

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87912; File No. SR-NSCC-2019-802)

January 8, 2020

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Advance Notice to Issue Term Debt as Part of its Liquidity Risk Management

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 notice is hereby given that on December 13, 2019, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice SR-NSCC-2019-802 (“Advance Notice”) 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 Advance Notice from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

This Advance Notice is filed by NSCC in connection with a proposal to raise additional prefunded liquidity resources through the periodic issuance and private placement of term debt (“Debt Issuance”). The proceeds from the Debt Issuance would supplement NSCC’s existing default liquidity risk management resources. The proposed changes are described in greater detail below.

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections A and B below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

Written comments on the Advance Notice 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 Proposed Change

NSCC is proposing to raise additional prefunded liquidity through the periodic issuance and private placement of term debt to qualified institutional investors in an aggregate amount not to exceed \$10 billion, as described in greater detail below. The proceeds of the Debt Issuance would supplement NSCC's existing default liquidity resources, which also include, for example, the proceeds of the issuance and private placement of short-term, unsecured notes in the form of commercial paper and extendable notes ("Commercial Paper Program")³ and cash that would be obtained by

³ See Securities Exchange Act Release Nos. 75730 (August 19, 2015), 80 FR 51638 (August 25, 2015) (File No. SR-NSCC-2015-802); 82676 (February 9, 2018), 83 FR 6912 (February 15, 2018) (File No. SR-NSCC-2017-807).

drawing upon NSCC’s committed 364-day credit facility with a consortium of banks (“Line of Credit”).⁴

NSCC, along with its affiliates, The Depository Trust Company (“DTC”) and Fixed Income Clearing Corporation (“FICC,” and, together with NSCC and DTC, the “Clearing Agencies”), maintain a Clearing Agency Liquidity Risk Management Framework (“Framework”), which sets forth the manner in which NSCC measures, monitors and manages the liquidity risks that arise in or are borne by it.⁵ NSCC periodically measures its liquidity needs pursuant to the Framework.⁶ NSCC’s default liquidity resources collectively provide NSCC with liquidity to complete end-of-day settlement in the event of the default of a Member.⁷ The proposed Debt Issuance would supplement its existing default liquidity resources and provide NSCC with an additional

⁴ See Securities Exchange Act Release No. 80605 (May 5, 2017), 82 FR 21850 (May 10, 2017) (File Nos. SR-DTC-2017-802; SR-NSCC-2017-802).

⁵ See Securities Exchange Act Release Nos. 82377 (December 21, 2017), 82 FR 61617 (December 28, 2017) (File Nos. SR-DTC-2017-004; SR-FICC-2017-008; SR-NSCC-2017-005). Following approval of this proposal, the Clearing Agencies would file a proposed rule change to amend the Framework to include the proceeds of the Debt Issuance as an additional qualifying liquidity resource of NSCC.

⁶ Id.

⁷ Terms not defined herein are defined in NSCC’s Rules and Procedures (“Rules”) available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf. The events that constitute a Member default are specified in Rule 46 (Restrictions on Access to Services) of the Rules, which provides that NSCC’s Board of Directors may suspend a Member or prohibit or limit a Member’s access to NSCC’s services in enumerated circumstances; this includes default in delivering funds or securities to NSCC, or a Member’s experiencing such financial or operational difficulties that NSCC determines, in its discretion, that restriction on access to services is necessary for its protection and for the protection of its membership. Id.

resource it may draw from to meet its future liquidity needs, as measured pursuant to the Framework.⁸

By supplementing NSCC's existing default liquidity resources, the proposal would mitigate risks to NSCC that it is unable to secure default liquidity resources in an amount necessary to meet its liquidity needs. For example, the proposal would help mitigate the risks that investor demand for the short-term notes issued under the Commercial Paper Program weakens, or that NSCC is unable to renew its Line of Credit at the targeted amount.

Terms of the Debt Issuance. NSCC would engage a trustee and underwriting banks to issue the term debt to qualified institutional investors through a private placement and offering in reliance on an exemption from registration under Section 4(a)(2) of the Securities Act of 1933.⁹ NSCC would be party to certain transaction documents in connection with each issuance and private placement, including an indenture with the trustee and purchase agreements. The purchase agreements would each be based on the standard form of dealer agreement for similar debt issuances, which is published by the Securities Industry and Financial Markets Association. The material terms and conditions of the Debt Issuance are summarized below.

NSCC is proposing to issue up to an aggregate amount of \$10 billion in term debt, with an expected average amount issued and outstanding at any time of approximately \$2-3 billion, as necessitated by liquidity needs. While, at the time of this filing, NSCC's current liquidity needs would not require it to issue up to an aggregate amount of \$10

⁸ Supra note 5.

