

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-81044; File No. SR-NSCC-2017-009)

June 29, 2017

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Further Describe and Codify Existing Practices Relating to the Bond Haircut

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 23, 2017, 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 by the clearing agency. 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

The proposed rule change consists of amendments to NSCC’s Rules & Procedures (“Rules”)³ in order to (1) provide additional transparency in the Rules with respect to the existing methodology for calculating margin on Members’ Net Unsettled Positions and Net Balance Order Unsettled Positions (for purposes of this filing, referred to collectively herein as “Net Unsettled Positions”) in corporate and municipal bonds (“Bond Haircut”), which are excluded from the parametric volatility component of the margin calculation (“VaR Charge”); and (2) codify NSCC’s existing practice of applying

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Terms not defined herein are defined in the Rules, available at www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf.

the Bond Haircut to all corporate and municipal bonds without discretion, 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, 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.

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

1. Purpose

Proposal Overview

The proposed rule change would provide additional transparency in the Rules with respect to the calculation and the application of the Bond Haircut. NSCC currently excludes Net Unsettled Positions in corporate and municipal bonds from its parametric VaR calculation and instead charges a Bond Haircut, which is calculated by multiplying the absolute value of the Net Unsettled Positions in each security by a percentage that is no less than two percent.

NSCC is proposing to enhance the description of the Bond Haircut in Procedure XV to provide more detail regarding the determination of the applied percentage, and to codify NSCC's existing practice of applying the Bond Haircut to all corporate and municipal bonds without discretion.

The Required Deposit and the Bond Haircut

A primary objective of NSCC's Clearing Fund is to have on deposit from each applicable Member assets sufficient to satisfy losses that may otherwise be incurred by NSCC as the result of the default of the Member and the resultant close out of that Member's unsettled positions under NSCC's trade guaranty. Each Member's Clearing Fund required deposit is calculated daily pursuant to a formula set forth in Procedure XV of the Rules designed to provide sufficient funds to cover this risk of loss. The Clearing Fund formula accounts for a variety of risk factors through the application of a number of charges, each described in Procedure XV.

The VaR Charge is a core component of this formula and is designed to calculate the amount of money that may be lost on a portfolio over a given period of time assumed necessary to liquidate the portfolio, within a given level of confidence. Pursuant to Procedure XV, NSCC may currently exclude from this calculation Net Unsettled Positions in classes of securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner, including corporate and municipal bonds.

NSCC believes the Bond Haircut is a more appropriate measure of the risk presented to NSCC by its Members' positions in corporate and municipal bonds than the VaR Charge because the volatility of these securities is generally amenable to statistical analysis only in a complex manner. Because NSCC believes the Bond Haircut is more effective in capturing the risks presented by corporate and municipal bonds, in addition to adding more detail to Procedure XV regarding the calculation of the Bond Haircut, NSCC is also proposing to codify its existing practice by removing reference to discretion in application of the Bond Haircut to these securities.

a. Corporate Bonds

In order to calculate the Bond Haircut for positions in corporate bonds, NSCC first categorizes corporate bonds into security groups according to the bonds' remaining time to maturity and credit rating. NSCC then aligns each security group against a Merrill Lynch bond index.⁴ Each bond index is chosen to provide a valuation proxy for computing the appropriate margin for securities categorized into that group. NSCC calculates a haircut rate applicable to each security group based on historical returns of the aligned Merrill Lynch bond index in the specified look-back period and a predetermined calibration percentile. NSCC is proposing to clarify in Procedure XV that the look-back period shall be no shorter than 10 years. Currently, the look-back period is from 1995 to present day.⁵ The haircut rate for each security group is recalculated periodically, based on a predetermined frequency. While NSCC is proposing to clarify in

⁴ Bond indices are widely used to measure the risk of particular classes of corporate bonds. By aligning each security group to a Merrill Lynch bond index, NSCC is able to use widely accepted historical pricing information as a valuation proxy for each security group to correlate with the actual risk coverage for the particular attributes of the bonds. Using these reliable pricing proxies permits NSCC to conduct loss estimation associated with clearing these securities in a less complex statistical manner, while achieving the desired coverage target.

⁵ NSCC regularly reviews whether its margining methodology is achieving the desired risk mitigation objectives. In connection with such review, NSCC has determined to make technical enhancements to the calculation of the Bond Haircut as applied to positions in corporate bonds, including an adjustment to this look-back period. Such enhancements shall be proposed pursuant to a separate advance notice filing, to be filed pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010. 12 U.S.C. 5465(e)(1).

