



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

**Bold, underlined and shaded text** indicates proposed language added in connection with a separate proposal that has not yet been approved (SR-NSCC-2017-001, filed on March 14, 2017)

**Bold, underlined and highlighted text** indicates proposed additions to language that was added in connection with a separate proposal that has not yet been approved (SR-NSCC-2017-001, filed on March 14, 2017)

**~~Bold, strikethrough and highlighted text~~** indicates proposed deletions to language that was added in connection with a separate proposal that has not yet been approved (SR-NSCC-2017-001, filed on March 14, 2017)

## RULE 1. DEFINITIONS AND DESCRIPTIONS

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

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### **Credit Risk Rating Matrix**

**The term “Credit Risk Rating Matrix” means a matrix of credit ratings of Members specified in Section 4 of Rule 2B. The matrix is developed by the Corporation to evaluate the credit risk such Members pose to the Corporation and its Members and is based on factors determined to be relevant by the Corporation from time to time, which factors are designed to collectively reflect the financial and operational condition of a Member. These factors include (i) quantitative factors, such as capital, assets, earnings, and liquidity, and (ii) qualitative factors, such as management quality, market position/environment, and capital and liquidity risk management.**

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### **Illiquid Position**

**The term “Illiquid Position” means a Net Unsettled Position in an Illiquid Security that exceeds applicable volume thresholds. For net buy positions in an Illiquid Security, the volume thresholds shall be no greater than 100 million shares and based on the Member’s rating on the eCredit rRisk Rating mMatrix. For net sell positions in an Illiquid Security, the volume threshold shall be no greater than 1 million shares on an absolute value basis, and based on both the Member’s excess net capital and the Member’s rating on the eCredit rRisk Rating mMatrix.**

**In determining if the volume threshold is met with respect to a net sell position in Illiquid Securities, the Corporation shall apply an offset against shares of Illiquid Securities in the Member’s inventory at DTC to the quantity of shares in a Member’s Illiquid Position. Such offset shall not be applied to (1) net buy positions in Illiquid Securities, or (2) Members that have the weakest rating on the eCredit rRisk Rating mMatrix.**

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**Watch List**

**The term “Watch List” means, at any time and from time to time, the list of Members whose credit ratings derived from the Credit Risk Rating Matrix are 5, 6 or 7, as well as Members and Limited Members that, based on the Corporation’s consideration of relevant factors, including those set forth in Section 4(d) of Rule 2B, are deemed by the Corporation to pose a heightened risk to the Corporation and its Members.**

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RULE 2B. ONGOING MEMBERSHIP REQUIREMENTS AND MONITORING

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SEC. 2. DATA TO BE FILED WITH THE CORPORATION

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B. Notification of Changes in Condition

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(e) Failure to notify the Corporation under this Section may be deemed to be a violation of the Corporation's Rules and therefore may be subject to sanctions. **In addition, the Corporation may review the financial responsibility and operational capability of the Member to the extent provided in these Rules and Procedures and otherwise require from the Member additional reporting of its financial or operational condition at such intervals and in such detail as the Corporation shall determine, including, but not limited to, such information as the Corporation may request regarding the businesses and operations of the Member and its risk management practices with respect to services of the Corporation utilized by the Member for another Person or Persons, and shall make a determination as to whether such Member should be placed on the Watch List and/or be subject to enhanced surveillance by the Corporation consistent with the provisions of Section 4 of Rule 2B.**

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SEC. 4. ONGOING MONITORING ~~(SURVEILLANCE STATUS)~~

~~Based upon criteria as established by the Corporation from time to time (e.g. the "credit risk matrix"), a Member whose financial and/or operational condition has been determined to be such that it may increase, or potentially increase, operational and/or financial risk to the Corporation and/or its participants, may be placed on the corporation's "watch list".~~

**(a) All Members and certain Limited Members will be monitored and reviewed by the Corporation on an ongoing and periodic basis, which may include monitoring of news and market developments and review of financial reports and other public information.**

**(b) (i) A Member that is (A) a U.S. bank or trust company that files the Consolidated Report of Condition and Income ("Call Report"), (B) a U.S. broker-dealer that files the Financial and Operational Combined Uniform Single Report ("FOCUS Report") or the equivalent with its regulator or (C) a non-U.S. bank or trust company that has audited financial data that is**

publicly available, will be assigned a credit rating by the Corporation in accordance with the Credit Risk Rating Matrix. Such Member's credit rating will be reassessed each time the Member provides the Corporation with requested information pursuant to Section 2B(e) of Rule 2B, or as may be otherwise required under the Rules and Procedures (including this Rule 2B, Section 4).

(ii) Because the factors used as part of the Credit Risk Rating Matrix may not identify all risks that a Member specified in paragraph (b)(i) of this Section 4 may present to the Corporation, the Corporation may, in its discretion, override such Member's credit rating derived from the Credit Risk Rating Matrix to downgrade the Member. This downgrading may result in the Member being placed on the Watch List, and/or it may subject the Member to enhanced surveillance based on relevant factors, including those set forth in paragraph (d) below. The Corporation may also take such additional actions with regard to the Member as are permitted by the Rules and Procedures.

(c) Members other than those specified in paragraph (b)(i) of this Section 4 and Limited Members that are monitored and reviewed by the Corporation pursuant to paragraph (a) of this Section 4 will not be assigned a credit rating by the Credit Risk Rating Matrix but may be placed on the Watch List and/or may be subject to enhanced surveillance based on relevant factors, including those set forth in paragraph (d) below, as the Corporation deems necessary to protect the Corporation and its Members.

