts will be treated as a part of that Member’s Regular Activity Supplemental Deposit or Special Activity Supplemental Deposit, as applicable.

#### *Operation of the Funding Obligation*

Each Regular Activity Liquidity Provider will be obligated to contribute to the Clearing Fund, no later than five (5) business days following the effective date of the renewal of the Credit

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<sup>5</sup> NSCC plans to use an interim date calculation as the first calculation under the proposed rule, should it become effective on a date after the effective date of the 2013 renewal of its Credit Facility.



Facility, the amount of its Regular Activity Liquidity Obligation, reduced (i) dollar for dollar by amounts committed to the Credit Facility by that Regular Activity Liquidity Provider or its affiliates, and (ii) ratably (among all Regular Activity Liquidity Providers) by amounts committed to the Credit Facility by the lenders party thereto which are not Members or their affiliates.

If the amount of the Regular Activity Second Tranche Liquidity Obligation of an unaffiliated Member or Affiliated Family exceeds its Regular Activity First Tranche Liquidity Obligation (including because the unaffiliated Member or Affiliated Family had no Regular Activity First Tranche Liquidity Obligation), such Regular Activity Liquidity Provider will be obligated to contribute its calculated amount within three (3) business days following the final notice of such amount. If the Regular Activity Second Tranche Liquidity Obligation of an unaffiliated Member or Affiliated Family is less than its Regular Activity First Tranche Liquidity Obligation, then it shall be entitled to a refund of the amount of the difference, provided, that nothing shall reduce or in any way affect any commitment or other obligation of any Member or its affiliate under the Credit Facility.

Promptly after calculation of the Special Activity Liquidity Obligations, NSCC will inform Special Activity Liquidity Providers of their Special Activity Liquidity Obligations, and those Special Activity Liquidity Providers must make their Special Activity Supplemental Deposits to the Clearing Fund in cash no later than the close of business on the second business day preceding the applicable Options Expiration Activity Period (i.e., generally the Wednesday before the options expiration date).

However, if a Special Activity Liquidity Provider anticipates that its Special Activity Peak Liquidity Exposure at any time during an Options Expiration Activity Period will be greater

than the amount calculated by NSCC, it may, no later than the first business day of that Options Expiration Activity Period, make an additional cash deposit to the Clearing Fund that is in excess of its Required Deposit and is designated as a “Special Activity Prefund Deposit.” Members may also, at their discretion, deposit to the Clearing Fund amounts in excess of their Required Deposit that are designated “Regular Activity Prefund Deposits.” Because Prefund Deposits are included in calculating available liquidity resources, they thus reduce NSCC’s Supplemental Liquidity Needs, as well as the depositing Member’s Regular Activity (or Special Activity) Peak Liquidity Exposure.

As noted above under “Interim Adjustments and Calls,” to the extent that NSCC observes a peak shortfall that breaches predetermined thresholds at any time throughout the year, the amount of the shortfall will be allocated solely to the Member responsible for the activity that caused the shortfall. The liquidity called as a result of that shortfall will be held until the next applicable reset period. This is intended to incentivize Members to make Prefund Deposits to avoid Liquidity Calls, since Prefund Deposits are refunded after the period of activity for which they were made, while Liquidity Calls are retained until the next regular calculation of the applicable supplemental deposit.

*Treatment and Use of the Supplemental Deposits*

All Regular Activity Supplemental Deposits (other than Regular Activity Prefund Deposits), as adjusted semi-annually, shall remain on deposit in the Clearing Fund, and may not be withdrawn by the applicable Member until five (5) business days after the next following maturity date of the Credit Facility (generally, for a period of 364 days). Regular Activity Prefund Deposits shall remain on deposit in the Clearing Fund and may not be withdrawn by the applicable Member until seven (7) days after they are deposited. All Special Activity

Supplemental Deposits (including Special Activity Prefund Deposits) may be refunded to the Special Activity Liquidity Providers seven (7) business days after the end of the applicable Options Expiration Activity Period.

Any amounts deposited in response to a Liquidity Call for an additional Regular Activity Supplemental Deposit must remain in the Clearing Fund until the next semi-annual calculations of the Regular Activity Liquidity Obligations, and any amounts deposited in response to a Liquidity Call for an additional Special Activity Supplemental Deposit must remain in the Clearing Fund until two (2) business days preceding the next Options Expiration Activity Period.

A Member's Supplemental Deposit will be made in addition to its Required Deposit to the Clearing Fund, and any other deposit of any such Member to the Clearing Fund.

