

## SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-82006; File Nos. SR-DTC-2017-016; SR-NSCC-2017-016; SR-FICC-2017-020)

November 2, 2017

Self-Regulatory Organizations; The Depository Trust Company; National Securities Clearing Corporation; Fixed Income Clearing Corporation; Order Approving Proposed Rule Changes to Adopt the Clearing Agency Securities Valuation Framework

### I. Introduction

On September 8, 2017, The Depository Trust Company (“DTC”), National Securities Clearing Corporation (“NSCC”), and Fixed Income Clearing Corporation (“FICC,” each a “Clearing Agency,” and together with DTC and NSCC, the “Clearing Agencies”), filed with the Securities and Exchange Commission (“Commission”) proposed rule changes SR-DTC-2017-016, SR-NSCC-2017-016, and SR-FICC-2017-020, respectively, 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> The proposed rule changes were published for comment in the Federal Register on September 27, 2017.<sup>3</sup> The Commission did not receive any comment letters on the proposed rule changes. For the reasons discussed below, the Commission approves the proposed rule changes.

### II. Description of the Proposed Rule Changes

The Clearing Agencies propose to adopt the Clearing Agency Securities Valuation Framework (“Framework”) of the Clearing Agencies, as described below.

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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> See Securities Exchange Act Release No. 81667 (September 21, 2017), 82 FR 45106 (September 27, 2017) (SR-DTC-2017-016; SR-NSCC-2017-016; SR-FICC-2017-020) (“Notice”).

A. Overview of the Framework

The Framework would address the manner in which the Clearing Agencies select and review “Pricing Vendors” and value securities that the Clearing Agencies process or otherwise hold. The proposed rule changes would set forth the securities valuation practices adopted by the Clearing Agencies for securities eligible for clearance and settlement processing by the applicable Clearing Agency; and in the case of FICC and NSCC, as central counterparties (“CCPs”), securities eligible to be held in their respective clearing funds.<sup>4</sup>

B. Selection of Pricing Vendors

Each Clearing Agency would price securities for both end-of-day and intraday value primarily through pricing data supplied by third-party pricing vendors (“Pricing Vendors”).<sup>5</sup> For most securities, Pricing Vendors would supply the Clearing Agencies with intraday pricing data on at least an hourly basis.<sup>6</sup> Pricing Vendors would be selected by each Clearing Agency based on a review of their service, including, at a minimum, a review of Pricing Vendors’ securities coverage and a price quality check.<sup>7</sup>

The Framework would provide that each security be assigned a primary source Pricing Vendor (“Primary Pricing Vendor”) and a secondary source Pricing Vendor (“Secondary Pricing Vendor”).<sup>8</sup> In the event that the Primary Pricing Vendor becomes unavailable, unreliable, or

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<sup>4</sup> Id.

<sup>5</sup> Id. at 45107.

<sup>6</sup> Certain securities may not be priced daily, and others may only be priced once each business day. Id.

<sup>7</sup> Id.

<sup>8</sup> Id.

otherwise unusable with respect to a security, the Secondary Pricing Vendor would be designated as the replacement for the Primary Pricing Vendor with respect to such security.<sup>9</sup>

Each Clearing Agency would perform due diligence on each Pricing Vendor prior to engagement, and at least annually thereafter, to assess the reliability of such Pricing Vendor.<sup>10</sup> Reliability of a Pricing Vendor would be determined by each Clearing Agency based on a range of factors, including whether such Pricing Vendor can provide accurate and timely pricing data with respect to each security.<sup>11</sup>

C. Monitoring and Pricing

Each Clearing Agency would monitor and review each applicable Pricing Vendor's pricing at least once each business day to determine (i) whether any security's price has remained unchanged for an extended period; (ii) whether a security has been dropped from the Pricing Vendor's file; and (iii) whether any other circumstances exist that may call into question the reliability of any security's price.<sup>12</sup>

Each security's end-of-day price would be date stamped, and each intraday price would be time and date stamped. Both end-of-day and intraday prices would be identified with a Pricing Vendor source.<sup>13</sup> In the event that both a Primary Pricing Vendor and a Secondary Pricing Vendor become unavailable, unreliable, or otherwise unusable with respect to a security,

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<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> Id.

