

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-92381; File No. SR-NSCC-2021-008)

July 13, 2021

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Clearing Agency Model Risk Management Framework

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 July 7, 2021, 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. NSCC filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(1) thereunder.<sup>4</sup> 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 clarifies the scope of the Clearing Agency Model Risk Management Framework (“Framework”) of NSCC and its affiliates The Depository Trust Company (“DTC”) and Fixed Income Clearing Corporation (“FICC,” and together with NSCC, the “CCPs,” and the CCPs together with DTC, the “Clearing Agencies”).<sup>5</sup> The

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(1).

<sup>5</sup> The Framework sets forth the model risk management practices that the Clearing Agencies follow to identify, measure, monitor, and manage the risks associated with the design, development, implementation, use, and validation of quantitative

Framework has been adopted by the Clearing Agencies to support their compliance with Rule 17Ad-22(e) (the “Covered Clearing Agency Standards”).<sup>6</sup> The proposed rule change<sup>7</sup> would amend the Framework to clarify that the Framework applies solely to models<sup>8</sup> utilized by the Clearing Agencies that are subject to the model risk management requirements set forth in Rule 17Ad-22(e)(4), (e)(6), and (e)(7) under the Act.<sup>9</sup> The proposed rule change also makes other technical and clarifying changes to the text, as more fully 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

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models. The Framework is filed as a rule of the Clearing Agencies. See Securities Exchange Act Release No. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File Nos. SR-DTC-2017-008; SR-FICC-2017-014; SR-NSCC-2017-008) (“2017 Notice”) and Securities Exchange Act Release No. 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File Nos. SR-DTC-2020-008; SR-FICC-2020-004; SR-NSCC-2020-008) (“2020 Notice”) (collectively, the MRMF Filings”).

<sup>6</sup> 17 CFR 240.17Ad-22(e). Each of DTC, NSCC and FICC is a “covered clearing agency” as defined in Rule 17Ad-22(a)(5) and must comply with Rule 17Ad-22(e).

<sup>7</sup> Amending the Framework does not require any changes to the Rules, By-Laws and Organization Certificate of DTC, the Rulebook of the Government Securities Division of FICC, the Clearing Rules of the Mortgage-Backed Securities Division of FICC, or the Rules & Procedures of NSCC, because the Framework is a standalone document. See MRMF Filings, supra note 5.

<sup>8</sup> See infra note 16 for the definition of “model” as adopted by the Clearing Agencies pursuant to the Framework.

<sup>9</sup> 17 CFR 240.17Ad-22(e)(4), (e)(6) and (e)(7). References to Rule 17Ad-22(e)(6) and compliance therewith apply to the CCPs only and do not apply to DTC.

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

The proposed rule change clarifies the scope of the Framework to make clear that it applies solely to models that are subject to Rule 17Ad-22(e)(4), (e)(6), and (e)(7).<sup>10</sup> The proposed rule change also makes other technical and clarifying changes to the text.

Background

The Framework is maintained by the Clearing Agencies to support their compliance with the requirements of the Covered Clearing Agency Standards relating to model risk management. The Covered Clearing Agency Standards require that the Clearing Agencies take a variety of steps to manage the models that they employ in identifying, measuring, monitoring, and managing their respective credit exposures and liquidity risks, including that the Clearing Agencies conduct daily backtesting of model performance, periodic sensitivity analyses of models, and annual validation of models.<sup>11</sup>

The Framework outlines the applicable regulatory requirements described above, describes the risks that the Clearing Agencies' model risk management program are designed to mitigate, and sets forth specific model risk management practices and requirements adopted by the Clearing Agencies in order to ensure compliance with the

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<sup>10</sup> Id.

<sup>11</sup> Id.

Covered Clearing Agency Standards. These practices and requirements include, among other things, the maintenance of a model inventory, a process for rating model materiality and complexity, processes for performing model validations and resolving findings identified during model validation, and processes for model performance monitoring, including backtesting and sensitivity analyses. The Framework also describes applicable internal ownership and governance requirements.<sup>12</sup>

The Depository Trust & Clearing Corporation (“DTCC”), the parent company of the Clearing Agencies, has established a robust model risk management program, which applies to models employed across multiple business lines and corporate functions.<sup>13</sup> DTCC may implement changes in its model risk management program from time to time, some of which changes may impact only lower-risk, lower-materiality models that are not subject to the specific model risk management requirements of the Covered Clearing Agency Standards. The Clearing Agencies previously adopted changes to the Framework in connection with proposed enhancements to their model risk management program, which rule changes also deleted the defined term “Clearing Agency Model” on grounds that the Framework related solely to models of the Clearing Agencies, and it was unnecessary to use the modifier “Clearing Agency”.<sup>14</sup> In view of continued expansion of DTCC’s model risk management program, however, the Clearing Agencies desire to

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<sup>12</sup> See MRMF Filings, supra note 5, for additional information on the contents of the Framework.