⁹ 15 U.S.C. 77d(a)(2).

billion, NSCC believes that is advisable to authorize up to this aggregate amount in order to help manage its potential future liquidity needs and the potential risk that it is not able to obtain the requisite amounts from its other sources of default liquidity.

NSCC estimates that each issuance would be in an amount between approximately \$250 million and \$1.5 billion, with an initial issuance expected to be approximately \$1 billion.¹⁰ NSCC believes an initial issuance should be at an amount that would attract the attention of potential investors. Therefore, NSCC believes that approximately \$1 billion would be an appropriate amount for the initial issuance for this reason.

The term debt would be represented by unsecured, unsubordinated and non-convertible medium-term and long-term global notes held in the name of The Depository Trust Company (“DTC”), or its nominee, Cede & Co. The notes would be issued and transferred only through the book-entry system of DTC. The term debt would be interest bearing at either fixed or floating interest rates that are set at market rates customary for such type of debt and reflective of the creditworthiness of NSCC.

NSCC expects the average maturity of the term debt issued under the Debt Issuance would range between two and ten years, which are the typical lengths of medium- and long-term debt. NSCC already issues short-term debt through the Commercial Paper Program,¹¹ and NSCC does not believe maturities over ten years would be suitable as debt with longer maturities are generally more expensive to issue

¹⁰ If market conditions at the time of the inaugural issuance are favorable, NSCC may issue an initial aggregate amount of more than \$1 billion.

¹¹ Supra note 3.

and may present higher risks related to interest rates. NSCC would time each debt issuance and stagger maturity dates of each issuance in order to ladder the maturities. NSCC would have the ability to make use of optional features to call any of the issued term debt, in whole or in part, at any time prior to the maturity date of that debt. The issued term debt may also contain renewable terms.

NSCC would hold the proceeds from the Debt Issuance in either its cash deposit account at the Federal Reserve Bank of New York (“FRBNY”) or in accounts at other creditworthy financial institutions in accordance with the Clearing Agency Investment Policy.¹² These amounts would be available to draw to complete settlement as needed.

NSCC Liquidity Risk Management. 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. NSCC’s liquidity risk management plays an integral part in NSCC’s ability to perform its role as a CCP. If a Member defaults, as a CCP, NSCC will need to complete settlement of guaranteed transactions on the failing Member’s behalf from the date of default through the

¹² See Securities Exchange Act Release Nos. 79528 (December 12, 2016), 81 FR 91232 (December 16, 2016) (File Nos. SR-DTC-2016-007, SR-FICC-2016-005, SR-NSCC-2016-003); 84949 (December 21, 2018), 83 FR 67779 (December 31, 2018) (File Nos. SR-DTC-2018-012, SR-FICC-2018-014, SR-NSCC-2018-013). Following notice of no-objection by the Commission of this proposal, the Clearing Agencies would file a proposed rule change to amend the Clearing Agency Investment Policy to include the proceeds of the Debt Issuance as default liquidity funds, within the definition of “Investable Funds,” as such term is defined therein, and provide that such amounts would be held in bank deposits at eligible commercial banks or at NSCC’s cash deposit account at the FRBNY.

remainder of the settlement cycle (currently two days for securities that settle on a regular way basis in the U.S. markets).

As noted above, the Framework describes NSCC's liquidity risk management strategy to maintain sufficient liquidity resources in order to meet the potential funding required to settle outstanding transactions of a defaulting Member, or affiliated family of Members, in a timely manner.¹³ The Framework also addresses how NSCC meets its requirement to hold qualifying liquid resources, as such term is defined in Rule 17Ad-22(a)(14) under the Act,¹⁴ sufficient to meet its minimum liquidity resource requirement in each relevant currency for which it has payment obligations owed to its Members. NSCC considers each of its existing default liquidity resources to be qualifying liquid resources.¹⁵ These resources include: (1) the cash in NSCC's Clearing Fund;¹⁶ (2) the cash that would be obtained by drawing upon its Line of Credit; (3) additional cash deposits, known as "Supplemental Liquidity Deposits", designed to cover the heightened liquidity exposure arising around monthly option expiry periods, required from those Members whose activity would pose the largest liquidity exposure to NSCC;¹⁷ and (4) cash proceeds from the Commercial Paper Program. The proceeds from the Debt Issuance would also be default liquidity that is considered a qualifying liquid resource.

¹³ Supra note 5.

¹⁴ 17 CFR 240.17Ad-22(a)(14).

¹⁵ Id.

¹⁶ See Rule 4 and Procedure XV of the Rules, supra note 5.