(d) The factors to be considered by the Corporation under paragraphs (b)(ii) and (c) of this Section 4 include, but are not limited to, (i) news reports and/or regulatory observations that raise reasonable concerns relating to the Member or Limited Member, (ii) reasonable concerns around the Member's or Limited Member's liquidity arrangements, (iii) material changes to the Member's or Limited Member's organizational structure, (iv) reasonable concerns of the Corporation about the Member's or Limited Member's financial stability due to particular facts and circumstances, such as material litigation or other legal and/or regulatory risks, (v) failure of the Member or Limited Member to demonstrate satisfactory financial condition or operational capability or if the Corporation has a reasonable concern regarding the Member's or Limited Member's ability to maintain applicable membership standards and (vi) failure of the Member or Limited Member to provide information required by the Corporation to assess risk exposure posed by the Member's or Limited Member's activity (including information requested by the Corporation pursuant to Section 2B(e) of this Rule 2B).

**(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 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 Deposit of a Member or Limited Member that has been placed on the Watch List as provided in Section 9 of Rule 4.**

**(f) ~~Members included on the watch list are subject to closer monitoring by the Corporation, and the~~ A Member or Limited Member being subject to enhanced surveillance or being placed on the Watch List shall result in a more thorough monitoring of the Member's or Limited Member's financial condition and/or operational capability, which could include, for example, on-site visits or additional due diligence information requests from the Corporation. In addition, the Corporation may require a Member or Limited Member placed on the Watch List and/or subject to enhanced surveillance to make more frequent financial disclosures, including, without limitation, interim and/or pro forma reports. Members and Limited Members that are subject to enhanced surveillance are also reported to the Corporation's management committees and regularly reviewed by a cross-functional team comprised of senior management of the Corporation. The Corporation may also take such additional actions with regard to such any Member or Limited Member (including a Member or Limited Member placed on the Watch List and/or subject to enhanced surveillance) as are permitted within by these Rules and Procedures.**

**(g) Unless the context otherwise requires, the parent bank holding company of a Member that has been admitted to membership in accordance with section 1.B.2.(a)(ii) of Addendum B, and any material banking subsidiary of such parent bank holding company, shall, for the purpose of applying ~~the surveillance status rule~~ this Section 4, be treated as if it were also a Member, so that the Member, the parent bank holding company and any affiliated material banking subsidiary shall be required individually to meet the standards for a Member not on the Watch List under surveillance, if the Member is not to be placed on ~~the Watch List~~ surveillance status.**

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#### RULE 4. CLEARING FUND

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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 participant's Required Deposit. On any day that the Corporation has determined 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. Notwithstanding the foregoing, the Corporation may, in its discretion, determine to withhold all or part of any excess deposit of a participant if such participant **has been placed on the Watch List**~~is subject to surveillance~~ pursuant to these Rules.

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## PROCEDURE XV. CLEARING FUND FORMULA AND OTHER MATTERS<sup>1</sup>

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### I.(A) Clearing Fund Formula for Members

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#### (1) For CNS Transactions

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**The Corporation shall apply the greater of the Illiquid Charge or the Market Maker Domination Charge if it determines that the Illiquid Position is subject to both charges. Members that are not rated by the eCredit rRisk Rating mMatrix are not subject to the Illiquid Charge.**

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#### (2) For Balance Order Transactions

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**The Corporation shall apply the greater of the Illiquid Charge or the Market Maker Domination Charge if it determines that the Illiquid Position is subject to both charges. Members that are not rated by the eCredit rRisk Rating mMatrix are not subject to the Illiquid Charge.**

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### I.(B) Additional Clearing Fund Formula

#### (1) Additional Deposits for Members on **the Watch List Surveillance**

Any Member **or Limited Member** who is placed on **the Watch List surveillance status** shall be required to make such additional Clearing Fund deposits as determined by the Corporation on the same day as requested by the Corporation within such timeframe as required by the Corporation from time to time.

#### **(2) Family-Issued Securities**

The Corporation shall require Members who are rated 5, 6, or 7 on the **eCredit rRisk Rating mMatrix** to contribute to the Clearing Fund an amount determined by multiplying the absolute value of any long Net Unsettled Positions in classes of “family-issued

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



securities” (defined as securities that were issued by either that Member or by an affiliate of that Member) by a percentage designated by the Corporation; such percentage, to be no less than 40% and up to 100%, ~~would shall~~ be determined, from time to time, in the sole discretion of the Corporation, within the parameters described as follows, based on the Member’s rating on the **eCredit rRisk Rating mMatrix** and on the type of family-issued securities submitted to the Corporation.

Fixed income securities that are family-issued securities ~~would shall~~ be charged a haircut rate of no less than 80% for firms that are rated 6 or 7 on the **eCredit rRisk Rating mMatrix**, and no less than 40% for firms that are rated 5 on the **eCredit rRisk Rating mMatrix**; and equity securities that are family-issued securities ~~would initially shall~~ be charged a haircut rate of 100% for firms that are rated 6 or 7 on the **eCredit rRisk Rating mMatrix**, and no less than 50% for firms that are rated 5 on the **eCredit rRisk Rating mMatrix**.

The Corporation shall exclude long Net Unsettled Positions in such family-issued securities of Members who are rated 5, 6, or 7 on the **eCredit rRisk Rating mMatrix** from the calculations describe in Subsections I.(A)(1)(a)(i) and (ii) and I.(A)(2)(a)(i) and (ii).

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II. Minimum Clearing Fund and Additional Deposit Requirements

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(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.**

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