<sup>13</sup> DTCC operates on a shared services model with respect to the Clearing Agencies. Most corporate functions are established and managed on an enterprise-wide basis pursuant to intercompany agreements under which it is generally DTCC that provides a relevant service to a Clearing Agency.

<sup>14</sup> See 2020 Notice, supra note 5.

avoid any doubt as to the applicability of the Framework to specific models, and therefore propose to adopt further clarifying changes to the text of the Framework.

#### Proposed Rule Change

Section 1 (Executive Summary) of the Framework recites the regulatory requirements applicable to model risk management for credit risk models, liquidity risk models, and margin models that are set forth in the Covered Clearing Agency Standards. The proposed rule change clarifies the Framework’s scope by (i) amending Section 1 of the Framework to add a sentence that states that the Framework supports the Clearing Agencies in complying with their rule filing requirements under Rule 19b-4<sup>15</sup> because the Framework itself is a rule that governs the Clearing Agencies’ management of their credit risk, margin, and liquidity risk management models and (ii) adding a footnote that states that only those models that satisfy the definition of “model” set forth in Section 3.1 of the Framework, and that support the Clearing Agencies’ compliance with the Standards, are models subject to the Framework and, in contrast, models of the Clearing Agencies that would satisfy the definition of “model” as set forth under Section 3.1 of the Framework, but do not support the Clearing Agencies’ compliance with the Standards, are not subject to the Framework.<sup>16</sup> In this regard, the proposed rule change would also amend certain

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<sup>15</sup> 17 CFR 240.19b-4.

<sup>16</sup> Pursuant to Section 3.1 of the Framework, the Clearing Agencies have adopted the following definition of “model”: “[M]odel” refers to a quantitative method, system, or approach that applies statistical, economic, financial, or mathematical theories, techniques, and assumptions to process input data into quantitative estimates. A “model” consists of three components: an information input component, which delivers assumptions and data to the model; a processing component, which transforms inputs into estimates; and a reporting component, which translates the estimates into useful business information. The definition of ‘model’ also covers quantitative approaches whose inputs are partially or wholly qualitative or based on expert judgment, provided that the output is quantitative in

references to models in subsequent sections to refer to models “subject to this Framework”. Specifically, the text “subject to this Framework” would modify references to models in (i) Section 3.1 with respect to (a) models to be added to the Clearing Agencies’ model inventory and (b) models subject to validation as set forth in Section 2,<sup>17</sup> (ii) Section 3.2 (Model Materiality and Complexity) with respect to the assignment of complexity ratings to models,<sup>18</sup> (iii) Section 3.3 (Full Model Validation) with respect to a requirement relating to the validation of new models,<sup>19</sup> (iv) Section 3.4 (Periodic Model Validation) with respect to periodic validation of models,<sup>20</sup> (v) Section 3.5 (Model Change Management) with respect to models that require changes in either structure or technique, (vi) Section 3.7 (Resolution of Model Validation Findings) with respect to

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nature. See 2017 Notice, supra note 5. See also Supervisory Guidance on Model Risk Management, SR Letter 11-7 Attachment, dated April 4, 2011, issued by the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, available at <https://www.federalreserve.gov/supervisionreg/srletters/sr1107a1.pdf>, page 3.

<sup>17</sup> Also in this regard, the applicable sentence that this reference would be added to would also replace the words “All models (including, without limitation, all credit risk models margin models, and liquidity risk models)” with “All models.” The described reference to “subject to this Framework” would be added after the newly added text “All models.”

<sup>18</sup> In this instance, the new text “subject to this Framework” would be preceded with the added text “that is” so that the reference to “model” in this context reads “... model that is subject to this Framework ... .”

<sup>19</sup> Similar to the prior reference from Section 3.1, the added reference to “subject to this Framework” in Section 3.3 would be preceded with the added text “that is” so that the reference to “model” in this context reads “... new model that is subject to this Framework ... .”