¹⁷ Supplemental Liquidity Deposits are described in Rule 4A of the Rules, supra note 7.

By providing NSCC with additional, prefunded, and readily available qualifying liquid resources to be used to complete end-of-day settlement as needed in the event of a Member default, the Debt Issuance would provide additional certainty, stability, and safety to NSCC, its Members, and the U.S. equities market that it serves as a CCP.

NSCC believes the Debt Issuance may also reduce its concentration risk with respect to its default liquidity resources. NSCC would not limit the potential qualified institutional investors that purchase term debt and, therefore, is not able to ensure that the Debt Issuance would reduce concentration risk. However, the types of entities who typically invest in term debt include, for example, insurance companies, asset managers and pension funds, and these entities are generally not Members of NSCC or lenders under the Line of Credit. While these types of entities are the same types of entities that invest in commercial paper, the firms that invest in term debt are generally not the same firms that invest in commercial paper. Therefore, the prospective investors in the term debt are not expected to be the same firms that currently provide any material amount of default liquidity resources to NSCC either through the Commercial Paper Program or the Line of Credit, nor as NSCC Members.

Anticipated Effect on and Management of Risk

NSCC's consistent ability to timely complete settlement is a key part of NSCC's role as a CCP and allows NSCC to mitigate counterparty risk within the U.S. markets. In order to sufficiently perform this key role in promoting market stability, it is critical that NSCC has access to adequate liquidity resources to enable it to complete end-of-day settlement, notwithstanding the default of a Member. NSCC believes that the overall impact of the proposed Debt Issuance on risks presented by NSCC would be to reduce

the liquidity risks associated with NSCC's operation as a CCP by providing it with an additional source of liquidity to complete end-of-day settlement in the event of a Member default. NSCC further believes that a reduction in its liquidity risk would reduce systemic risk and would have a positive impact on the safety and soundness of the clearing system.

While the proposed Debt Issuance, like any liquidity resource, would involve certain risks, most of these risks are standard in any debt issuance. One risk associated with the proposed Debt Issuance would be the risk that NSCC does not have sufficient funds to repay issued term debt when the notes mature. NSCC believes that this risk is extremely remote, as the proceeds of the Debt Issuance would be used only in the event of a Member default, and NSCC would replenish that cash, as it would replenish any of its liquidity resources that are used to facilitate settlement in the event of a Member default, with the proceeds of the close out of that defaulted Member's portfolio. This notwithstanding, in the event that proceeds from the close out are insufficient to fully repay a liquidity borrowing, then NSCC would look to its loss waterfall to repay any outstanding liquidity borrowings.¹⁸ NSCC would further mitigate this risk through the timing of each debt issuance and by staggering the maturity dates of the issued term debt in a way that would provide NSCC with time to complete the close out of a defaulted Member's portfolio. A second risk is that NSCC may be unable to issue new term debt as issued notes mature due to, for example, stressed markets at the time the issued debt matures. This risk is mitigated by the fact that NSCC maintains a number of different

¹⁸ See Rule 4 (Clearing Fund) of the Rules, supra note 7.

default liquidity resources, described above, and would not depend on the Debt Issuance as its sole source of liquidity.

NSCC may face interest rate risk, which is the risk that the borrowing interest rate on issued debt is higher than the interest rate at which proceeds of issued debt would be invested. NSCC would mitigate this risk by issuing term debt at different maturities and at both fixed interest rates and floating interest rates. The interest rates for the term debt issued at floating interest rates would generally correlate with the rates on investments of those proceeds and would be expected to result in a largely stable net spread between the borrowing interest rate and the investment interest rate, mitigating this risk. For the term debt issued at a flat interest rate, NSCC would consider interest rate swaps as a method to mitigate interest rate risk, depending on market environment at that time.

NSCC could also face a related financial risk that the expense of a Debt Issuance exceeds NSCC's income and negatively impacts NSCC's financial health or its creditworthiness. NSCC would mitigate this risk by evaluating the expected interest rate risk (discussed above) and expense of a Debt Issuance prior to issuing any debt, and if the financing costs for the issuance of term debt increase, such that it is not financially advisable to issue additional term debt, then NSCC may determine to use its alternative liquidity resources to meet its liquidity needs during those market conditions.

NSCC believes that the significant systemic risk mitigation benefits of providing NSCC with additional, prefunded liquidity resources outweigh these risks.

