

in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission believes that the proposal to eliminate the daily liability caps in Rules 13.2(b)(1) and (2) could result in more ETP Holders receiving fuller compensations on their claims.¹¹ The proposal could also reduce the risk that losses suffered by an ETP Holder would be treated differently depending on whether other ETP Holders suffered losses on the same day.¹² In addition, the Commission notes that, under the proposal, the maximum amount of compensation would continue to be proportionally allocated if claims arising during a single calendar month exceed the monthly liability cap.¹³

With respect to the Exchange's proposal to retroactively apply the elimination of the daily liability caps, the Commission notes that approval of the proposal would make additional funds available to compensate ETP Holders affected by the system issue on March 20, 2017. Also, as the Exchange notes, the proposal would promote equal treatment between ETP Holders who suffered a loss on March 20, 2017 and ETP Holders who suffered a loss on a different day.¹⁴ Specifically, according to the Exchange, the proposal would enable it to fully compensate ETP Holders for claims arising from the system issue on March 20, 2017.¹⁵ Moreover, according to the Exchange, prior to March 20, 2017, it has never received a claim that exceeded the liability limits, and thus it was never prevented from fully compensating an ETP Holder.¹⁶

The Commission further believes that the other proposed changes are consistent with the Act. Specifically, the Commission believes that the addition of the text "successors, representatives or customers thereof" to Rule 13.2(a) would clarify the scope of the limitation of liability in that provision.¹⁷ As the

Exchange notes, Rule 13.2 currently does not authorize the compensation of successors, representatives, or customers of ETP Holders because the rule does not currently reference them.¹⁸ The Commission also believes that the replacement of the words "acknowledged receipt of" with the word "received" in Rule 13.2(b) would provide transparency regarding the scope of the rule.¹⁹ Finally, the Commission believes that the addition of paragraph (d) to Rule 13.2 would clarify that all claims for compensation must be submitted in writing, and would provide ETP Holders additional time to evaluate losses that may have occurred on the prior trading day, particularly if an issue occurred later in the day.²⁰

Based on the foregoing, the Commission believes that the proposed rule change is consistent with the Act.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²¹ that the proposed rule change (SR-NYSEArca-2017-46), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Eduardo A. Aleman,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-81192; File Nos. SR-DTC-2017-005; SR-FICC-2017-009; SR-NSCC-2017-006]

Self-Regulatory Organizations; The Depository Trust Company; Fixed Income Clearing Corporation; National Securities Clearing Corporation; Notice of Filing Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Changes to Adopt the Clearing Agency Stress Testing Framework (Market Risk)

July 24, 2017.

I. Introduction

On April 7, 2017, The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC"), and National Securities Clearing Corporation ("NSCC," each a "Clearing Agency," and collectively, the "Clearing Agencies"), filed with the Securities and Exchange Commission ("Commission") proposed rule changes SR-DTC-2017-005, SR-FICC-2017-009, and SR-NSCC-2017-006, respectively, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² The proposed rule changes were published for comment in the **Federal Register** on April 25, 2017.³ The Commission did not receive any comment letters on the proposed rule changes. On June 7, 2017, the Commission designated a longer period for Commission Action on the proposed rule changes.⁴ On July 19, 2017, the Clearing Agencies each filed Amendment No. 1 to their respective proposed rule changes (hereinafter, "Proposed Rule Change"). Amendments No. 1 would clarify how the Clearing Agencies would use scenarios to estimate the profits and losses ("P&L") of a member closeout. This order institutes proceedings under Section 19(b)(2)(B) of the Act⁵ to determine whether to approve or disapprove the Proposed Rule Changes.

II. Description of the Proposed Rule Changes

The Proposed Rule Changes would adopt the Clearing Agency Stress

¹¹ The Commission notes that the rules of certain other national securities exchanges also only include monthly liability caps, and no daily liability caps. *See, e.g.*, Nasdaq Stock Market LLC ("Nasdaq") Rule 4626.

¹² *See* Notice, *supra* note 3, at 26968.