A Member's Supplemental Deposit will be considered part of that Member's actual deposit to the Clearing Fund, and, as such, may be used to satisfy obligations of that Member to NSCC, in the same manner as provided in Section 3 of Rule 4. Therefore, if the Member who contributed the Supplemental Deposit defaults, NSCC will be permitted to use its entire actual deposit, which will include the amount of its Supplemental Deposit, to satisfy any loss resulting from closing out that Member's open positions.

A Member's Supplemental Deposit will not, however, constitute part of its Required Deposit under NSCC's Rule 4, and, as such, will not be used, pursuant to Section 4 of Rule 4, to satisfy the obligations of any other Member of NSCC that has defaulted in the performance of its obligations to NSCC. A Member's Supplemental Deposit, therefore, will not be used in calculating any pro rata charge (i.e., loss assessment) due from that Member in the event of the default of another Member under Rule 4. Supplemental Deposits will also not be subject to the provisions of Section 6 of Rule 4 when a Member ceases to be a participant.

Pending any permitted use described in NSCC's Rules, the aggregate of all Supplemental Deposits on deposit at NSCC may be invested by NSCC as permitted pursuant to the investment policy adopted by NSCC and as in effect from time to time, and in the same manner the Clearing Fund is invested pursuant to such investment policy. Any interest earned on investment of a Supplemental Deposit, as a part of a Member's actual deposit, will be payable at the rate that NSCC earns on the investment of such funds, credited monthly and paid on demand.

*Implementation Timeframe*

Pending Commission approval, Members will be advised of the implementation date of this proposal through issuance of an NSCC Important Notice. Members will be provided not less than ten (10) days' notice of the first date on which Supplemental Deposits will be payable.

*Proposed Rule Changes*

NSCC proposes to amend its Rules to create a new Rule 4A to reflect the changes as described above. For both the Regular Activity Supplemental Deposits and the Special Activity Supplemental Deposits, the new Rule 4A will provide: (i) a general description of the relevant Supplemental Deposit, (ii) a provision describing the calculation and operation of the funding obligation, and (iii) a description of the treatment and permitted uses of the Supplemental Deposit by NSCC. NSCC believes that this proposed rule change contributes to NSCC's goal of assuring that NSCC has adequate liquidity resources to meet its settlement obligations during both Regular Activity Periods and Options Expiration Activity Periods, notwithstanding the default of its unaffiliated Members and/or Affiliated Families that pose the largest aggregate liquidity exposure over the relevant settlement cycle. As such, NSCC believes that the proposal is consistent with the requirements of the Act, as amended, and the rules and regulations thereunder applicable to NSCC.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NSCC believes that the proposed rule change will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. By calculating an unaffiliated Member's or Affiliated Family's Supplemental Deposit funding obligation in proportion to the liquidity needs that such unaffiliated Member or Affiliated Family presents to NSCC, NSCC believes that the proposed rule change will ensure that NSCC's Members fairly and equitably contribute to NSCC's liquidity resources for settlement. Further, NSCC believes that the proposed rule change contributes to the goal of financial stability in the event of Member default, rendering not unreasonable or inappropriate any burden on competition that the changes could be regarded as imposing.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments relating to the proposed rule change have not yet 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.<sup>6</sup> The clearing agency shall post notice on its website of proposed changes that are implemented.

#### 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](mailto:rule-comments@sec.gov). Please include File No. SR-NSCC-2013-02 on the subject line.

##### Paper Comments:

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

All submissions should refer to File No. SR-NSCC-2013-02. 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

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<sup>6</sup> NSCC also filed the proposals contained in this proposed rule change as an advance notice Pursuant to Section 806(e)(1) of the Clearing Supervision Act and Rule 19b-4(n)(1)(i) thereunder. 12 U.S.C. 5465(e)(1); 17 CFR 240.19b-4(n)(i). Proposed changes filed under the Clearing Supervision Act may be implemented either: at the time the Commission notifies the clearing agency that it does not object to the proposed change and authorizes its implementation, or, if the Commission does not object to the proposed change, within 60 days of the later of (i) the date that the advance notice was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. 12 U.S.C. 5465(e)(1)(G).

of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings also will be available for inspection and copying at the principal office of NSCC and on NSCC's website at [http://dtcc.com/downloads/legal/rule\\_filings/2013/nsc/SR-NSCC-2013-02.pdf](http://dtcc.com/downloads/legal/rule_filings/2013/nsc/SR-NSCC-2013-02.pdf).

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-NSCC-2013-02 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.<sup>7</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).