exemptive relief granted by the Commission. The Exchange further notes that it does not currently list any series of Managed Portfolio Shares, so there is no immediate impact of implementing such functionality. For these reasons, the Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission waives the 30-day operative delay and designates the proposed rule change operative upon filing.[14]

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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:

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–CboeBZX–2020–028 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–CboeBZX–2020–028. 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 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 the Exchange. 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–CboeBZX–2020–028 and should be submitted on or before April 21, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[15]

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2020–06613 Filed 3–30–20; 8:45 am]

BILLING CODE 8011–01–P

[14] For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[15] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–88474; File No. SR–NSCC–2020–003]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change To Enhance National Securities Clearing Corporation's Haircut-Based Volatility Charge Applicable to Illiquid Securities and UITs and Make Certain Other Changes to Procedure XV

March 25, 2020.

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 March 16, 2020, 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.[3] 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 consists of modifications to NSCC's Rules & Procedures (''Rules'')[4] in order to enhance the calculation of certain components of the Clearing Fund formula. First, the proposed rule change would clarify and enhance the methodology for identifying securities as illiquid for purposes of determining the applicable calculation of the volatility component of the Clearing Fund formula, and would revise the definition of ''Illiquid Security'' in the Rules to reflect these changes.[5] Second, the proposed rule change would enhance the calculation of the haircut-based volatility component of the Clearing Fund formula that is applied to positions in (1) Illiquid Securities (which include securities that are priced at less than a penny (''sub-penny securities'') and initial public offerings (''IPOs'')), and (2) unit investment trusts (''UITs''). Third, the proposed rule change would eliminate the existing Illiquid Charge, as the risk it was designed to address would be addressed by the other enhancements being proposed. Finally, NSCC would make certain changes to Section I.(A) of Procedure XV (Clearing Fund Formula and Other Matters) of the Rules (''Procedure XV'')[6] for greater transparency. Each of these proposed changes are described in greater detail below.

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.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] On March 16, 2020, NSCC filed this proposed rule change as an advance notice (SR–NSCC–2020–802) with the Commission 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, 12 U.S.C. 5465(e)(1), and Rule 19b–4(n)(1)(i) under the Act, 17 CFR 240.19b–4(n)(1)(i). A copy of the advance notice is *available at http://www.dtcc.com/legal/sec-rule-filings.aspx.*

[4] Capitalized terms not defined herein are defined in the Rules, *available at http://dtcc.com/~/media/Files/Downloads/legal/rules/nscc_rules.pdf.*

[5] *See* Rule 1 (Definitions and Descriptions). *Id.*

[6] Procedure XV, *supra* note 4.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

NSCC is proposing a number of enhancements to its methodology for calculations of certain components of the Clearing Fund. First, NSCC is proposing to (1) clarify and improve the transparency and use of the term ''Illiquid Security'' for purposes of determining the applicable calculation of the volatility component of the Clearing Fund formula to Net Unsettled Positions in those securities, and (2) enhance the methodology used in this term by including additional criteria.[7] Specifically, certain criteria relating to listing national securities exchanges would continue to be utilized and would be enhanced and described with greater clarity and transparency under the proposed changes. In addition, NSCC would (i) add securities' market capitalization and a median illiquidity ratio, as described in greater detail below, as additional measurements of liquidity and (ii) remove the references to OTC Bulletin Board and OTC Link issue. NSCC would revise the definition of ''Illiquid Security'' in the Rules to reflect these enhancements.

Second, NSCC would enhance the calculation of the haircut-based volatility component of the Clearing Fund methodology for Net Unsettled Positions in securities whose volatility is less amenable to statistical analysis and securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner. Currently, NSCC uses a fixed percentage in the calculation of charges for Net Unsettled Positions in each of these securities.[8] NSCC would modify these calculations by adding two specific categories for Illiquid Securities (as newly defined pursuant to the proposed changes) and UITs. For Illiquid Securities, NSCC would apply a percentage that is based on the applicable security's price level and for both Illiquid Securities and UITs, NSCC would recalculate the applicable percentages applied to such securities at least annually. NSCC would retain the existing general categories for securities whose volatility is less amenable to statistical analysis and securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner for securities that fall within those descriptions but that are not Illiquid Securities or UITs, and would continue to apply a fixed percentage to such securities.

Third, NSCC would eliminate the existing Illiquid Charge. The Illiquid Charge was designed to cover the risk that NSCC may be unable to easily liquidate Net Unsettled Positions in Illiquid Securities in the event of a Member default due to the securities' lack of marketability and other characteristics. This risk would be addressed by the enhanced criteria for identifying Illiquid Securities, and the enhanced calculation of the applicable haircut-based volatility charge proposed by this filing. Therefore, NSCC believes the Illiquid Charge would no longer be needed to address these risks. In connection with this proposed change, NSCC would also remove the definition of ''Illiquid Position'' from the Rules, as this term is only used in connection with the calculation of the Illiquid Charge.

Finally, NSCC would provide greater detail to describe the treatment of Net Unsettled Positions in corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities in Section I.(A) of Procedure XV for greater transparency.

Each of the proposed changes is described in more detail below.

(i) Overview of the Required Fund Deposit and NSCC's Clearing Fund

As part of its market risk management strategy, NSCC manages its credit exposure to Members by determining the appropriate Required Fund Deposits to the Clearing Fund and monitoring its sufficiency, as provided for in the Rules.[9] The Required Fund Deposit serves as each Member's margin. The objective of a Member's Required Fund Deposit includes mitigation of potential losses to NSCC associated with liquidation of the Member's portfolio in the event NSCC ceases to act for that Member (hereinafter referred to as a ''default'').[10] The aggregate of all Members' Required Fund Deposits, together with certain other deposits required under the Rules, constitutes the Clearing Fund of NSCC, which it would access, among other instances, should a defaulting Member's own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that Member's portfolio.

Pursuant to the Rules, each Member's Required Fund Deposit amount consists of a number of applicable components, each of which is calculated to address specific risks faced by NSCC, as identified within Procedure XV.[11] Generally, the largest component of Members' Required Fund Deposits is the volatility component. The volatility component is designed to calculate the amount of money that could be lost on a portfolio over a given period of time assumed necessary to liquidate the portfolio, within a 99% confidence level.

NSCC has two methodologies for calculating the volatility component. For the majority of Net Unsettled Positions, NSCC calculates the volatility component as the greater of (1) the larger of two separate calculations that utilize a parametric Value at Risk (''VaR'') model, (2) a gap risk measure calculation based on the concentration threshold of the largest non-index position in a portfolio, and (3) a portfolio margin floor calculation based on the market values of the long and short positions in the portfolio (''VaR Charge'').[12] Pursuant to Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV, certain Net Unsettled Positions are excluded from the calculation of the VaR Charge and are instead charged a haircut-based volatility component that is calculated by multiplying the absolute value of the position by a percent determined by NSCC that is (i) not less than 10% for securities whose volatility is less amenable to statistical analysis and (ii) not less than 2% for securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner.[13] Generally, certain equity securities, including Illiquid Securities, fall within the first category as securities whose volatility is less amenable to statistical analysis and fixed-income securities, including UITs, fall within the second category as

[7] ''Net Unsettled Positions'' and ''Net Balance Order Unsettled Positions'' refer to net positions that have not yet passed their settlement date, or did not settle on their settlement date, and are referred to collectively in this filing as Net Unsettled Positions. NSCC does not take into account any offsets, such as inventory held at other clearing agencies, when determining Net Unsettled Positions for the purpose of calculating the volatility component. *See* Procedure XV, *supra* note 4.

