

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82910; File No. SR-NSCC-2017-018)

March 20, 2018

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Loss Allocation Rules and Make Other Changes

I. Introduction

On December 18, 2017, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² proposed rule change SR-NSCC-2017-018 to amend the loss allocation rules and make other changes (“Proposed Rule Change”).³ The Proposed Rule Change was published for comment in the Federal Register on January 8, 2018.⁴ The Commission did not receive any comments on the Proposed Rule Change. On February 8, 2018, pursuant to Section 19(b)(2)(A)(ii)(I) of the Act,⁵ the Commission designated a longer period within which to

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On December 18, 2017, NSCC filed this proposal as an advance notice (SR-NSCC-2017-806) with the Commission pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”) and Rule 19b-4(n)(1)(i) of the Act (“Advance Notice”). On January 24, 2018, the Commission extended the review period of the Advance Notice for an additional 60 days pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act. See 12 U.S.C. 5465(e)(1); 17 CFR 240.19b-4(n)(1)(i); 12 U.S.C. 5465(e)(1)(H); and Securities Exchange Act Release No. 82584 (January 24, 2018), 83 FR 4377 (January 30, 2018) (SR-NSCC-2017-806).

⁴ Securities Exchange Act Release No. 82428 (January 2, 2018), 83 FR 897 (January 8, 2018) (SR-NSCC-2017-018) (“Notice”).

⁵ 15 U.S.C. 78s(b)(2)(A)(ii)(I).

approve, disapprove, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change.⁶ This order institutes proceedings, pursuant to Section 19(b)(2)(B) of the Act,⁷ to determine whether to approve or disapprove the Proposed Rule Change.

II. Summary of the Proposed Rule Change⁸

As described in the Notice,⁹ NSCC proposes to revise its Rules and Procedures to primarily change (i) the loss allocation process,¹⁰ (ii) the loss allocation governance for Declared Non-Default Loss Events,¹¹ and (iii) the retention time for the Actual Deposit of former members.¹²

⁶ Securities Exchange Act Release No. 82670 (February 8, 2018), 83 FR 6626 (February 14, 2018) (SR-DTC-2017-022; SR-FICC-2017-022; SR-NSCC-2017-018).

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ The Commission notes that the Summary of the Proposed Rule Change section does not describe the Proposed Rule Change in its entirety. Other changes include, but are not limited to, the clarification of defined terms, various aspects of the Clearing Fund application, and detailed procedures of the loss allocation. The complete Proposed Rule Change can be found in the Notice. See Notice, supra note 4. In addition, the text of the Proposed Rule Change is available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>.

⁹ The description of the Proposed Rule Change herein is based on the statements prepared by NSCC in the Notice. See Notice, supra note 4. Each capitalized term not otherwise defined herein has its respective meaning either (i) as set forth in the Rules and Procedures of NSCC, available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>, or (ii) as set forth in the Notice.

¹⁰ See Notice, supra note 4, at 898-901.

¹¹ See id. at 901.

¹² See id. at 901-02.

A. Loss Allocation Process

NSCC states that it would retain the current core loss allocation process.¹³

However, NSCC proposes to revise certain elements and introduce certain new loss allocation concepts, by making five key changes to its loss allocation process.

First, NSCC proposes to replace the calculation of its corporate contribution from no less than 25 percent of its retained earnings or such higher amount as the Board of Directors shall determine to a defined Corporate Contribution.¹⁴ The proposed Corporate Contribution would be defined as an amount equal to 50 percent of NSCC's General Business Risk Capital Requirement.¹⁵ NSCC's General Business Risk Capital Requirement is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.¹⁶ In addition, NSCC proposes to mandatorily apply Corporate Contribution (i) prior to a loss allocation among Members, and (ii) to losses arising from both Defaulting Member Events and Declared Non-Default Loss Events.¹⁷

Second, NSCC proposes to introduce an Event Period to address the allocation of losses and liabilities that may arise from or relate to multiple Defaulting Member Events, Declared Non-Default Loss Events, or both that arise in quick succession.¹⁸ The proposal

¹³ Id. at 898.

¹⁴ Id.

¹⁵ Id.

¹⁶ Id.; 17 CFR 240.17Ad-22(e)(15).

¹⁷ Notice, supra note 4, at 898.

¹⁸ Id. at 899.

would group together Defaulting Member Events and Declared Non-Default Loss Events occurring in a period of 10 business days for purposes of allocating losses to Members in one or more rounds, subject to the limitations of loss allocation in the Proposed Rule Change.¹⁹

Third, NSCC proposes to introduce a loss allocation “round,” which would mean “a series of loss allocations relating to an Event Period, the aggregate amount of which is limited by the sum of the Loss Allocation Caps of affected Members.”²⁰ NSCC would notify Members subject to a loss allocation of the amounts being allocated to them.²¹ Each Member would have five business days from the issuance of such first Loss Allocation Notice for the round to notify NSCC of its election to withdraw from membership with NSCC, and thereby benefit from its Loss Allocation Cap.²²

Fourth, NSCC proposes to implement a “look-back” period to calculate a Member’s loss allocation pro rata share and its Loss Allocation Cap.²³ NSCC proposes to calculate each Member’s pro rata share of losses and liabilities in any round to be equal to (i) the average of a Member’s Required Fund Deposit for 70 business days prior to the first day of the applicable Event Period (“Average RFD”) divided by (ii) the sum of Average RFD amounts for all Members that are subject to a loss allocation in such

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Id.

