

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81439; File No. SR-NSCC-2017-015)

August 18, 2017

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Amend and Clarify a Margin Charge Relating to CNS Fails Position

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 August 11, 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 would amend provisions in NSCC’s Rules and Procedures (“Rules”)<sup>3</sup> regarding an existing margin charge that is applied when a Member fails to settle a Short Position or a Long Position by the applicable settlement date (“CNS Fails Charge”) and would clarify NSCC’s current practices with respect to the assessment and collection of the CNS Fails Charge.

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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> Capitalized terms not defined herein are defined in the Rules, available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf).

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

The proposed rule change would (1) amend provisions in the Rules regarding the CNS Fails Charge, which NSCC currently imposes on each NSCC member ("Member"),<sup>4</sup> as part of each Member's Required Deposit to the NSCC Clearing Fund, which is due at the start of each business day, when all conditions to the application of the charge, as described below, are met, and (2) clarify NSCC's current practices with respect to the assessment and collection of the CNS Fails Charge.

(i) The Required Deposit and the CNS Fails Charge

NSCC uses a risk-based margin methodology to assess Required Deposits from all Members. The Required Deposit is comprised of a number of risk-based component charges, including the CNS Fails Charge, which are calculated and assessed daily. The

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<sup>4</sup> The CNS Fails Charge is currently imposed by NSCC pursuant to Procedure XV, Section I.(A)(1)(f). Id.

objective of the Required Deposit is to mitigate potential losses to NSCC associated with the liquidation of the Member's portfolio if NSCC ceases to act for a Member.<sup>5</sup>

When a Member does not satisfy its obligation to either pay the net settlement proceeds or deliver the securities due by the applicable Settlement Date, NSCC, as a central counterparty, is exposed to credit and market risks. Such exposures generally increase when the Member's risk of default increases, as reflected by the Member's credit rating derived from the Credit Risk Rating Matrix.<sup>6</sup> Therefore, in order to reduce the risk exposures to NSCC and to incentivize Members to satisfy their obligations relating to their outstanding trades on Settlement Date, NSCC currently calculates and collects the CNS Fails Charge from Members with Short Positions and/or Long Positions that did not settle on the Settlement Date ("CNS Fails Positions"). The amount of the CNS Fails Charge imposed on a Member varies based on the Member's credit rating derived from the Credit Risk Rating Matrix to reflect the potential increase in credit risk from Members with higher risk of default.

This proposed rule change would amend the Rules regarding the CNS Fails Charge. Specifically, where certain percentages are used to calculate the CNS Fails Charge for a Member, the proposed rule change would amend the Rules to include such specific percentages. In doing so, the proposed rule change would add transparency as

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<sup>5</sup> When NSCC restricts a Member's access to services generally, NSCC is said to have "ceased to act" for the Member. Rule 46 (Restrictions on Access to Services) sets out the circumstances under which NSCC may cease to act for a Member and the types of actions it may take. Supra note 3.

<sup>6</sup> See Exchange Act Release Nos. 80734 (May 19, 2017), 82 FR 24177 (May 25, 2017) (SR-NSCC-2017-002) and 80731 (May 19, 2017), 82 FR 24174 (May 25, 2017) (SR-NSCC-2017-801).

well as clarify NSCC's current practices with respect to the assessment and collection of this existing margin charge.

(ii) Calculation of the CNS Fails Charge

For a Member with CNS Fails Positions, the CNS Fails Charge is calculated by multiplying the Current Market Value for such Member's aggregate CNS Fails Positions by a percentage. For a Member that is rated 1 through 4 on the Credit Risk Rating Matrix, the CNS Fails Charge is 5 percent of the Member's aggregate CNS Fails Positions. For a Member that is rated 5 or 6 on the Credit Risk Rating Matrix, the CNS Fails Charge is 10 percent of the Member's aggregate CNS Fails Positions. For a Member that is rated 7 on the Credit Risk Rating Matrix, NSCC is currently charging such Member 20 percent of the Member's aggregate CNS Fails Positions – 10 percent of the charge is imposed pursuant to Procedure XV, Section I.(A)(1)(f) and the remaining 10 percent of the charge is imposed pursuant to Procedure XV, Section I.(B)(1). To improve the transparency of the CNS Fails Charge in the Rules and to clarify NSCC's current practices with respect to the assessment and collection of the CNS Fails Charge, NSCC is proposing to amend the Rules to provide that, for any Member that is rated 7 on the Credit Risk Rating Matrix, the CNS Fails Charge would be 20 percent of the Member's aggregate CNS Fails Positions. Members that are not rated by the Credit Risk Rating Matrix are not subject to the CNS Fails Charge; however, they can be placed on the Watch List as deemed necessary by NSCC to protect itself and its Members.<sup>7</sup>

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<sup>7</sup> Section 4(c) of Rule 2B (Ongoing Membership Requirements and Monitoring), supra note 3.

Members that are placed on the Watch List are required to make additional Clearing Fund deposits when deemed necessary by NSCC from time to time.<sup>8</sup>

(iii) Detailed Description of the Proposed Rule Changes

NSCC is proposing to amend Rule 1 to add a definition for CNS Fails Position. The proposed definition would provide that the term “CNS Fails Position” means either a Long Position or a Short Position that did not settle on the Settlement Date.