[8] *See* Section I.(A)(1)(a)(ii) and Section I.(A)(2)(a)(ii) of Procedure XV, *supra* note 4.

[9] *See* Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters), *supra* note 4. NSCC's market risk management strategy is designed to comply with Rules 17Ad–22(e)(4) and (e)(6) under the Securities Exchange Act of 1934, where these risks are referred to as ''credit risks.'' 17 CFR 240.17Ad–22(e)(4) and (e)(6).

[10] The Rules identify when NSCC may cease to act for a Member and the types of actions NSCC may take. For example, NSCC may suspend a firm's membership with NSCC or prohibit or limit a Member's access to NSCC's services in the event that Member defaults on a financial or other obligation to NSCC. *See* Rule 46 (Restrictions on Access to Services) of the Rules, *supra* note 4.

[11] *See* Procedure XV, *supra* note 4.

[12] *See* Sections I.(A)(1)(a)(i) and I.(A)(2)(a)(i) of Procedure XV, *supra* note 4.

[13] Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV, *supra* note 4.

securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner.[14] The securities that fall within either one of these categories tend to exhibit unpredictable illiquid characteristics, such as low trading volumes or infrequent trading. Because the VaR Charge is a model-based calculation, which generally relies on predictability, this charge may be less reliable for measuring market risk of securities that exhibit unpredictable illiquid characteristics.[15] Therefore, NSCC believes that the haircut-based volatility charge is a more appropriate measure of volatility for Net Unsettled Positions in these securities.

In addition to charging a haircut-based volatility component rather than a VaR Charge for certain Illiquid Securities, Members' Required Fund Deposits may also include an Illiquid Charge, which is calculated as described in Sections I.(A)(1)(h) and I.(A)(2)(f) of Procedure XV.[16] The Illiquid Charge is a component of the Clearing Fund that may be assessed with respect to ''Illiquid Positions,'' which are Net Unsettled Positions in ''Illiquid Securities'' that exceed applicable volume thresholds, as described in the definition of Illiquid Position in Rule 1 of the Rules.[17] The Illiquid Charge is designed to mitigate the risk that NSCC may face when liquidating Net Unsettled Positions in these securities following a Member default.

Currently, an Illiquid Security is defined in the Rules as ''a security, other than a family-issued security as defined in Procedure XV, that either (i) is not traded on or subject to the rules of a national securities exchange registered under [the Act]; or (ii) is an OTC Bulletin Board [18] or OTC Link issue.'' [19]

NSCC regularly assesses its market and credit risks, as such risks are related to its margining methodologies, to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market.[20] The proposed changes described below are a result of NSCC's regular review of the effectiveness of its margining methodology.

(ii) Proposed Enhancements to the Definition of Illiquid Security

NSCC is proposing to revise the Rules to (1) enhance certain existing criteria used in the definition of Illiquid Security for purposes of determining the applicable calculation of the volatility component; (2) remove certain criteria that would become unnecessary following the proposed enhancements; (3) enhance the definition by introducing additional criteria; and (4) repurpose the enhanced definition of Illiquid Security to use with respect to the calculation of the volatility component, as described below. NSCC believes that the proposed changes would provide Members with improved clarity and transparency into the methodology used to apply this definition. The proposed change would also provide NSCC with additional measures of a security's liquidity to improve its ability to apply margin that reflects the risk characteristics of that security.

Following the implementation of the proposed enhancements to this definition, as described below, the definition of Illiquid Security in Rule 1 of the Rules would be a security that: (i) Is not listed on a specified securities exchange (defined below) as determined on a daily basis; (ii) is listed on a specified securities exchange and, as determined on a monthly basis, (a)(I) its market capitalization is considered a micro-capitalization (as described below) as of the last business day of the prior month or (II) it is an American depositary receipt (''ADR''); and (b) the median of its calculated illiquidity ratio (defined below) of the prior six months exceeds a threshold that would be determined by NSCC on a monthly basis and is based on the 99th percentile of the illiquidity ratio of non-micro-capitalization common stocks [21] over the prior six months; or (iii) is listed on a specified securities exchange, and, as determined on a monthly basis, has fewer than 31 business days of trading history over the past 153 business days on such exchange. As discussed above, because the VaR Charge is a model-based calculation, which generally relies on predictability, the VaR Charge may be less reliable for measuring market risk of securities that exhibit unpredictable illiquid characteristics.[22] Each of the types of securities that would be in the definition of Illiquid Security are securities that tend to exhibit unpredictable illiquid characteristics including limited trading volumes or infrequent trading.

For purposes of this definition a ''specified securities exchange'' would be a national securities exchange that has established listing services and is covered by industry pricing and data vendors.[23] Initially, NSCC would define micro-capitalization as capitalization of less than $300 million. Consistent with generally prevailing views, NSCC believes that given the lack of public information and limited trading volumes, securities with capitalization below this threshold tend to involve higher risks and exhibit illiquid characteristics.[24] NSCC may adjust this definition from time to time as appropriate in order to continue to reflect a threshold that captures securities with capitalization that would indicate that the securities exhibit illiquid characteristics. Changes to the micro-capitalization threshold would be subject to NSCC's model risk management governance procedures set forth in the Clearing Agency Model Risk Management Framework (''Model Risk Management Framework'').[25] NSCC

[14] UITs are redeemable securities, or units, issued by investment companies that offer fixed security portfolios for a defined period of time.

[15] More specifically, the model that is used to calculate the VaR Charge relies on assumptions that are based on historic observations of a security's price. Such assumptions are not reliable predictors of price for securities that exhibit illiquid characteristics, which generally have low trading volumes or are infrequently traded.

[16] Sections I.(A)(1)(h) and I.(A)(2)(f) of Procedure XV, *supra* note 4.

[17] Rule 1, *supra* note 4.

[18] The OTC Bulletin Board is an interdealer quotation system that is used by subscribing members of the Financial Industry Regulatory Authority (''FINRA'') to reflect market making interest in eligible securities (as defined in FINRA's Rules). *See http://www.finra.org/industry/otcbb/otc-bulletin-board-otcbb.*

[19] OTC Link is an electronic inter-dealer quotation system that displays quotes from broker-dealers for many over-the-counter securities. *See https://www.otcmarkets.com.*

[20] *See* 17 CFR 240.17Ad–22(e)(6)(i), (e)(6)(vi).