²³ Id. at 900.

round.²⁴ Additionally, NSCC proposes that each Member's Loss Allocation Cap would be equal to the greater of (i) its Required Fund Deposit on the first day of the applicable Event Period or (ii) its Average RFD.²⁵

Fifth, NSCC proposes to revise the cap on a loss allocation and the withdrawal process followed by the loss allocation. As proposed, if a Member provides notice of its withdrawal from membership, the Member's maximum amount of losses with respect to any loss allocation round would be its Loss Allocation Cap.²⁶ NSCC further proposes that Members would have two business days after NSCC issues a first round Loss Allocation Notice to pay the amount specified in such notice.²⁷ Members would have five business days from the issuance of the first Loss Allocation Notice in any round to decide whether to terminate its membership, provided that the Member complies with the requirements of the proposed withdrawal process.²⁸

B. Loss Allocation Governance for Declared Non-Default Loss Events

NSCC proposes to enhance the governance around Declared Non-Default Loss Events that would trigger a loss allocation by specifying that the Board of Directors would have to determine that there is a non-default loss that (i) may present a significant and substantial loss or liability, so as to materially impair the ability of NSCC to provide clearance and settlement services in an orderly manner, and (ii) will potentially generate

²⁴ Id.

²⁵ Id.

²⁶ Id.

²⁷ Id. at 900 and 905.

²⁸ Id. at 900.

losses to be mutualized among Members in order to ensure that NSCC may continue to offer clearance and settlement services in an orderly manner.²⁹ NSCC would then be required to promptly notify Members of this determination.³⁰

C. Retention Time for the Actual Deposit of a Former Participant

NSCC proposes that if a Member gives notice to NSCC of its election to withdraw from membership, NSCC would return the Member's Actual Deposit in the form of cash or securities within 30 calendar days and Eligible Letters of Credit within 90 calendar days.³¹ The return would be made after all of the Member's transactions have settled, and all matured and contingent obligations to NSCC for which the Member was responsible while a Member have been satisfied, except NSCC may retain for up to two years the Actual Deposits from Members who have sponsored Accounts at DTC.³² This proposed rule would reduce the period in which NSCC may retain a Member's Actual Deposit pursuant to the current rule.³³

III. Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act³⁴ to determine whether the Proposed Rule Change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and

²⁹ Id. at 901.

³⁰ Id.

³¹ Id. at 901-902.

³² Id.

³³ Id. at 907.

³⁴ 15 U.S.C. 78s(b)(2)(B).

policy issues raised by the Proposed Rule Change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the Proposed Rule Change, and provide the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Change.

Pursuant to Section 19(b)(2)(B) of the Act,³⁵ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the Proposed Rule Change's consistency with Section 17A of the Act,³⁶ and the rules thereunder, including the following provisions:

- Section 17A(b)(3)(F) of the Act,³⁷ which requires, among other things, that the rules of a clearing agency, such as NSCC, must be designed to promote the prompt and accurate clearance and settlement of securities transactions, 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, and to protect investors and the public interest;
- Rule 17Ad-22(e)(13) under the Act,³⁸ which requires, in general, a covered clearing agency, such as NSCC, to establish, implement, maintain and enforce

³⁵ Id.

³⁶ 15 U.S.C. 78q-1.

³⁷ 15 U.S.C. 78q-1(b)(3)(F).

³⁸ 17 CFR 240.17Ad-22(e)(13).

written policies and procedures reasonably designed to ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations.

- Rule 17Ad-22(e)(23)(i) under the Act,³⁹ which requires a covered clearing agency, such as NSCC, to establish, implement, maintain and enforce written policies and procedures reasonably designed to publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the Proposed Rule Change. In particular, the Commission invites the written views of interested persons concerning whether the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act,⁴⁰ Rule 17Ad-22(e)(13) under the Act,⁴¹ Rule 17Ad-22(e)(23)(i) under the Act,⁴² or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to

³⁹ 17 CFR 240.17Ad-22(e)(23)(i).

⁴⁰ 15 U.S.C. 78q-1(b)(3)(F).

⁴¹ 17 CFR 240.17Ad-22(e)(13).

⁴² 17 CFR 240.17Ad-22(e)(23)(i).

Rule 19b-4(g) under the Act,⁴³ any request for an opportunity to make an oral presentation.⁴⁴

Interested persons are invited to submit written data, views, and arguments regarding whether the Proposed Rule Change should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

The Commission asks that commenters address the sufficiency of NSCC's statements in support of the Proposed Rule Change, which are set forth in the Notice,⁴⁵ in addition to any other comments they may wish to submit about the Proposed Rule Change.

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-2017-018 on the subject line.

⁴³ 17 CFR 240.19b-4(g).

⁴⁴ Section 19(b)(2) of the Act grants to the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

⁴⁵ See Notice, supra note 4.

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-2017-018. 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 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 The Depository Trust & Clearing Corporation'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-2017-018 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁶

Eduardo A. Aleman
Assistant Secretary

⁴⁶ 17 CFR 200.30-3(a)(57).