NSCC is also proposing to amend Procedure XV, Section I.(A)(1)(f) to provide that a Member’s contribution to the Clearing Fund shall include an amount that is calculated by multiplying the Current Market Value for such Member’s aggregate CNS Fails Positions by (i) 5 percent for Members rated 1 through 4 on the Credit Risk Rating Matrix, (ii) 10 percent for Members rated 5 or 6 on the Credit Risk Rating Matrix, or (iii) 20 percent for Members rated 7 on the Credit Risk Rating Matrix.

2. Statutory Basis

NSCC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. Specifically, NSCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>9</sup> and Rules 17Ad-22(e)(4), (e)(6)(i), and (e)(23)(i),<sup>10</sup> each as promulgated under the Act, for the reasons described below.

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<sup>8</sup> Section I.(B)(1) of Procedure XV (Clearing Fund Formula and Other Matters), supra note 3.

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>10</sup> 17 CFR 240.17Ad-22(e)(4), (e)(6)(i), and (e)(23)(i).

Section 17A(b)(3)(F) of the Act requires that the Rules be designed to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible.<sup>11</sup> The proposed rule changes to clarify NSCC's current practices regarding the assessment and collection of the CNS Fails Charge would provide transparency in the Rules with respect to the charge. By doing so, these proposed rule changes would ensure that the Rules remain transparent, accurate and clear, which would enable all stakeholders to readily understand their respective rights and obligations regarding NSCC's clearance and settlement of securities transactions. Therefore, NSCC believes that these 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. In addition, the proposed rule changes to amend provisions in the Rules regarding the CNS Fails Charge would protect NSCC from potential losses in the event that a Member defaults. Specifically, the CNS Fails Charge is calculated and collected by NSCC from Members with CNS Fails Positions in order to mitigate the credit exposures to NSCC resulting from those positions. Mitigating NSCC's risk exposures from CNS Fails Positions would promote the safeguarding of securities and funds that are within NSCC's custody or control, consistent with the requirements of Section 17A(b)(3)(F) of the Act.

Rule 17Ad-22(e)(4) under the Act requires NSCC to 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

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<sup>11</sup> 15 U.S.C. 78q-1(b)(3)(F).

exposures arising from its payment, clearing and settlement processes.<sup>12</sup> The CNS Fails Charge is being imposed on Members with CNS Fails Positions in order to reduce credit exposures to NSCC resulting from those positions. As proposed, it is designed to obtain from such Member financial resources commensurate with the credit exposures posed to NSCC by such Member's CNS Fails Positions. Therefore, NSCC believes that management of its credit exposures to its Members through the CNS Fails Charge is consistent with Rule 17Ad-22(e)(4) under the Act.

Rule 17Ad-22(e)(6)(i) under the Act requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its Members by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio and market.<sup>13</sup> When applicable, the CNS Fails Charge is a component of a Member's Required Deposit and is designed to cover NSCC's credit exposures to Members with CNS Fails Positions. As described above, the CNS Fails Charge is determined based on the amount of CNS Fails Positions in a Member's portfolio and is commensurate with the Member's default risk. Therefore, NSCC believes the coverage of its credit exposures to its Members through the CNS Fails Charge is consistent with Rule 17Ad-22(e)(6)(i) under the Act.

Rule 17Ad-22(e)(23)(i) under the Act requires NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly

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<sup>12</sup> 17 CFR 240.17Ad-22(e)(4).

<sup>13</sup> 17 CFR 240.17Ad-22(e)(6)(i).

disclose all relevant rules and material procedures.<sup>14</sup> The proposed rule change to clarify NSCC's current practices with respect to the assessment and collection of the CNS Fails Charge would also improve the transparency of the Rules regarding the CNS Fails Charge. As such, NSCC believes that the proposed rule change would promote disclosure of relevant rules and material procedures relating to the CNS Fails Charge and therefore is consistent with Rule 17Ad-22(e)(23)(i) under the Act.

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

NSCC does not believe that the proposed rule change to amend the provisions in the Rules relating to the CNS Fails Charge would impose any burden on competition that is not necessary or appropriate in furtherance of the Act.<sup>15</sup> NSCC believes that the CNS Fails Charge is necessary for NSCC to limit its exposures to potential losses from defaults by Members with CNS Fails Positions. Additionally, NSCC believes that the CNS Fails Charge is appropriate because it is imposed on Members on an individualized basis and is reasonably calculated based on the Members' default risks as well as the risks posed to NSCC by the Members' CNS Fails Positions. Therefore, NSCC believes any burden on competition imposed by the CNS Fails Charge would be necessary and appropriate in furtherance of the Act in order to limit NSCC's exposures to the risks being mitigated by such charge.

NSCC does not believe that the proposed rule change to clarify NSCC's current practices with respect to the assessment and collection of the CNS Fails Charge would

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<sup>14</sup> 17 CFR 240.17Ad-22(e)(23)(i).

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



impact competition.<sup>16</sup> The proposed rule change would increase the transparency of the Rules regarding this existing charge and codify NSCC's current practices with respect to the assessment and imposition of the charge. As such, NSCC believes that this 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

Written comments relating to this proposed rule change have not been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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:

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<sup>16</sup> Id.

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-2017-015 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NSCC-2017-015. 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 20549-1090 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-2017-015 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>17</sup>

Robert W. Errett  
Deputy Secretary

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