[21] Securities that are exchange-traded products (''ETPs'') or ADRs would not be included when calculating the illiquidity ratio threshold. ETPs are not included when calculating the illiquidity ratio threshold because the underlying common stocks that comprise the indexes of equity ETPs are included in the calculation. ADRs are not included when calculating the illiquidity ratio threshold because the market capitalization of ADRs may be difficult to calculate because each ADR often converts to different number of shares of a local security. In addition, if NSCC is unable to retrieve data to calculate the illiquidity ratio for the median illiquidity ratio for a security on any day, NSCC would use a default value for that day for purposes of the calculation for the security (*i.e.,* the security would essentially be treated as illiquid for that day).

[22] *See supra* note 15.

[23] The exchanges that would initially be specified securities exchanges are: New York Stock Exchange LLC, NYSE American LLC, NYSE Arca, Inc., The Nasdaq Stock Market and Cboe BZX Exchange, Inc.

[24] *See, e.g., https://www.sec.gov/reportspubs/investor-publications/investorpubsmicrocapstockhtm.html.*

[25] *See* Securities Exchange Act Release No. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File No. SR–NSCC–2017–008) (describes the adoption of the Model Risk Management Framework of NSCC which sets forth the model risk management practices of NSCC) and Securities Exchange Act Release No. 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR–NSCC–2018–009) (amends the Model Risk Management Framework). The Model Risk Management Framework describes the model

would notify Members of changes to the micro-capitalization threshold by important notice. For purposes of the definition of Illiquid Security, the ''illiquidity ratio'' of a security on any day would be equal to (i) the price return of such security on such day (based on the natural logarithm of the ratio between the closing price of the stock on such day to the closing price of the stock on the prior trading day) divided by (ii) the average daily trading amount [26] of such security over the prior 20 business days.[27]

a. Enhancements to the Existing Criteria in the Definition of Illiquid Security

NSCC is proposing to enhance existing criteria in the definition of Illiquid Security as set forth below.

In the current definition, an Illiquid Security is a security that is ''either (i) not traded or subject to the rules of a national securities exchange registered under the Securities Exchange Act of 1934, as amended; or (ii) is an OTC Bulletin Board or OTC Link issue.'' [28] On a daily basis, NSCC receives from third party vendors data relating to securities processed through NSCC which indicates the exchanges, if any, on which each security is listed. If a security is not listed on of one of the national securities exchanges covered by the third party vendors, then, currently, NSCC would consider that security an Illiquid Security for the purpose of calculating the Illiquid Charge.[29] Based on historic performances, NSCC believes the national securities exchanges that the vendors cover for this purpose are appropriate for determining if a security exhibits characteristics of liquidity because such exchanges have established listing services and are covered by industry pricing and data vendors. NSCC believes that such exchanges tend to list securities that exhibit liquid characteristics such as having more available public information, larger trading volumes and higher capitalization. NSCC continues to believe this analysis is appropriate for identifying securities that exhibit illiquid characteristics, and would retain and enhance this criterion in the definition in the Rules by specifying that it uses the specified securities exchanges that have established listing services and that are covered by industry pricing and data vendors and providing that it would determine on a daily basis whether securities are subject to the rules of a specified securities exchange.

NSCC would use the same process for determining whether a security is an Illiquid Security based on if such security is listed on a national security exchange and would enhance the definition to reflect the process that will be used. NSCC would change ''national securities exchange registered under the Securities Exchange Act of 1934, as amended'' to ''specified securities exchange'' in the definition of Illiquid Security and add a defined term for ''specified securities exchange'', which would be a national securities exchange that has established listing services and is covered by industry pricing and data vendors.

As a further enhancement, NSCC is proposing to replace the phrase ''not traded on or subject to the rules of'' with ''not listed on'' to more accurately describe the process that NSCC and its vendors use to determine if a security is on a national securities exchange. In addition, determining whether a security is listed on an exchange is more definitive and more reliably verifiable than determining whether a security is traded on or subject to the rules of a securities exchange. NSCC is also proposing to remove references to the OTC Bulletin Board and OTC Link issues in the definition of Illiquid Security. NSCC believes that the definition as revised pursuant to this rule change would capture securities listed on the OTC Bulletin Board and OTC Link and the reference to such platforms is unnecessary.

NSCC is also proposing to remove the phrase ''other than a family issued security as defined in Procedure XV'' from the definition of Illiquid Security because family issued security is not defined in Procedure XV and, given the new proposed use of the definition of Illiquid Security together with other proposed changes, it is not necessary to exclude Family-Issued Securities from the definition. The current defined term ''Illiquid Security'' is only used in the defined term ''Illiquid Position'' and in sections relating to the Illiquid Charge which would be removed pursuant to the proposed changes as described herein. The phrase ''other than a family issued security as defined in Procedure XV'' was intended to ensure that long Net Unsettled Positions in Family-Issued Securities are excluded from the Illiquid Charge.[30] Currently, short Net Unsettled Positions in Family-Issued Securities whose volatility is less amenable to statistical analysis are subject to the haircut set forth in Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV. In addition, short Net Unsettled Positions in Family-Issued Securities that are Illiquid Positions are currently subject to the Illiquid Charge.[31] Long Net Unsettled Positions in Family Issued Securities are not subject to the haircut set forth Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV nor to the Illiquid Charge.

As described below, following the proposed rule change, the defined term Illiquid Security would be repurposed to be used in Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV which sections would apply to certain short Net Unsettled Positions in Family-Issued Securities.[32] As is the case

management practices adopted by NSCC, which have been designed to assist NSCC in identifying, measuring, monitoring, and managing the risks associated with the design, development, implementation, use, and validation of ''models'' which would include the methodology for determining the volatility component of the Clearing Fund. *Id.*

[26] The daily trading amount equals the daily trading volume multiplied by the end-of-day price.

[27] NSCC believes that the 20-business day period is sufficient to reflect recent market activity for the security.

[28] *See* Rule 1, *supra,* note 4.

[29] The exchanges that have established listing services that the vendors cover for this purpose are: New York Stock Exchange LLC, NYSE American LLC, NYSE Arca, Inc., The Nasdaq Stock Market and Cboe BZX Exchange, Inc. Members' Clearing Fund Summary reports, available through the DTCC Risk Portal, identify securities within their portfolio by the ticker symbol and whether those securities are considered Illiquid Securities for purposes of the calculation of the Illiquid Charge. This information provides Members with insight into the basis for their margin calculations.

[30] Long Net Unsettled Positions in Family-Issued Securities are not subject to the Illiquid Charge because the risk that long Net Unsettled Positions in Family-Issued Securities raise, wrong way risk, is separately provided for by a separate charge for such securities. *See* Section I.(A)(1)(a)(iv) and Section I.(A)(2)(a)(iv), *supra* note 4. Wrong way risk is a risk that an exposure to a counterparty is highly likely to increase when the creditworthiness of that counterparty deteriorates. *See* Principles for financial market infrastructures, issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions, pg. 47 n.65 (April 2012), *available at http://www.bis.org/publ/cpss101a.pdf.* Short Net Unsettled Positions in Family-Issued Securities do not present the same wrong way risk as long Net Unsettled Positions in Family-Issued Securities. *See* note 29 below.