Procedure XV that such recalculation shall occur at least annually, currently the recalculation is performed on a daily basis.⁶

Further, NSCC determines the appropriate specified look-back period and predetermined calibration percentile, which shall not be less than 99 percent, in order to account for the particularized risk characteristics of corporate bonds, including market, liquidity and idiosyncratic risk (i.e., the volatility of a particular issue compared to the volatility of the index).

b. Municipal Bonds

The Bond Haircut for positions in municipal bonds is calculated at the CUSIP level. In order to account for price and valuation volatility, NSCC has set a tenor-based haircut schedule that applies according to the remaining time to maturity for separate categories of municipal bonds. Currently, NSCC applies this schedule to six separate categories of municipal bonds. For municipal bonds rated BBB+ or lower and for non-rated bonds, an additional factor is applied based on the applicable municipal sector. If a municipal bond is not mapped to any particular sector, the highest numerical municipal factor is applied to positions in that bond. NSCC reviews and re-assigns, as necessary, the risk factors assigned to each municipal sector no less frequently than annually.

This additional factor is added to lower rated municipal bonds because variable risk factors exist between municipal sectors. In addition to the risk associated with time-to-maturity, municipal bonds may also pose credit risk depending upon the bonds' assigned credit rating. The added sector-based factor, applicable to lower-rated

⁶ NSCC has also determined that the frequency of re-calibration of the haircut rates should be adjusted, and will propose to change this frequency pursuant to an advance notice filing. *Id.*

municipal bonds, is designed to compensate for this additional credit risk. Therefore, NSCC believes the Bond Haircut as applied to municipal bonds is also an appropriate measure for the risk presented by these positions.

Proposed Changes to Procedure XV

In order to make the proposed changes, NSCC would exclude Net Unsettled Positions in corporate and municipal bonds from Procedure XV, Sections I.(A)(1)(a)(ii) and (2)(a)(ii). These Sections of Procedure XV would continue to provide NSCC with discretion to exclude certain securities, as described therein and other than corporate and municipal bonds, from its VaR margin calculation and instead apply a haircut-based margin charge. NSCC would add new Sections I.(A)(1)(a)(iii) and (2)(a)(iii) to Procedure XV to include more transparency around the determination of the Bond Haircut and to make clear that the Bond Haircut shall apply to all Net Unsettled Positions in corporate and municipal bonds, in lieu of a VaR Charge, and would not be subject to NSCC's discretion.

2. Statutory Basis

Section 17A(b)(3)(F) of the Act, requires, in part, that the Rules promote the prompt and accurate clearance and settlement of securities transactions.⁷ The proposed rule change with respect to the Bond Haircut would provide additional transparency in the Rules regarding the calculation and application of the Bond Haircut, and would codify NSCC's practice to apply the Bond Haircut to all positions in corporate and municipal bonds without discretion. The proposed changes would ensure that the Rules remain transparent, accurate and clear, which would enable all stakeholders to readily

⁷ 15 U.S.C. 78q-1(b)(3)(F).

understand their rights and obligations in connection with NSCC's clearance and settlement of securities transactions. Therefore, NSCC believes that the 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.⁸

Rule 17Ad-22(e)(23)(i) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for publicly disclosing all relevant rules and material procedures.⁹ Rule 17Ad-22(e)(23)(ii) under the Act requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in NSCC.¹⁰ The proposed rule change enhances the transparency in the Rules regarding the calculation and application of the Bond Haircut and codifies NSCC's practice to apply the Bond Haircut to all positions in corporate and municipal bonds without discretion. In this way, the proposed rule change provides for the public disclosure, through the new Procedure XV, Sections I.(A)(1)(a)(iii) and (2)(a)(iii) of the Rules, of the rules and procedures through which NSCC calculates and applies the Bond Haircut. The proposed rule change would allow NSCC to further provide its participants with sufficient information regarding the Bond Haircut to enable those participants to identify and evaluate the risks and material costs associated with the calculation and application of the Bond Haircut, which are incurred

⁸ Id.

⁹ 17 CFR 240.17Ad-22(e)(23)(i).

¹⁰ 17 CFR 240.17Ad-22(e)(23)(ii).

through their participation in NSCC. As such, NSCC believes the proposed rule change is consistent with Rule 17Ad-22(e)(23)(i) and (ii) under the Act.¹¹

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

NSCC does not believe that the proposed rule change would impact competition.¹² The proposed rule change would increase transparency of the Rules by codifying NSCC's current practice with respect to the assessment and imposition of the Bond Haircut. As such, NSCC believes that the proposed rule change would not impact Members or have any impact on competition.

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

NSCC has not received any written comments relating to this proposal. NSCC will notify the Commission of any written comments it receives .

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and paragraph (f) of Rule 19b-4 thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

¹¹ 17 CFR 240.17Ad-22(e)(23)(i), (ii).

¹² 15 U.S.C. 78q-1(b)(3)(I).

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-2017-009 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-2017-009. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m.

and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change; 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 Number SR-NSCC-2017-009 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.¹³

Jill M. Peterson
Assistant Secretary

¹³ 17 CFR 200.30-3(a)(12).