<sup>20</sup> Similar to the prior reference from Section 3.3, the added reference to “subject to this Framework” in Section 3.4 would be followed with the added text “that is” so that the reference to “model” in this context reads “... model subject to this Framework that is ... .”

internal tracking and reporting relating to model validations<sup>21</sup> and (vii) Section 4.2 (Escalation)<sup>22</sup> with respect to internal escalation of model performance monitoring oversight concerns.<sup>23</sup>

The proposed rule change makes several other technical and clarifying changes to the text of the Framework. It revises a sentence in Section 1 that currently states “FICC/GSD, FICC/MBSD, and NSCC are each a “Central Counterparty” or “CCP” and are collectively referred to as the “Central Counterparties” or “CCPs”. The proposed revisions to this sentence (i) changes the first reference to “Central Counterparty” from a capitalized term to an uncapitalized term, (ii) deletes the second reference to this term in this sentence (shown as “Central Counterparties”) such that “CCP” will be the sole defined term used to described central counterparties, and (iii) adds “below” after the words “referred to.”

It defines a term for “Clearing Agency Model Documentation” to reduce the repetition of listing numerous documents that are subordinate to the Framework with respect to model risk management. The proposed rule change updates the titles of certain

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<sup>21</sup> The reference to model in this instance also refers to a new model or a model change and the applicable text reads “... new model or model change ....” To improve the flow of the text, the words “or model change” would be deleted and “or changed” would be added after “new.” Also, the addition of “subject to this Framework” would be preceded by newly added words “that is” so that the reference to “model” in this case refers to “... new or changed model that is subject to this Framework ... .”

<sup>22</sup> In this instance the existing text does not use the word “model” even though it is referencing the escalation of issues relating to models. The applicable sentence currently begins with “[a]ll model performance monitoring oversight concerns ....”

<sup>23</sup> See MRMF Filings, supra note 5, for additional information on the contents of these sections, and the Framework in general.

Clearing Agency Model Documentation.<sup>24</sup> It also consolidates a reference to supplementary model risk documentation applicable to the Clearing Agencies that may be created from time to time into the newly defined term “Clearing Agency Model Documentation”. The proposed rule change adds this defined term to three sentences in Section 1 to replace references in the section to specifically named model documentation and supplemental model documentation. It also consolidates two references that respectively provide that the documentation that is specifically named in the Framework, and the supplemental documentation that may be created, are subordinate to the Framework and are reasonably and fairly implied by the Framework, into one such reference with respect to Clearing Agency Model Documentation.

The proposed rule change updates prior references to the Model Validation & Control unit (defined in the Framework as “MVC”), the name of which has recently changed, to instead refer generically to the unit within the Clearing Agencies’ Group Chief Risk office that performs second-line model risk management functions. This generic reference to this unit would be defined as “MRM” in the Framework and, therefore, all references to “MVC” would be replaced with “MRM” beginning from the first use of “MVC” in Section 3, and with respect to all subsequent references to “MVC,”

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<sup>24</sup> Section 1 provides that this documentation each of which may be updated, amended, retired, or replaced from time to time. In this regard, the text would be updated to reflect that (i) “DTCC Model Validation Procedures” has been changed to “Model Validation Procedures”, (ii) “DTCC Model Performance Monitoring Procedures” has been changed to “DTCC Model Performance Standards & Policy”, and (iii) “DTCC Backtesting Procedures” has been changed to “Clearing Agency Backtesting Procedures.” Also, the “Quantitative Risk Management Policy” and “Quantitative Risk Management Monitoring Procedures” would be added as supporting documents.



through and including the last reference to “MVC” in the second to last paragraph of Section 5.

In addition, a sentence in Section 3.1 that states “[a]ll Model Validations are performed by MVC, which consists of qualified persons who are free from influence from the persons responsible for the development or operation of the models being validated, as required by the risk management standards described in Section 2[.]” would be revised to delete the clause “as required by the risk management standards described in Section 2” and the comma immediately preceding that clause would be deleted. This clause is unnecessary because it follows in a paragraph that already makes reference to the referenced “risk management standards” in a similar context.

Also, a sentence in Section 3.8 describes that as part of model performance monitoring, on at least a monthly basis, a sensitivity analysis is performed on each CCP’s margin models, the key parameters and assumptions for backtesting of such margin models are reviewed, and modifications will be considered to ensure the backtesting practices are appropriate for determining the adequacy of such CCP’s margin resources. This sentence ends with a clause that states “which Quantitative Risk Management (“QRM”) performs as required by the risk management standards described in Section 2.” The reference to the requirements of Section 2 is unnecessary when naming the group that performs these tasks. Therefore, Clearing Agencies will delete the clause referencing these requirements, and a comma that proceeds it, from the sentence in Section 3.8 described immediately above, and add a new sentence, to follow the existing sentence, stating that Quantitative Risk Management performs these functions, without referencing the requirements described in Section 2. The new sentence will read

“Quantitative Risk Management (“QRM”) performs these functions.” In addition, in this same sentence, the proposed rule change will delete “a” that currently appears before the words “sensitivity analysis”.