<sup>12</sup> Id.

<sup>13</sup> Id.

the applicable Clearing Agency would assign such security its last available price.<sup>14</sup> If pricing data for a security is unavailable from a Pricing Vendor, or if the last available price is deemed to be unreliable or unusable, the applicable Clearing Agency would establish a price for the security based on valuation models, where applicable, and in accordance with the policies and procedures that support the Framework.<sup>15</sup>

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization.<sup>16</sup> After carefully considering the proposed rule changes, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to the Clearing Agencies. Specifically, the Commission finds that the proposed rule changes are consistent with Section 17A(b)(3)(F) of the Act<sup>17</sup> as well as Rules 17Ad-22(e)(4)(i)<sup>18</sup> and (e)(6)(iv)<sup>19</sup> under the Act.

#### A. Consistency with Section 17A(b)(3)(F)

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a registered clearing agency be designed to promote prompt and accurate clearance and settlement, and assure the

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<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>17</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>18</sup> 17 CFR 240.17Ad-22(e)(4)(i).

<sup>19</sup> 17 CFR 240.17Ad-22(e)(6)(iv).

safeguarding of securities and funds which are in the custody or control of the Clearing Agencies or for which they are responsible.<sup>20</sup>

As described above, the Framework would describe the manner in which the Clearing Agencies select and review their Pricing Vendors, and how the Clearing Agencies value securities that the Clearing Agencies process or otherwise hold. By describing the Clearing Agencies' Pricing Vendors selection process and securities valuation practices in a clear and comprehensive manner, the Framework is designed to provide (i) reliable sources of timely price data, and (ii) a sound valuation practice when pricing data is not readily available. In doing so, the Framework would help the Clearing Agencies to promptly and accurately value (i) the securities that the Clearing Agencies process for clearance and settlement purposes; (ii) for DTC, the available collateral for a participant's net settlement obligation, which DTC monitors to help mitigate the credit risk that participants<sup>21</sup> present to DTC;<sup>22</sup> and (iii) for NSCC and FICC, the securities held in their respective clearing funds, which are maintained to help mitigate the credit risk that participants present to NSCC and FICC, as applicable.<sup>23</sup> By establishing a framework for accurately valuing securities that the Clearing Agencies process and hold for risk management purposes, the Framework would better position the Clearing Agencies to continue

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<sup>20</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>21</sup> DTC refers to its participants as "Participants," while NSCC and FICC refer to their participants as "Members." These terms are defined in the rules of each of the Clearing Agencies. In this order, "participant" or "participants" refers to both the Participants of DTC and the Members of FICC and NSCC.

<sup>22</sup> DTC: Disclosure under the Principles for Financial Market Infrastructures, [available at http://www.dtcc.com/legal/policy-and-compliance](http://www.dtcc.com/legal/policy-and-compliance).

<sup>23</sup> NSCC: Disclosure under the Principles for Financial Market Infrastructures, and FICC: Disclosure under the Principles for Financial Market Infrastructures, [available at http://www.dtcc.com/legal/policy-and-compliance](http://www.dtcc.com/legal/policy-and-compliance).

their critical operations and services, promptly and accurately, and mitigate the risk of financial loss to the Clearing Agencies and their non-defaulting participants due to a participant default.

