

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82676; File No. SR-NSCC-2017-807)

February 9, 2018

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of No Objection to an Advance Notice to Increase the Authorized Amount Under the Prefunded Liquidity Program

On December 12, 2017, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-NSCC-2017-807 (“Advance Notice”) 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)² under the Securities Exchange Act of 1934 (“Exchange Act”).³ The Advance Notice was published for comment in the Federal Register on January 2, 2018.⁴ The Commission received one comment on the Advance Notice. The comment letter was supportive, but brief, and without specific reasons for the view.⁵ This publication serves

¹ 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated NSCC a systemically important financial market utility on July 18, 2012. See Financial Stability Oversight Council 2012 Annual Report, Appendix A, <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>. Therefore, NSCC is required to comply with the Clearing Supervision Act and file advance notices with the Commission. See 12 U.S.C. 5465(e).

² 17 CFR 240.19b-4(n)(1)(i).

³ 15 U.S.C. 78s(b)(1).

⁴ Securities Exchange Act Release No. 82403 (December 26, 2017), 83 FR 176 (January 2, 2017) (File No. SR-NSCC-2017-807) (“Notice”).

⁵ See letter from Alexandre Blais, dated January 1, 2018 (“[I] am all for this.”).

as notice that the Commission does not object to the changes set forth in the Advance Notice.

I. Description of the Advance Notice

The Advance Notice is a proposal by NSCC to address liquidity risk that is present when NSCC acts as central counterparty (“CCP”) to a transaction with an NSCC member. Liquidity risk can arise for NSCC where there is a member default and NSCC must continue to complete end-of-day settlement on an ongoing basis. In such circumstances, NSCC will need to complete settlement of guaranteed transactions by delivering to its other members cash or securities on the failing member’s behalf from the date of default through the remainder of the settlement cycle.

One of the resources NSCC uses to manage liquidity risk arising from a member default is its Prefunded Liquidity Program, which NSCC established through a previous advance notice to which the Commission did not object.⁶ Currently, the Prefunded Liquidity Program provides NSCC with the authority to raise up to \$5 billion through the private placement of unsecured debt (commercial paper and extendible notes, collectively “Notes”).⁷ NSCC holds the cash proceeds from the issuance of the Notes in a cash deposit account at the Federal Reserve Bank of New York or a bank counterparty that has been approved pursuant to the Clearing Agency Investment Policy.⁸ In the event of a default by an NSCC member, NSCC can use the cash to manage the resultant liquidity

⁶ Securities Exchange Act Release No. 75730 (August 19, 2015), 80 FR 51638 (August 25, 2015) (SR-NSCC-2015-802).

⁷ Notice, 83 FR at 177.

⁸ Id.

need and complete settlement.⁹ NSCC may not access or use the cash for any other purpose.¹⁰

NSCC filed the Advance Notice to increase the authorized amount under its Prefunded Liquidity Program. Under the Advance Notice, NSCC seeks to increase the amount available to it under the Prefunded Liquidity Program from \$5 billion to \$10 billion.¹¹ According to NSCC, the proposed expanded authorized amount under NSCC's Prefunded Liquidity Program would enable NSCC to continue to maintain a sufficient amount of liquid resources in compliance with its regulatory requirements through the issuance of additional Notes in the event its liquidity needs increase.¹² Specifically, NSCC stated that it would provide NSCC with the flexibility to reduce its reliance on its credit facility, as necessary.¹³ NSCC has observed varying levels of interest by the credit markets in recent years and stated that it cannot be certain that it will be able to continue to renew the credit facility at levels that would meet its projected liquidity needs in future years.¹⁴

⁹ Id. at 178.

¹⁰ Id.

¹¹ Id. at 177.

¹² Id.

¹³ Id.; see Securities Exchange Act Release No. 80605 (May 5, 2017), 82 FR 21850 (May 10, 2017) (SR-DTC-2017-802; SR-NSCC-2017-802) (authorizing NSCC to enter into a 364-day credit facility with a consortium of banks).

¹⁴ Notice, 83 FR at 177.

II. Discussion and Commission Findings

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act 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.¹⁵

Section 805(a)(2) of the Clearing Supervision Act¹⁶ authorizes the Commission to prescribe regulations containing risk-management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act¹⁷ provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support the stability of the broader financial system.

¹⁵ See 12 U.S.C. 5461(b).

¹⁶ 12 U.S.C. 5464(a)(2).

¹⁷ 12 U.S.C. 5464(b).

Section 805(c) provides, in addition, that the Commission’s risk-management standards may address such areas as risk-management and default policies and procedures, among others areas.¹⁸

The Commission has adopted risk-management standards under Section 805(a)(2) of the Clearing Supervision Act¹⁹ and the Exchange Act (“Rule 17Ad-22”).²⁰ Rule 17Ad-22 requires each covered clearing agency, among other things, to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for operations and risk-management practices on an ongoing basis.²¹ As such, it is appropriate for the Commission to review advance notices for consistency with the objectives and principles for risk-management standards described in Section 805(b) of the Clearing Supervision Act²² and Rule 17Ad-22.²³

The Commission believes the proposal in the Advance Notice is consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,²⁴ and Rule 17Ad-22, in particular Rule 17Ad-22(e)(7)(i) and (ii),²⁵ as described in detail below.

¹⁸ 12 U.S.C. 5464(c).

¹⁹ 12 U.S.C. 5464(a)(2).

²⁰ 15 U.S.C. 78q-1.

²¹ 17 CFR 240.17Ad-22.

²² 12 U.S.C. 5464(b).

²³ 17 CFR 240.17Ad-22.