[31] The defined term ''Illiquid Security'' currently excludes ''a family issued security as defined in Procedure XV'', however, family issued security is not defined in Procedure XV. The defined term Illiquid Security was added to the Rules in 2017. *See* Securities Exchange Act Release No. 80260 (March 16, 2017), 82 FR 14781 (March 22, 2017) (File No. SR–NSCC–2017–001). When the defined term was added, the section where family issued securities was defined in Procedure XV was referring to a separate charge that was applied to long Net Unsettled Positions in Family-Issued Securities and the exclusion of ''family issued security'' from the defined term Illiquid Security was intended to refer to long Net Unsettled Positions in Family-Issued Securities not short Net Unsettled Positions in Family-Issued Securities.

[32] NSCC has identified exposure to specific wrong-way risk when it acts as central counterparty to a Member with long positions in Family-Issued Securities. In the event a Member with long positions in Family-Issued Securities defaults,

Continued

currently, only long Net Unsettled Positions in Family-Issued Securities would be excluded from the calculations in Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV which would be noted in I.(A)(1)(a)(ii) as proposed below. The proposed rule change would not change the treatment of long Net Unsettled Positions in Family-Issued Securities which would remain subject to the calculations set forth in Sections I.(A)(1)(a)(iv) and I.(A)(2)(a)(iv) of Procedure XV.

NSCC believes that each of these proposed changes would improve the definition for its new proposed purpose and improve Members' transparency into the application of the existing criteria of the Illiquid Security definition.

b. New Criteria in the Definition of Illiquid Security

NSCC is also proposing to include additional criteria in order to identify securities that exhibit illiquid characteristics and may not be captured by the existing definition as described below.

Although the criterion for this definition relating to whether a security is traded on or subject to the rules of a specified securities exchange would be determined on a daily basis, as noted above, under the proposal, NSCC would also apply new criteria, described below, on a monthly basis, to identify those securities that are subject to the rules of a specified securities exchange but may still exhibit illiquid characteristics and should be identified as Illiquid Securities. The new criteria would be based on (i) the security's market capitalization and (ii) the trading history of the security. In addition, ADRs would also be subject to additional review to determine if they should be deemed to be Illiquid Securities.

First, NSCC is proposing to revise the definition of Illiquid Security to identify securities issued by an entity with a micro-capitalization, which can be a characteristic of illiquidity. For purposes of this criterion, NSCC would calculate the product of the outstanding shares and market price on a daily basis for each issuance. Each month, NSCC would use the average of those calculations over the prior month to determine market capitalization. If the average for a particular security is below a threshold determined by NSCC from time to time, the security would be considered micro-capitalization. Initially, NSCC would define micro-capitalization as capitalization of less than $300 million. Securities with a capitalization below $300 million and which are considered micro-capitalization tend to exhibit illiquid characteristics such as limited public information and lower trading volumes. NSCC may update the micro-capitalization threshold from time to time as announced by an important notice to the Members. Changes to the threshold would be subject to NSCC's model risk governance procedures set forth in the Model Risk Management Framework.[33]

If the average market capitalization of a security is considered micro-capitalization or if the security is an ADR, then the security would be subject to an additional illiquidity ratio test described below to determine if it is an Illiquid Security. NSCC believes it is appropriate to subject a security to the illiquidity ratio test if a security is considered within the range of micro-capitalization because the capitalization of a security could be an indicator of the lack of liquidity of a security. In addition, for ADRs, the market capitalization of the ADR may be difficult to calculate because each ADR often converts to different number of shares of a local security. As a result, NSCC has decided to subject all ADRs to the illiquidity ratio test to determine if it is an Illiquid Security. As noted above,[34] ETPs and ADRs would be excluded from the pool of securities that are used to calculate the illiquidity ratio threshold. However, ETPs that are considered micro-capitalization and ADRs would be subject to the illiquidity ratio test to determine if they are Illiquid Securities.

If a security is considered within the range of micro-capitalization or if the security is an ADR, it would be subject to additional illiquidity ratio test that would include the application of an ''illiquidity ratio'' to determine if the security should be deemed an Illiquid Security. The illiquidity ratio of a security on any day would be equal to (i) the security's price return on such day (based on the natural logarithm of the ratio between the closing price of the stock on such day to the closing price of the stock on the prior trading day) divided by (ii) the average daily trading amount[35] of such security over the prior 20 business days.[36] The illiquidity ratio for each security that is subject to this illiquidity ratio test would be determined monthly.

A security that is subject to the illiquidity ratio test would only be deemed an Illiquid Security if the calculated median illiquidity ratio of the prior six months exceeds a threshold to be determined by NSCC on a monthly basis based on the 99th percentile of the illiquidity ratio of non-micro-capitalization common stocks over the prior six months.[37] If the calculated median illiquidity ratio of a security did not exceed such threshold it would not be deemed an Illiquid Security and would be subject to the VaR Charge. NSCC believes the illiquidity ratio would provide it with a reliable measurement of a security's liquidity because NSCC would use the absolute value of the daily return-to-volume ratio to capture price impact. Given the same dollar amount of trading activity, higher price impact typically indicates less liquidity.

Second, NSCC would include in the Illiquid Security definition securities that are subject to the rules of a specified securities exchange, but, as determined on a monthly basis, have fewer than 31 business days of trading history over the past 153 business days on such exchange. NSCC has historically used this time period to identify IPOs which tend to exhibit illiquid characteristics due to their limited trading history.[38]

In order to implement these proposed changes, NSCC would include these additional criteria in the revised definition of ''Illiquid Security'' in Rule 1 of the Rules.

NSCC would close out those positions following a likely drop in the creditworthiness of the issuer, possibly resulting in a loss to NSCC from a resulting drop in price in the securities. As such, NSCC provides a specific charge for such securities. *See id.* Short positions present a different risk profile than long positions in this close out scenario based on, in part, the difference in the potential responsiveness of price change to quantity that may occur when NSCC is liquidating a long position in an Illiquid Security, compared to when it is liquidating a short position. As a result, the charge for Family-Issued Securities is only applied to long positions in such securities.

[33] *See supra* note 25.

[34] *See supra* note 21.

[35] *Supra* note 26.

[36] For example, assuming Stock A has a closing price of $10 on day 1, and a closing price of $11 on day 2, then the ''price return'' as of day 2 would be abs(log(11/10)) = 0.09531018. Assuming the average daily trading amount of the stock over the prior 20 business days is $1,100,000, the daily ''illiquidity ratio'' for Stock A on day 2 is 0.09531018 divided by 1,100,000 × 10^6 = 0.0866.

[37] *See supra* note 21.

[38] NSCC has observed that the use of the metric, 31 business days of trading over the past 153 business days, has been useful in identifying securities, such as IPOs, that exhibit illiquid characteristics based on their limited trading history. As such, NSCC would use this metric in the definition of Illiquid Security to ensure that these securities, including IPOs, are identified as Illiquid Securities.