¹³ *See* proposed changes to Rule 13.2(c). As described above, the Exchange also proposes to make conforming changes in Rule 13.2(c) to eliminate the reference to allocation among claims arising "on a single trading day." *See supra* notes 5-6.

¹⁴ *See* Notice, *supra* note 3, at 26968.

¹⁵ *See id.* at 26969.

¹⁶ *See id.*

¹⁷ The Commission notes that this change is consistent with the rules of certain other national

securities exchanges. *See, e.g.*, Bats BZX Exchange, Inc. Rule 11.16(a).

¹⁸ *See* Notice, *supra* note 3, at 26967.

¹⁹ The Commission notes that this change is consistent with the rules of certain other national securities exchanges. *See, e.g.*, New York Stock Exchange LLC Rule 18(b).

²⁰ The Commission notes that this change is consistent with the rules of certain other national securities exchanges. *See, e.g.*, Nasdaq Rule 4626(b)(6).

²¹ 15 U.S.C. 78s(b)(2).

²² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ *See* Securities Exchange Act Release No. 80485 (April 19, 2017), 82 FR 19131 (April 25, 2017) (SR-DTC-2017-005; SR-FICC-2017-009; SR-NSCC-2017-006) ("Notice").

⁴ *See* Securities Exchange Act Release No. 80876 (June 7, 2017), 82 FR 27091 (June 13, 2017) (SR-DTC-2017-005; SR-FICC-2017-009; SR-NSCC-2017-006).

⁵ 15 U.S.C. 78s(b)(2)(B).

Testing Framework (Market Risk) (“Framework”), which would set the Clearing Agencies’ procedures for identifying, measuring, monitoring, and managing their credit exposures to members. Although the Framework would be a rule of each Clearing Agency, the Proposed Rule Changes do not require any changes to the Rules, By-Laws and Organizational Certificate of DTC (“DTC Rules”), the Rulebook of GSD (“GSD Rules”), the Clearing Rules of MBSD (“MBSD Rules”), or the Rules & Procedures of NSCC (“NSCC Rules”), as the Framework would be a standalone document.⁶

In general, the Framework would describe the stress-testing practices adopted by the Clearing Agencies. The Clearing Agencies designed their stress testing to ensure the sufficiency of each Clearing Agency’s total prefunded-financial resources.⁷ The Framework would describe (i) the sources of each Clearing Agency’s total prefunded-financial resources; (ii) the Clearing Agencies’ stress-testing methodologies; (iii) the Clearing Agencies’ stress-testing governance and execution processes; and (iv) the Clearing Agencies’ model-validation practices.⁸

A. Sources of Prefunded-Financial Resources

The Framework would outline the prefunded-financial resources and related stress-testing methodologies of the Clearing Agencies. The Framework would begin by describing the applicable regulatory requirements, with respect to credit risk management, of each Clearing Agency and how the Clearing Agencies address those requirements.⁹ The Framework would address these requirements by describing how the Clearing Agencies maintain what each deems to be sufficient prefunded-financial resources to cover fully their credit exposures to each of their respective members with a high degree of confidence.¹⁰ The

Framework would also describe how the Clearing Agencies maintain additional prefunded-financial resources that, at a minimum, would enable them to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the affiliated family of members (“Affiliated Family”) that would potentially cause the largest aggregate credit exposure to the Clearing Agency in extreme but plausible market conditions (“Cover One Requirement”).¹¹ Because the credit risks and prefunded-financial resources of each Clearing Agency differ, the Framework would describe the prefunded-financial resources and related stress-testing methodologies of the Clearing Agencies separately.¹²

With respect to FICC and NSCC, the Framework would describe that such prefunded-financial resources are their respective clearing funds, containing deposits from their members of both cash and eligible securities.¹³ The Framework would describe that such deposits are calculated for each individual member pursuant to the GSD Rules, MBSD Rules, or NSCC Rules, as applicable, and each member’s deposits would be referred to in the Framework as its “Required Deposit.”¹⁴