The proposed rule change also makes certain technical and grammatical corrections, including elimination of unused or misapplied defined terms. The proposed rule change deletes the text “in compliance with applicable legal requirements” from sentence in Section 1 (Executive Summary) that states that Section 3 of the Framework describes key aspects of the Framework in terms of the manner in which the Clearing Agencies identify, measure, monitor, and manage model risk. Referring to compliance with applicable legal requirements with respect to an individual section is unnecessary, because Section 1 contains a separate reference indicating that the Framework itself is designed to support compliance with the legal requirements set forth under the Covered Clearing Agency Standards relating to model risk management. The proposed rule change would also modify the beginning of the sentence described immediately above that currently includes the text “Section 3 describes key aspects of the Framework in terms of the manner in which the Clearing Agencies identify, measure, monitor, and manage model risk...” to delete the words “Framework in terms of the” to simplify the text by deleting a clause that does not enhance the meaning of the sentence.

Finally, the proposed rule change replaces a reference to “quantitative models” to “models” in the Executive Summary under Section 1. This use of “quantitative” is

redundant because, by definition, models covered by the Framework are quantitative in nature.<sup>25</sup>

## 2. Statutory Basis

NSCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,<sup>26</sup> as well as Rule 17Ad-22(e)(4), (e)(6), and (e)(7) thereunder,<sup>27</sup> for the reasons described below.

Section 17A(b)(3)(F) of the Act<sup>28</sup> requires, inter alia, that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible. As described above, the Framework describes the process by which the Clearing Agencies identify, measure, monitor, and manage the risks associated with the design, development, implementation, use, and validation of quantitative models. The quantitative models covered by the Framework are utilized by the Clearing Agencies, as applicable, to manage risks associated with the safeguarding of securities and funds that are in their custody or control or for which they are responsible, and the proposed rule change clarifies the applicability of the Framework to specific models, thereby better supporting

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<sup>25</sup> As noted above, pursuant to Section 3.1 of the Framework, the term “model” refers to a quantitative method, system, or approach that applies statistical, economic, financial, or mathematical theories, techniques, and assumptions to process input data into quantitative estimates.

<sup>26</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>27</sup> 17 CFR 240.17Ad-22(e)(4), (e)(6) and (e)(7). References to Rule 17Ad-22(e)(6) and compliance therewith apply to the CCPs only and do not apply to DTC.

<sup>28</sup> 15 U.S.C. 78q-1(b)(3)(F).

the ability of the Clearing Agencies to perform these important risk management functions and comply with other regulatory requirements, including Rule 19b-4.

Rule 17Ad-22(e)(4), (e)(6), and (e)(7)<sup>29</sup> requires, inter alia, that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to manage risks associated with its credit risk management models, margin models, and liquidity risk management models, as applicable. As discussed above, the proposed rule change clarifies the applicability of the Framework to such types of models, thereby better supporting the ability of the Clearing Agencies to comply with these requirements. Therefore, the Clearing Agencies believe that the proposed changes to the Framework are consistent with Rule 17Ad-22(e)(4), (e)(6), and (e)(7).<sup>30</sup>

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

The Clearing Agencies do not believe that the proposed rule change would have any impact, or impose any burden, on competition because the proposed rule change simply clarifies the scope and administration of the Framework by the Clearing Agencies and would not effectuate any changes to the Clearing Agencies' model risk management tools as they currently apply to their respective Members or Participants.

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

The Clearing Agencies have not solicited or received any written comments relating to this proposal. The Clearing Agencies will notify the Commission of any written comments received by the Clearing Agencies.

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<sup>29</sup> 17 CFR 240.17Ad-22(e)(4), (e)(6) and (e)(7). References to Rule 17Ad-22(e)(6) and compliance therewith apply to the CCPs only and do not apply to DTC.

<sup>30</sup> Id.

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)<sup>31</sup> of the Act and paragraph (f)<sup>32</sup> 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.

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 Number SR-NSCC-2021-008 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-2021-008. This file number

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<sup>31</sup> 15 U.S.C 78s(b)(3)(A).

<sup>32</sup> 17 CFR 240.19b-4(f).

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-2021-008 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>33</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>33</sup> 17 CFR 200.30-3(a)(12).