(iii) Proposed Enhancement to the Volatility Component Applicable to Illiquid Securities and UITs

NSCC is also proposing to enhance the calculation of the haircut-based volatility component for Illiquid Securities and UITs. As described above, Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV currently provide that NSCC has the discretion to exclude from the VaR Charge Net Unsettled Positions in classes of securities whose volatility is (1) less amenable to statistical analysis, or (2) amenable to generally accepted statistical analysis only in a complex manner, and permits NSCC to instead calculate the volatility charge for Net Unsettled Positions in these securities as a haircut-based charge.[39]

Pursuant to this authority, NSCC calculates the volatility charge for IPOs by multiplying the absolute value of the Net Unsettled Position by a fixed 15%, and calculates the volatility charge for all other Illiquid Securities (as currently defined) and sub-penny securities by multiplying the absolute value[40] of the Net Unsettled Position by a fixed 20%. Net Unsettled Positions in UITs are subject to the same haircut-based volatility charge as other securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner. Today, NSCC generally does not adjust the applicable haircut-based volatility charge, which is a percent that is no less than 2%, pursuant to Procedure XV.

Based on backtesting results, NSCC has observed that market price movements are correlated to a security's market price. Therefore, NSCC believes it would be able to calculate a haircut-based volatility charge that more appropriately addresses the risks presented by a Net Unsettled Position if NSCC considers a security's price level or risk profile when determining the haircut percentage to be used in that calculation. As described below, NSCC is proposing to enhance the calculation of the haircut-based volatility component for Illiquid Securities and UITs. In order to implement the changes described below, NSCC would revise Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV by including new subsections (A)(I) and (II) and (B)(I) and (II) relating to such securities.

a. Enhancing the Volatility Charge for Illiquid Securities

First, NSCC is proposing to enhance the haircut-based volatility charge for Illiquid Securities. The applicable percent would be determined at least annually[41] as the highest of (1) 10%, (2) a percent benchmarked to be sufficient to cover 99.5th percentile of the historical 3-day return of each group of Illiquid Securities[42] in each Member's portfolio and (3) a percent benchmarked to be sufficient to cover 99th percentile of the historical 3-day return of each group in each Member's portfolio after incorporating a fixed transaction cost.[43] The applicable percent, and the determination of how often the applicable percent is determined if more often than annually, would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework.[44] The look-back period for this calibration would be no less than five years and would initially be five years to be consistent with the historical data set used in model development. The look-back period may be adjusted by NSCC as necessary consistent with the model risk management practices adopted by NSCC to respond to, for example, market events that impact liquidity in the market and Member backtesting deficiencies. Adjustments to the look-back period would be subject to NSCC's model risk governance procedures set forth in the Model Risk Management Framework.[45] Generally, lower priced securities that may present NSCC with a greater risk would be charged a haircut-based volatility charge based on a higher percent.

NSCC would group Illiquid Securities by price level, and Illiquid Securities that are sub-penny securities would be separately grouped by long or short position, where each group is assigned a percent to be used in the calculation of the haircut-based volatility charge. The price level groupings would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework.[46] The proposal would allow NSCC to calculate this charge based on the market price of Illiquid Securities. With respect to an Illiquid Security that is not a sub-penny security, NSCC would calculate one haircut-based volatility charge for short and long positions. However, with respect to an Illiquid Security that is a sub-penny security, NSCC would calculate the haircut-based volatility charge for short positions and long positions separately. NSCC believes the proposed change is appropriate for Illiquid Securities that are sub-penny securities, particularly as short positions in sub-penny securities could experience price movements of more than 100%. Further, these securities are typically issued by companies with low market capitalization, and may be susceptible to market manipulation, enforcement actions, or private litigation. The proposed change would allow NSCC to calculate a haircut-based volatility charge that accounts for this risk of price movements. Although sub-penny securities would be separately grouped by price level based on the sub-penny values, since the price of sub-penny securities is rounded up to one cent when it is entered into the Continuous Net Settlement System and Balance Order Accounting Operation, the current market price of each sub-penny security would be deemed to be one cent for purposes of applying the haircut-based volatility charge.

By setting a floor of 10%, the proposal would allow NSCC to charge an amount that has been adequate, based on historical observation, to address risks presented by Net Unsettled Positions in these securities and is consistent with the current methodology, which also sets a floor for the haircut-based volatility charge of no less than 10%. In this way, the haircut-based volatility charge would be calculated to allow NSCC to collect margin at levels that reflect the risk presented by these Net Unsettled Positions. Unlike the current methodology which provides NSCC the discretion to apply a haircut, NSCC would not have discretion as to whether to apply the haircut-based volatility charge to Illiquid Securities and all Illiquid Securities would be subject to the charge.

In order to implement this proposed change, NSCC would describe the haircut-based volatility charge applicable to Illiquid Securities in the

[39] *See* Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV, *supra* note 4.

[40] For purposes of the calculating the absolute value, the share price of each sub-penny security is rounded up to one cent. If a transaction in any security with a share price below one cent is entered into NSCC's Continuous Net Settlement system or Balance Order Accounting Operation, NSCC rounds up the price of the security to one cent.

[41] A number of important considerations consistent with the model risk management practices adopted by NSCC could prompt more frequent haircut review, such as material deterioration of Members' backtesting performance, market events or structure changes, and model validation findings. *See also* Model Risk Management Framework, *supra* note 25.

[42] NSCC would group Illiquid Securities by price level, and Illiquid Securities that are sub-penny securities would be separately grouped by long or short position, as discussed in more detail below.

[43] The fixed transaction cost would be equal to one-half of the estimated bid-ask spread and would be included in the simulated liquidation gain/loss of the positions in each Member's portfolio.

[44] *See supra* note 25.

[45] *See supra* note 25.

[46] *See supra* note 25.

new Sections I.(A)(1)(a)(ii)(B)(I) and I.(A)(2)(a)(ii)(B)(I) of Procedure XV.

b. Enhancing the Volatility Charge for UITs

NSCC is also proposing to revise the calculation of the haircut-based volatility charge applied to UITs by reviewing the percent used in this calculation at least annually, in order to apply a haircut-based volatility charge to Net Unsettled Positions in UITs that is more closely based on a measurement of the risk presented by Members' portfolio composition and market conditions.

Currently, NSCC applies a haircut-based volatility charge that is a fixed 2% to Net Unsettled Positions in securities whose volatility is amenable to generally accepted statistical analysis (for example, the methodology used to calculate the VaR Charge) only in a complex manner, which include UITs. NSCC is proposing to continue to apply a haircut-based volatility charge to Net Unsettled Positions in UITs that would be no less than 2%, as currently provided for in Procedure XV, but would re-calculate the applicable percent designated by NSCC at least annually. The re-calculation of the applicable percent would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework.[47] Subject to this existing floor, the applicable percent would be benchmarked to be sufficient to cover 99.5th percentile of the historical 3-day return of UITs in each Member's portfolio, with a lookback period of no less than five years. Unlike the current methodology which provides NSCC the discretion to apply a haircut, NSCC would not have discretion as to whether to apply the haircut-based volatility charge to UITs and all UITs would be subject to the charge.