Therefore, the Commission finds that the proposed rule changes are designed to help promote prompt and accurate clearance and settlement, and assure the safeguarding of securities and funds which are in the custody or control of the Clearing Agencies or for which they are responsible, consistent with Section 17A(b)(3)(F) of the Act.<sup>24</sup>

B. Consistency with Rule 17Ad-22(e)(4)(i)

Rule 17Ad-22(e)(4)(i) under the Act requires that each covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>25</sup>

As described above, the Framework would describe how the Clearing Agencies select and review their Pricing Vendors, and how the Clearing Agencies price securities that the Clearing Agencies process or otherwise hold, even when pricing data becomes unavailable or unreliable. In doing so, the Framework would help ensure that each Clearing Agency uses (i) reliable sources of timely price data when pricing securities processed or otherwise held by the Clearing Agency and (ii) clear valuation procedures when pricing data is not readily available or reliable. The Framework would further provide that the prices provided by each Pricing Vendor would be reviewed at least daily, which would help ensure that prices are accurate and reliable.

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<sup>24</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>25</sup> 17 CFR 240.17Ad-22(e)(4)(i).

By codifying these aforementioned practices in the Framework, the Framework is designed to help ensure that securities are priced appropriately. By appropriately pricing securities, the Clearing Agencies can more accurately calculate the value of the securities that the Clearing Agencies monitor or held for risk management purposes, as described above. Based on the value of the securities, a Clearing Agency may require a participant to provide more financial resources or limit the participants' activities pursuant to the Clearing Agency's rules, in order to better manage the credit risk presented by the participant.<sup>26</sup> Therefore, the Commission finds that the proposed rule changes are designed to help ensure that the Clearing Agencies maintain sufficient financial resources to cover their credit exposure to each participant with a high degree of confidence, consistent with Rule 17Ad-22(e)(4)(i) under the Act.<sup>27</sup>

C. Consistency with Rule 17Ad-22(e)(6)(iv)

Rule 17Ad-22(e)(6)(iv) under the Act requires that each covered clearing agency that is a CCP to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, uses reliable sources of timely price data and uses procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable.<sup>28</sup>

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<sup>26</sup> See the GSD Rulebook of FICC, Rule 4 – Clearing Fund and Loss Allocation; the MBSD Clearing Rules of FICC, Rule 4 – Clearing Fund and Loss Allocation; Rules and Procedures of NSCC, Procedure XV – Clearing Fund Formula and Other Matters; By-Laws and Organizational Certificate of DTC, Rule 4 – Participants Fund and Participants Investment, available at <http://dtcc.com/legal/rules-and-procedures>.

<sup>27</sup> 17 CFR 240.17Ad-22(e)(4)(i).

<sup>28</sup> 17 CFR 240.17Ad-22(e)(6)(iv).

As described above, the Framework provides that NSCC and FICC, each a CCP, would perform due diligence on each Pricing Vendor prior to engagement, and at least annually thereafter, to assess the reliability of such Pricing Vendor. The Framework also describes how NSCC and FICC would select two Pricing Vendors for each security in case one becomes unavailable, unreliable, or otherwise unusable. In the event that both Primary and Secondary Pricing Vendors become unavailable, unreliable, or unusable, the Framework provides that NSCC and FICC would assign each affected security its last available price. The Framework would further provide that, if the last available price is unavailable, unreliable, or otherwise unusable for a security, NSCC and FICC would establish a price for that security based on valuation models (where applicable) and in accordance with the policies and procedures that support the Framework. By setting forth how NSCC and FICC would select Pricing Vendors that can provide timely and reliable pricing data, and how NSCC and FICC would price securities when pricing data is not readily available or reliable, the Commission finds that the proposed rule changes are consistent with Rule 17Ad-22(e)(6)(iv) under the Act.<sup>29</sup>

### III. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and in particular with Section 17A(b)(3)(F)<sup>30</sup> of the Act and the rules and regulations thereunder.

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<sup>29</sup> Id.

<sup>30</sup> 15 U.S.C. 78q-1(b)(3)(F).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that proposed rule changes SR-DTC-2017-016, SR-NSCC-2017-016, or SR-FICC-2017-020 be, and hereby are, APPROVED.<sup>31</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>32</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>31</sup> In approving the Proposed Rule Changes, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>32</sup> 17 CFR 200.30-3(a)(12).