With respect to DTC, the Framework would describe that its prefunded financial resources are cash deposits to its “Participants Fund.”¹⁵ The Framework would also describe that DTC may use its risk management control, the “Collateral Monitor,” to monitor and assure that the settlement obligations of each member are fully collateralized.¹⁶

B. Stress-Testing Methodology

The Framework would describe the stress-testing methodologies that the Clearing Agencies use to test the sufficiency of their total prefunded-financial resources against Cover One Requirements. The Framework would state that the stress testing would be designed to identify potential weaknesses in the methodologies used to calculate members’ Required Deposits and to determine collateral haircuts.¹⁷

The Framework would describe in detail the three key components of the development of stress-testing methodologies:

1. *Risk Identification.* The Clearing Agencies would identify the principal credit-risk drivers that are representative and specific to each Clearing Agency’s clearing and/or collateral portfolio under stressed market conditions.¹⁸

2. *Scenario Development.* The Clearing Agencies would construct comprehensive and relevant sets of extreme but plausible historical and hypothetical stress scenarios for the identified risk drivers.¹⁹ The Framework would describe how the Clearing Agencies would develop and select both historical and hypothetical scenarios that reflect stressed market conditions.²⁰ Historical scenarios would be based on stressed market conditions that occurred on specific dates in the past.²¹ Contrastingly, hypothetical stress scenarios would be theoretical market conditions.²²

3. *Risk Measurement and Aggregation.* The Clearing Agencies would calculate the risk metrics of each Clearing Agency’s actual portfolio to estimate the P&L of a close out over a suitable stressed period of risk, deficiencies, and coverage ratios.²³ The Framework would describe how the Clearing Agencies would develop P&L estimation methodologies, and how they would calculate risk metrics that are applicable to such methodologies under the chosen stress-testing scenarios.²⁴ The Clearing Agencies could use a number of P&L methodologies for stress-testing purposes, including risk sensitivity, index mapping, and actual or approximate historical shock approaches.²⁵

The Framework would further describe the stress-testing methodology by stating that the Clearing Agencies would calculate member stress deficiencies,²⁶ Affiliated Family

⁶ Available at <http://www.dtcc.com/en/legal/rules-and-procedures>. FICC is comprised of two divisions: The Government Securities Division (“GSD”) and the Mortgage-Backed Securities Division (“MBSD”). Each division serves as a central counterparty, becoming the buyer and seller to each of their respective members’ securities transactions and guarantying settlement of those transactions, even if a member defaults. GSD provides, among other things, clearance and settlement for trades in U.S. Government debt issues. MBSD provides, among other things, clearance and settlement for trades in mortgage-backed securities. GSD and MBSD maintain separate sets of rules, margin models, and clearing funds. Notice at 19131.

⁷ Notice, 82 at 19132.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ See 17 CFR 240.17Ad-22(e)(4)(iii).

¹² Notice, 82 at 19132.

¹³ *Id.* Any eligible security is subject to a haircut. GSD Rule 4 (Clearing Fund and Loss Allocation), MBSD Rule 4 (Clearing Fund and Loss Allocation), and NSCC Rule 4 (Clearing Fund), *supra* note 4.

¹⁴ *Id.*

¹⁵ *Id.* DTC Rule 4 (Participants Fund and Participants Investment). *Supra* note 4.

¹⁶ Notice, 82 at 19132. “Collateral Monitor” is defined in DTC Rule 1, Section 1 (Definitions), and its calculation is further provided for in the DTC Settlement Service Guide of the DTC Rules. *Supra* note 4.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ Notice, 82 at 19133.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ The Framework would define “member stress deficiency” for each scenario as, with respect to FICC and NSCC, the stress loss exceeding the applicable member’s Required Deposits. The Framework would define “member stress deficiency” for each scenario at DTC as the shortfall of a member’s Collateral Monitor. *Id.*

deficiencies,²⁷ and Cover One Ratios daily.²⁸

The Framework would further state that FICC and NSCC would consider non-Cover-One Ratio coverages, such as comparing member stress deficiencies against such member's known financial resources (e.g., equity capital base), to keep abreast of potential financial vulnerabilities facing such member.²⁹ Additionally, the Framework would state that DTC would also test the adequacy of its collateral haircuts by measuring "Haircut Deficiency" as the amount of stress losses exceeding the haircut applied to collateral securities.³⁰