In order to implement this proposed change, NSCC would describe the haircut-based volatility charge applicable to UITs in the new Sections I.(A)(1)(a)(ii)(B)(II) and I.(A)(2)(a)(ii)(B)(II) of Procedure XV.

c. Enhancing Existing Language for Volatility Charge

NSCC is also proposing to re-arrange the existing language relating to securities whose volatility is (1) less amenable to statistical analysis, or (2) amenable to generally accepted statistical analysis only in a complex manner, to clarify the language and make it more transparent. NSCC would move the description of securities whose volatility is less amenable to statistical analysis to new Sections I.(A)(1)(a)(ii)(A)(I) and I.(A)(2)(a)(ii)(A)(I) of Procedure XV and move the description of securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner to new Sections I.(A)(1)(a)(ii)(A)(II) and I.(A)(2)(a)(ii)(A)(II). NSCC would indicate that securities that are Illiquid Securities or UITs would not be subject to these general categories. NSCC would also remove the phrase ''such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (*e.g.,* five dollars)'' which was intended as an example of securities whose volatility is less amenable to statistical analysis because NSCC does not believe that the example adequately describes all of the securities that are less amenable to statistical analysis and may be misleading. In addition, securities in the example would include securities that are Illiquid Securities and that would no longer be subject to this general category. In addition, NSCC is proposing to remove the phrase ''other than corporate and municipal bonds,'' which qualifies securities amenable to generally accepted statistical analysis only in a complex manner, because the treatment of corporate and municipal bonds would be clarified as set forth in subsection (v) below.

NSCC believes that the new defined term Illiquid Security would identify all securities for which a haircut is currently applied because such securities are less amenable to statistical analysis pursuant to Sections I.(A)(1)(a)(ii)(x) and I.(A)(2)(a)(ii)(x) of Procedure XV.[48] The haircut for Illiquid Securities upon implementation of the rule change would be calculated pursuant to the new category for Illiquid Securities under Sections I.(A)(1)(a)(ii)(B)(I) and I.(A)(2)(a)(ii)(B)(I) of Procedure XV rather than Sections I.(A)(1)(a)(ii)(A)(I) and I.(A)(2)(a)(ii)(A)(I) of Procedure XV. NSCC believes that UITs are currently substantially all of the securities for which a haircut is currently applied because such securities are amenable to generally accepted statistical analysis only in a complex manner pursuant to Sections I.(A)(1)(a)(ii)(y) and I.(A)(2)(a)(ii)(y) of Procedure XV.[49] The haircut for UITs upon implementation of the rule change would be calculated pursuant to the new category for UITs under Sections I.(A)(1)(a)(ii)(B)(II) and I.(A)(2)(a)(ii)(B)(II) of Procedure XV rather than Sections I.(A)(1)(a)(ii)(A)(II) and I.(A)(2)(a)(ii)(A)(II) of Procedure XV.

There are some types of securities that are amenable to generally accepted statistical analysis only in a complex manner that would not constitute UITs and for which a haircut would continue to be calculated using the category for securities that are amenable to generally accepted statistical analysis only in a complex manner upon implementation of the rule change. NSCC believes that there are no current types of securities for which the haircut would be calculated using the general category for securities that are less amenable to statistical analysis upon implementation of the rule change. NSCC, however, may deem it necessary to calculate a haircut for securities that fall within this existing category, if such securities do not fall within the categories for Illiquid Securities, after assessing margin suitability or future asset class reviews. Therefore, NSCC is proposing to keep these two more general categories in the Rules revised as contemplated above. As with these existing general categories currently, NSCC would have the discretion to determine whether a security fits within one of these categories. NSCC would follow its existing risk management practices and procedures when determining whether to apply a security that is not an Illiquid Security or a UIT to one of these categories. Applying a new security to one of these categories would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework.[50]

(iv) Proposal To Eliminate the Illiquid Charge

NSCC is proposing to eliminate the existing Illiquid Charge in conjunction with the aforementioned enhancements. The Illiquid Charge is currently imposed on Net Unsettled Positions in Illiquid Securities, in addition to other applicable components of the Clearing Fund. Because the current haircut-based volatility charge is a flat charge, calculated as a percentage of the

[47] *See supra* note 25.

[48] *See* Sections I.(A)(1)(a)(ii)(x) and I.(A)(2)(a)(ii)(x) of Procedure XV, *supra* note 4.

[49] *See* Sections I.(A)(1)(a)(ii)(y) and I.(A)(2)(a)(ii)(y) of Procedure XV, *supra* note 4. Note that the haircuts for municipal and corporate bonds which are also fixed-income securities that are amenable to generally accepted statistical analysis only in a complex manner are separately calculated pursuant to Sections I.(A)(1)(a)(iii) and I.(A)(2)(a)(iii) of Procedure XV. *See* Sections I.(A)(1)(a)(iii) and I.(A)(2)(a)(iii) of Procedure XV, *supra* note 4. Examples of fixed income securities that may remain subject to calculations under Sections I.(A)(1)(a)(ii)(A)(I) and I.(A)(2)(a)(ii)(A)(I) of Procedure XV would include preferred stock or other fixed income securities that are amenable to generally accepted statistical analysis only in a complex manner other than UITs or corporate or municipal bonds.

[50] *See supra* note 25.

absolute value of these Net Unsettled Positions, it may not currently address the lack of liquidity and marketability that are characteristic of Illiquid Securities. The Illiquid Charge is calculated and applied to address these additional risks. Currently, due to the existing definition of Illiquid Security, the Illiquid Charge has limited applicability, and generally only applies to a small population of securities that exhibit illiquid characteristics (*i.e.,* over-the-counter securities traded off-exchange).[51]

However, NSCC believes the proposed enhancements would address the risks presented by Net Unsettled Positions in Illiquid Securities more adequately. As described above, the enhanced methodology for identifying Illiquid Securities would enable NSCC to identify additional securities that could pose credit exposure to NSCC. Further, NSCC believes that the proposed methodology for calculating the applicable haircut-based volatility charge would be more responsive to the risks presented by Net Unsettled Positions in those securities because it would be based on historical performance and would be recalibrated more frequently. Therefore, NSCC is proposing to eliminate the Illiquid Charge in connection with these proposed rule changes as it would be no longer needed to address the risks presented by Illiquid Securities.

In connection with this change, NSCC would also remove the definition of ''Illiquid Position'' from Rule 1 of the Rules, as this term is only used in connection with the Illiquid Charge.

In order to implement this proposed change, NSCC would amend Rule 1 of the Rules by removing the definition of ''Illiquid Position,'' and NSCC would amend Procedure XV by removing references to the Illiquid Charge in subsection (g) of Section I.(A)(1) and subsection (e) of Section I.(A)(2) and removing subsection (h) of Section I.(A)(1) and subsection (f) of Section I.(A)(2) where the Illiquid Charge is currently described.