²⁴ 12 U.S.C. 5464(b).

A. Consistency with Section 805(b) of the Clearing Supervision Act

The Commission believes the Advance Notice proposal is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act.²⁶ Specifically, the Commission believes that the changes proposed in the Advance Notice are consistent with promoting robust risk management in the area of liquidity risk and promoting safety and soundness.

The Commission believes that the proposed expanded authorized amount under NSCC's Prefunded Liquidity Program would enhance NSCC's ability to access liquid resources that, in turn, would allow NSCC to continue to meet its settlement obligations to its clearing members in a timely fashion, thereby promoting robust liquidity risk management at NSCC. While the Commission notes that the proposed expansion permits NSCC to increase its reliance upon the Prefunded Liquidity Program, and hence the financial risks that accompany such reliance (e.g., maturity risk, rollover risk, and interest rate risk), NSCC has a variety of liquidity risk management tools at its disposal²⁷ and the Commission believes that the ability of NSCC to increase the Prefunded Liquidity Program, in lieu of or in combination with NSCC's other liquidity tools, promotes

²⁵ 17 CFR 240.17Ad-22(e)(7)(i) and (ii).

²⁶ 12 U.S.C. 5464(b).

²⁷ NSCC's other liquidity tools include: (1) NSCC's Clearing Fund (consisting of cash and U.S. treasury securities); (2) NSCC's committed 364-day credit facility with a consortium of banks ("Line of Credit"); and (3) Supplemental Liquidity Deposits, which are cash deposits designed to cover the heightened liquidity exposure arising around monthly option expiry periods by members whose activity would pose the largest liquidity exposure to NSCC during such periods.

NSCC's ability to manage liquidity risk through an overall diversified range of risk management tools.

The Commission also believes that expanding the authorized amount under NSCC's Prefunded Liquidity Program from \$5 billion to \$10 billion, as proposed, would promote safety and soundness by enabling NSCC to obtain additional liquid resources to cover a liquidity gap that could arise in the event of a member default. By covering such a gap, the proposal bolsters NSCC's ability to meet its settlement obligations in the event of a member default, thereby reducing the risk of loss contagion (i.e., the risk of losses arising at other NSCC members if NSCC is unable to deliver cash or securities on the defaulting member's behalf). Reducing the risk of loss contagion during a member default, in turn, enhances the ability of NSCC and its clearing members to continue to provide stability and safety to the financial markets that they serve. Therefore, by enhancing NSCC's ability to address losses and liquidity pressures that otherwise might cause financial distress to NSCC or its clearing members, the Advance Notice promotes safety and soundness.

Consistent with the conclusions discussed above, the Commission also believes that NSCC's proposal is consistent with reducing systemic risks and supporting the stability of the broader financial system. Reducing the risk of loss contagion would attenuate the transmission of financial shocks from defaulting members to non-defaulting members. Accordingly, the proposed changes would support the stability of the broader financial system. Thus, the Commission believes that the proposal contained in the Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act.

B. Consistency with Rules 17Ad-22(e)(7)(i) and (ii)

The Commission believes that the changes proposed in the Advance Notice are consistent with the requirements of Rules 17Ad-22(e)(7) under the Exchange Act. Rule 17Ad-22(e)(7) requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage liquidity risk that arises in or is borne by NSCC, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity, as specified in the rule.

In particular, Rule 17Ad-22(e)(7)(i) under the Exchange Act requires that each covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to “effectively measure, monitor, and manage the liquidity risk that arises in or is borne by [it], including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity by ... [m]aintaining sufficient liquid resources at the minimum in all relevant currencies to effect same-day ... 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 of obligation for the covered clearing agency in extreme but plausible conditions.”

As described above, the proposed expansion of the authorized amount under NSCC’s Prefunded Liquidity Program would increase the readily-available liquidity resources available to NSCC to continue to meet its liquidity obligations in a timely fashion in the event of a member default. The increased funds could thereby help

maintain sufficient liquidity resources to effect same-day settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios. Additionally, the increased size of the Prefunded Liquidity Program is designed to help ensure that NSCC has sufficient, readily-available qualifying liquid resources to meet the cash settlement obligations of its largest family of affiliated members. Therefore, the Commission finds that the proposal is consistent with Rule 17Ad-22(e)(7)(i).

Rule 17Ad-22(e)(7)(ii) under the Exchange Act requires each covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to “effectively measure, monitor, and manage the liquidity risk that arises in or is borne by [it], including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity by ... holding qualifying liquid resources sufficient” to satisfy payment obligations owed to clearing members. Rule 17Ad-22(a)(14) under the Exchange Act defines “qualifying liquid resources” to include, among other things, cash held either at the central bank of issue or at creditworthy commercial banks.

As described above, the proposed expansion of the authorized amount under NSCC’s Prefunded Liquidity Program would enable NSCC to hold additional cash proceeds from the issuance of the Notes in a cash deposit account at the Federal Reserve Bank of New York or a bank counterparty that has been approved pursuant to the Clearing Agency Investment Policy. Because the funds would be held at the Federal Reserve Bank of New York or a bank counterparty, they would qualify as qualifying liquid resource. Therefore, the Commission believes that the proposal is consistent with

Rule 17Ad-22(e)(7)(ii).

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,²⁸ that the Commission DOES NOT OBJECT to the Advance Notice (SR-NSCC-2017-807) and that NSCC is AUTHORIZED to implement the proposed change as of the date of this notice.

By the Commission.

Eduardo A. Aleman
Assistant Secretary

²⁸ 12 U.S.C. 5465(e)(1)(I).