Moreover, the Framework would state that the Clearing Agencies measure both specific and generic wrong way risk for each Clearing Agency's members and Affiliated Families.³¹ To measure specific wrong way risk, for each given Member and its Affiliated Family and each given scenario, the securities issued by the Affiliated Family would be subject to shocks that reflect the default of a Member's Affiliated Family. To measure general wrong way risk, the Framework would apply historical scenarios during the 2008 financial crisis to securities issued by the Affiliated Family as well as securities issued by the non-Affiliated Family.

The Framework would also describe the reverse stress-testing analyses that are performed by FICC and NSCC on at least a semi-annual basis.³² These analyses provide FICC and NSCC, as central counterparties, another means for testing the sufficiency of the Clearing Agencies' respective prefunded financial resources.³³ In conducting reverse stress-testing, FICC and NSCC would utilize scenarios of multiple defaults, extreme market shocks, or shocks for other risk factors, which would cause those Clearing Agencies, as applicable, to exhaust all of their respective prefunded financial resources.³⁴

²⁷ The Framework would define "Affiliated Family deficiency" as the aggregate of all member stress deficiencies within the applicable Affiliated Family. *Id.*

²⁸ The Framework would define "Cover One Ratio" as the ratio of Affiliated Family deficiency over the total value of the relevant Clearing Agency's clearing fund (or, for DTC, the Participants Fund), excluding the value of the applicable Affiliated Family's Required Deposits. *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

C. Stress-Testing Governance and Execution Process

The Framework would describe the Clearing Agencies' stress-testing governance and execution processes. Stress testing would be conducted daily for each of the Clearing Agencies, and stress-testing risk metrics also would be generated each day.³⁵ The Cover One Ratios and member stress deficiencies would be monitored against pre-established thresholds.³⁶ Breaches of these pre-established thresholds would initially be subject to more detailed studies to identify any potential impact to the applicable Clearing Agencies' Cover One Requirement.³⁷ The Framework would describe that, to the extent such studies indicate a potential impact to a Clearing Agency's Cover One Requirement, the threshold breach would be escalated internally and analyzed to determine if (i) there is a need to adjust the stress-testing methodology, or (ii) the threshold breach indicates an issue with a particular member.³⁸ Based on these analyses, the Clearing Agencies would determine the appropriate course of action.³⁹

D. Model Validation

The Framework would describe the process the Clearing Agencies would use to validate their stress-testing procedures. The Clearing Agencies would conduct comprehensive analyses of daily stress-testing results, the existing scenario sets (including any changes to such scenarios for the period since the last review), and the performance of the stress-testing methodologies along with key underlying parameters and assumptions.⁴⁰ These analyses would be performed at least monthly and would be conducted to assess whether each Clearing Agency's stress-testing components appropriately determine the sufficiency of the Clearing Agency's prefunded-financial resources.⁴¹ The Framework would state that such analyses may occur more frequently than monthly if, for example, (i) the products cleared or markets served by a Clearing Agency display high volatility or become less liquid, or (ii) the size or concentration of positions held by the

³⁵ *Id.*

³⁶ According to the Clearing Agencies, risk-threshold levels are chosen to assist each Clearing Agency in achieving a high degree of confidence that its Cover One Requirement is met daily. *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

applicable Clearing Agency's members increases significantly.⁴²

The Framework would state that the results of these analyses are reviewed monthly by the DTCC Enterprise Stress Testing Council.⁴³ The Framework would also state that daily stress-testing results are summarized and reported monthly to the DTCC Risk Management Committee.⁴⁴ Finally, the Framework would state that stress-testing methodologies and related models are subject to independent model validation on at least an annual basis.⁴⁵