(v) Proposal To Enhance Language in Section I.(A) of Procedure XV

In addition to the enhancements described above, NSCC is proposing to make the following changes to Section I.(A) of Procedure XV: (x) Add language in subsections (1)(a)(ii) and (iii), and (2)(a)(ii) and (iii), that indicates that Net Unsettled Positions in corporate and municipal bonds are excluded from calculations in subsections (1)(a)(i) and (ii), and (2)(a)(i) and (ii), respectively; and (y) add language in subsections (1)(a)(ii) and (iv), and 2(a)(ii) and (iv), that indicates that long Net Unsettled Positions in Family-Issued Securities are excluded from calculations in subsections (1)(a)(i) and (ii), and (2)(a)(i) and (ii), respectively. The current language indicates that corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities are excluded from calculations in subsections (1)(a)(i) and (2)(a)(i) but does not explicitly indicate that corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities are excluded from (1)(a)(ii) and (2)(a)(ii). NSCC currently applies a haircut for corporate and municipal bonds pursuant to (1)(a)(iii) and (2)(a)(iii) and long Net Unsettled Positions in Family-Issued Securities pursuant to subsections (1)(a)(iii) and (2)(a)(iii) and does not apply a haircut for those securities pursuant to subsections (1)(a)(ii) or (2)(a)(ii).[52] The proposed changes are intended to improve Members' transparency into the treatment of Net Unsettled Positions in corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities in Section I.(A) of Procedure XV and would not change NSCC's methodology with respect to corporate and municipal bonds or long Net Unsettled Positions in Family-Issued Securities.

2. Statutory Basis

NSCC believes that the proposed changes described above are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, NSCC believes that the proposed changes are consistent with Section 17A(b)(3)(F) of the Act,[53] and Rules 17Ad–22(e)(4)(i), (e)(6)(i), and (e)(6)(v), each promulgated under the Act,[54] for the reasons described below.

Section 17A(b)(3)(F) of the Act[55] requires that the rules of NSCC be designed to, among other things, assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible. NSCC believes the proposed changes are designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible because they are designed to enable NSCC to better limit its exposure to Members in the event of a Member default, as described below.

First, NSCC is proposing to enhance the definition of Illiquid Security by (i) enhancing an existing criterion used in this definition relating to whether a security is subject to the rules of a national securities exchange by specifying that NSCC would rely on a list of specified securities exchanges that includes exchanges that have established listing services and are covered by industry pricing and data vendors, (ii) deleting references to OTC Link and OTC Bulletin Board and (iii) adding new criteria it would use to assess the risks a security may present to NSCC due to its illiquid characteristics based on the market capitalization of the issuer of the security and the trading history of the security. The enhancements to the existing criterion relating to whether a security is subject to the rules of a national securities exchange would provide that NSCC would utilize a process that identifies securities listed on national securities exchanges that have established listing services and are covered by industry pricing and data vendors and as a result that list securities that are less likely to exhibit illiquid characteristics. Therefore, NSCC, by identifying which securities are listed on these exchanges, would enhance its ability to determine securities that exhibit illiquidity characteristics. In addition, the enhancements would improve Members' understanding of the analysis by ensuring that the Members better understand the process used by NSCC for defining Illiquid Securities based on whether a security is subject to the rules of a specified securities exchange. The references to OTC Link and OTC Bulletin Board would be removed because following the enhancements made pursuant to this rule change, the definition as revised pursuant to this rule change would capture securities listed on the OTC Bulletin Board and OTC Link and the reference to such platforms would be unnecessary.

The proposed additional criteria are designed to capture additional risk presented by securities that are subject to the rules of a specified securities exchange and exhibit illiquid characteristics based on the capitalization of the issuer or the trading history. NSCC believes that the new

[51] Between November 2017 and November 2018, the Illiquid Charge represented an average of approximately 1.5% of the total Clearing Fund requirement.

[52] As discussed above, currently, short Net Unsettled Positions in Family-Issued Securities whose volatility is less amenable to statistical analysis are subject to the haircut set forth in Sections I.(A)(1)(a)(ii) and I.(A)(2)(a)(ii) of Procedure XV. In addition, short Net Unsettled Positions in Family-Issued Securities that are Illiquid Positions are currently subject to the Illiquid Charge.

[53] 15 U.S.C. 78q–1(b)(3)(F).

[54] 17 CFR 240.17Ad–22(e)(4)(i), (e)(6)(i), and (e)(6)(v).

[55] 15 U.S.C. 78q–1(b)(3)(F).

criteria would enable NSCC to better limit its exposure to Members by applying a volatility component that is a more appropriate measure of volatility for Net Unsettled Positions in these securities exhibiting illiquid characteristics. Specifically, NSCC has observed that securities that are on a specified securities exchange but that have limited trading, such as IPOs, or that are considered micro-capitalization also exhibit illiquid characteristics. Finally, due to the potential difficulty in determining market capitalization accurately with respect to ADRs, NSCC would add ADRs to the definition of Illiquid Security so that they undergo the same review as if the ADRs were considered micro-capitalization. As such, NSCC believes that adding these criteria to the definition of Illiquid Security would provide a better and more accurate measure of volatility of illiquid securities.

Second, NSCC proposes enhancements to the haircut-based volatility charge for Illiquid Securities and UITs to allow NSCC to base this charge on these securities' price level and risk profile. In this way, the haircut-based volatility charge for Net Unsettled Positions in these securities would be calculated to enable NSCC to collect margin at levels that better reflect the risk presented by these Net Unsettled Positions and would help NSCC limit its exposures to Members. As an example, a recent impact study indicated that under the current methodology short positions in sub-penny securities and securities priced between one cent and one dollar exhibited the lowest average backtesting coverage percentages with 96.2% during the study period, whereas using the proposed methodology average backtesting coverage percentage for such securities would have increased to 99.5% over the study period.

Third, NSCC believes that the proposed clarifications to the language relating to securities whose volatility is (i) less amenable to statistical analysis or (2) amenable to generally accepted statistical analysis only in a complex manner would improve Members' understanding of the current analysis by ensuring that the Members better understand the process used by NSCC for these categories by adding clarity and transparency. In addition, by adding that such categories would not be used for securities that are not Illiquid Securities or UITs would allow Members to understand that Illiquid Securities and UITs would be subject to the new sections specific to those securities.

Fourth, NSCC believes that following the proposed changes, the Illiquid Charge would no longer be needed to address the credit exposures presented by Net Unsettled Positions in Illiquid Securities because such risks would be addressed by of the proposed haircut-based volatility enhancements.

Finally, NSCC believes that the proposed changes to the language in Section I.(A) of Procedure XV relating to Net Unsettled Positions in corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities would improve Members' transparency into the treatment of Net Unsettled Positions in corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities.