Consistency with Clearing Supervision Act

NSCC believes that that proposal would be consistent with Title VIII of the Clearing Supervision Act, specifically with the risk management objectives and

principles of Section 802(b)(1), and with certain of the risk management standards adopted by the Commission pursuant to Section 805(a)(2), for the reasons described below.¹⁹

(i) *Consistency with Section 805(b)(1) of the Clearing Supervision Act*

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.²⁰

NSCC believes the proposal is consistent with Section 805(b)(1) of the Clearing Supervision Act because it would support the mitigation of systemic risk in the financial system and promote financial stability in the event of a Member default by strengthening NSCC's liquidity. The proposed Debt Issuance is designed to reduce NSCC's liquidity risks by providing it with an additional source of liquidity to complete end-of-day settlement in the event of a Member default. By supplementing NSCC's existing default liquidity resources with prefunded liquidity, the proposal would contribute to NSCC's goal of assuring that NSCC has adequate liquidity resources to meet its settlement obligations notwithstanding the default of any of its Members.

In its critical role as a CCP, NSCC itself between counterparties to financial transactions, thereby reducing the risk faced by its Members and contributing to global financial stability. NSCC's liquidity risk management plays an integral part in NSCC's

¹⁹ 12 U.S.C. 5464(a)(2) and (b)(1).

²⁰ 12 U.S.C. 5464(b)(1).

ability to perform its role as a CCP. Therefore, a reduction of NSCC’s liquidity risk would be expected to also reduce systemic risk in the financial system and would promote financial stability by having a positive impact on the safety and soundness of the clearing system.

As a result, NSCC believes the proposed Debt Issuance would be consistent with the objectives and principles of Section 805(b)(1) of the Clearing Supervision Act, which specify the promotion of robust risk management, promotion of safety and soundness, reduction of systemic risks and support of the stability of the broader financial system by, among other things, strengthening the liquidity of systemically important financial market utilities, such as NSCC.

(ii) Consistency with Rule 17Ad-22(e)(7)(i) and (ii) under the Act

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like NSCC, and financial institutions engaged in designated activities for which the Commission is the supervisory agency or the appropriate financial regulator.²¹ The Commission has accordingly adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act²² and Section 17A of the Act (“Covered Clearing Agency Standards”).²³ The Covered Clearing Agency Standards require covered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain

²¹ 12 U.S.C. 5464(a)(2).

²² Id.

²³ 17 CFR 240.17Ad-22(e).

minimum requirements for their operations and risk management practices on an ongoing basis.²⁴

NSCC believes that the proposed Debt Issuance is consistent with Rule 17Ad-22(e)(7)(i) and (ii) of the Covered Clearing Agency Standards for the reasons described below.²⁵

Rule 17Ad-22(e)(7)(i) under the Act requires that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient liquid resources at the minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for the covered clearing agency in extreme but plausible market conditions.²⁶ Rule 17Ad-22(e)(7)(ii) under the Act requires that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to hold qualifying liquid resources sufficient to meet the minimum liquidity resource requirement under Rule 17Ad-22(e)(7)(i) in each relevant currency for which NSCC has payment obligations owed to its Members.²⁷

²⁴ Id.

²⁵ 17 CFR 240.17Ad-22(e)(7)(i), (ii).

²⁶ 17 CFR 240.17Ad-22(e)(7)(i).

²⁷ 17 CFR 240.17Ad-22(e)(7)(ii). For purposes of this Rule, “qualifying liquid resources” are defined in Rule 17Ad-22(a)(14) as including, in part, cash held either at the central bank of issue or at creditworthy commercial banks. 17 CFR 240.17Ad-22(a)(14).

As described above, the proposed Debt Issuance would provide NSCC with an additional resource of prefunded default liquidity, which it would use to complete end-of-day settlement in the event of the default of a Member. The proceeds of the Debt Issuance would be cash held by NSCC at either its cash deposit account at the FRBNY or at a creditworthy commercial bank, pursuant to the Clearing Agency Investment Policy.²⁸ Therefore, the proceeds of the Debt Issuance would be considered a qualifying liquid resource, as defined by Rule 17Ad-22(a)(14).²⁹ As such, the proposed Debt Issuance would support NSCC's ability to hold sufficient qualifying liquid resources to meet its minimum liquidity resource requirement under Rule 17Ad-22(e)(7)(i).³⁰

For these reasons, NSCC believes the proposal would support NSCC's compliance with Rule 17Ad-22(e)(7)(i) and (ii) by providing it with an additional qualifying liquid resource.³¹

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.

²⁸ Supra note 12.

²⁹ 17 CFR 240.17Ad-22(a)(14).

³⁰ 17 CFR 240.17Ad-22(e)(7)(i).

³¹ 17 CFR 240.17Ad-22(e)(7)(i), (ii).

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.

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-2019-802 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-2019-802. 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-2019-802 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

By the Commission.

Jill M. Peterson
Assistant Secretary