E. Notice of Filing of Amendment No. 1

As originally proposed, the Framework stated that it would use scenarios to measure specific and generic wrong way risk. The Clearing Agencies filed Amendment No. 1 to clarify that to capture specific wrong way risk, for each given Member and its Affiliated Family and each given scenario, the securities issued by the Affiliated Family would be subject to shocks that reflect the default of a Member's Affiliated Family. To capture general wrong way risk, the Framework would apply historical scenarios during the 2008 financial crisis to securities issued by the Affiliated Family as well as securities issued by the non-Affiliated Family.

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

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁴⁶ to determine whether the Proposed Rule Changes should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the Proposed Rule Changes. As noted above, 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 Changes, and provide arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Changes.

Pursuant to Section 19(b)(2)(B) of the Act,⁴⁷ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ 15 U.S.C. 78s(b)(2)(B).

⁴⁷ *Id.*

instituting proceedings to allow for additional analysis of the Proposed Rule Changes' consistency with the Act and the rules thereunder. Specifically, the Commission believes that the Proposed Rule Changes raise questions as to whether they are consistent with (i) Section 17A(b)(3)(F) of the Act,⁴⁸ which requires, in part, that clearing agency rules be designed to assure the safeguarding of securities in the custody or control of the clearing agency and, in general, protect investors and the public interest, and (ii) Rule 17Ad-22(e)(4) under the Act, which requires, in general, that each covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to, among other things, effectively identify, measure, monitor, and manage their credit exposures to participants and those arising from its payment, clearing, and settlement processes.⁴⁹

As discussed above, pursuant to the Proposed Rule Changes, Clearing Agencies would adopt the Framework, which would procedures for identifying, measuring, monitoring, and managing their credit exposures to members. The Commission solicits comment on whether the Proposed Rule Changes are consistent with Section 17A(b)(3)(F) of the Act⁵⁰ and Rule 17Ad-22(e)(4) under the Act.⁵¹

IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to issues raised by the Proposed Rule Changes. In particular, the Commission invites the written views of interested persons concerning whether the Proposed Rule Changes are consistent with Sections 17A(b)(3)(F) of the Act and Rules 17Ad-22(e)(4) under the Act, cited above, or any other provision of the Act, or the rules and regulations thereunder. Interested persons are invited to submit written data, views, and arguments on or before August 14, 2017. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal on or before August 18, 2017. 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 email to rule-comments@sec.gov. Please include File Number SR-FICC-2017-002 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 Numbers SR-DTC-2017-005, SR-FICC-2017-009, or SR-NSCC-2017-006. This file number should be included on the subject line if email 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Proposed Rule Changes 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 Web site 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 such filings also will be available for inspection and copying at the principal office of the Clearing Agencies and on DTCC's Web site (<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 Numbers SR-DTC-2017-005, SR-FICC-2017-009, or SR-NSCC-2017-006 and should be submitted on or before August 14, 2017. If comments are received, any rebuttal comments should be submitted on or before August 18, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵²

Eduardo A. Aleman,
Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-81196; File No. SR-FINRA-2017-025]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to the Definition of Non-Public Arbitrator

July 24, 2017.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 10, 2017, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 12100 of the Code of Arbitration Procedure for Customer Disputes ("Customer Code") and FINRA Rule 13100 of the Code of Arbitration Procedure for Industry Disputes ("Industry Code" and together, "Codes"), to define a non-public arbitrator to mean a person who is otherwise qualified to serve as an arbitrator, and is disqualified from service as a public arbitrator under the Codes.

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA 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. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

⁴⁸ 15 U.S.C. 78q-1(b)(3)(F).

⁴⁹ 17 CFR 240.17Ad-22(e)(4).

⁵⁰ 15 U.S.C. 78q-1(b)(3)(F).

⁵¹ 17 CFR 240.17Ad-22(e)(4).

⁵² 17 CFR 200.30-3(a)(57).