The Clearing Fund is composed of Members' Required Fund Deposits which include the volatility component, and is a key tool that NSCC uses to mitigate potential losses to NSCC associated with liquidating a Member's portfolio in the event of Member default. The changes relating to (a) enhancing the existing criterion for determining an Illiquid Security, (b) clarifying and enhancing the language relating to securities whose volatility is (i) less amenable to statistical analysis or (ii) amenable to generally accepted statistical analysis only in a complex manner and (c) changing the language in Section I.(A) of Procedure XV relating to Net Unsettled Positions in corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities, would enhance clarity and transparency for Members with respect to the volatility component allowing Members to have a better understanding of the Rules. Having clear and accurate Rules would help Members to better understand their rights and obligations regarding NSCC's clearance and settlement services. NSCC believes that when Members better understand their rights and obligations regarding NSCC's services, they can act in accordance with the Rules. NSCC believes that better enabling Members to comply with the Rules would promote the prompt and accurate clearance and settlement of securities transactions by NSCC consistent with the requirements of the Act, in particular Section 17A(b)(3)(F) of the Act.[56]

Each of the proposed changes listed above would improve the methodology relating to the volatility component enabling NSCC to better limit its exposure to Members such that, in the event of Member default, NSCC's operations would not be disrupted and non-defaulting Members would not be exposed to losses they cannot anticipate or control. In this way, the proposed rules are designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible and therefore consistent with Section 17A(b)(3)(F) of the Act.[57]

Rule 17Ad–22(e)(4)(i) under the Act[58] requires, in part, that NSCC 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, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.

As described above, NSCC believes that the proposed changes would enable it to better identify, measure, monitor, and, through the collection of Members' Required Fund Deposits, manage its credit exposures to Members by maintaining sufficient resources to cover those credit exposures fully with a high degree of confidence. More specifically, the proposed changes to the methodology for identifying Illiquid Securities would allow NSCC to better identify securities that may present credit exposures, for purposes of applying an appropriate margin charge. The proposed enhancements to the volatility charge applicable to Illiquid Securities and UITs would provide NSCC with a more effective measure of the risks that may be presented to NSCC by positions in the securities. Specifically, the proposal to base the calculation of the haircut-based volatility charge applied to positions in Illiquid Securities and UITs on those securities' price level and risk profile would enable NSCC to manage its credit exposures by allowing NSCC to collect and maintain sufficient resources to cover those credit exposures fully with a high degree of confidence. As an example, a recent impact study indicated that under the current methodology short positions in sub-penny securities and securities priced between one cent and one dollar exhibited the lowest average backtesting coverage percentages with 96.2% during the study period, whereas using the proposed methodology average backtesting coverage percentage for such securities would have increased to 99.5% over the study period. NSCC also believes that with the proposed changes NSCC could remove the Illiquid Charge

[56] *Id.*

[57] *Id.*

[58] 17 CFR 240.17Ad–22(e)(4)(i).

from the Clearing Fund formula because the proposed changes would provide NSCC with a more effective measure of risks related to Net Unsettled Positions in Illiquid Securities. As such, the proposed enhancements to the calculation of the volatility component would permit NSCC to more effectively identify, measure, monitor and manage its exposures to risk, and would enable it to better limit its exposure to potential losses from Member default.

Therefore, NSCC believes that the proposal would enhance NSCC's ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. As such, NSCC believes the proposed changes are consistent with Rule 17Ad–22(e)(4)(i) under the Act.[59]

Rule 17Ad–22(e)(6)(i) under the Act[60] requires, in part, that NSCC 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, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.

The Required Fund Deposits are made up of risk-based components (as margin) that are calculated and assessed daily to limit NSCC's credit exposures to Members. NSCC is proposing changes that are designed to more effectively address risk characteristics of Net Unsettled Positions in Illiquid Securities. NSCC believes that these changes would enable NSCC to produce margin levels that are more commensurate with the particular risk attributes of these securities, including the risk of increased transaction and market costs to NSCC to liquidate or hedge due to lack of liquidity or marketability of such positions.

For example, by enhancing the methodology for Illiquid Securities through an additional review of market capitalization of a security and the use of an illiquidity ratio, NSCC believes that the proposed change would allow NSCC to better identify those securities that may exhibit illiquid characteristics. The proposed changes to the haircut-based methodology to base the calculation on the price level and risk profile of the applicable security, rather than a static percent, would, NSCC believes, enable NSCC to more effectively measure the risks that are particular to Illiquid Securities and UITs. Backtesting results indicate that by calculating a haircut-based volatility charge that addresses the risks presented by a security's price level or risk profile, the proposed methodology would result in a volatility charge that more appropriately addresses the risk of these securities.

These proposed changes are designed to assist NSCC in maintaining a risk-based margin system that considers, and produces margin levels commensurate with, the risks and particular attributes of portfolios that exhibit illiquid risk attributes. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad–22(e)(6)(i) under the Act.[61]

Rule 17Ad–22(e)(6)(v) under the Act[62] requires, in part, that NSCC 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 an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products. NSCC is proposing to eliminate the Illiquid Charge because, NSCC believes, the other proposed changes would provide NSCC with a more effective measure of the risks presented by Illiquid Securities. Eliminating this charge would enable NSCC to remove what would become, with the implementation of the other proposed changes, an unnecessary component from the Clearing Fund calculation, and would help NSCC to rely on a more appropriate method of measuring its exposures to this risk. Therefore, NSCC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(v) under the Act.[63]

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

NSCC believes that the proposed changes to enhance its risk management of Illiquid Securities could have an impact on competition. Specifically, NSCC believes that the proposed changes could burden competition because they would result in larger Required Fund Deposit amounts for Members when the enhancements result in a haircut-based volatility component that is greater than the amount calculated pursuant to the current methodology. Impact studies indicate that the proposed changes would have resulted in an approximate 2.6% increase on average of NSCC's daily Clearing Fund had the proposed changes been in place over the period from November 2017 to October 2018.

When the proposal results in a larger volatility component, the proposed changes could burden competition for Members that have lower operating margins or higher costs of capital compared to other Members. Impact studies indicate that Members with higher percentages of Illiquid Securities in their portfolio, particularly penny or sub-penny securities, are more likely to be impacted by the proposed changes. However, the increase in Required Fund Deposit would be in direct relation to the specific risks presented by each Members' Net Unsettled Positions, and each Member's Required Fund Deposit would continue to be calculated with the same parameters and at the same confidence level for each Member. Therefore, Members that present similar Net Unsettled Positions, regardless of the type of Member, would have similar impacts on their Required Fund Deposit amounts. As such, NSCC does not believe that any burden on competition imposed by the proposed changes would be significant.

Further, NSCC believes that any burden on competition imposed by the proposed change would be both necessary and appropriate in furtherance of NSCC's efforts to mitigate risks and meet the requirements of the Act, as described in this filing and further below.

NSCC believes that the above described burden on competition that may be created by the proposed changes to margining Illiquid Securities and UITs would be necessary in furtherance of the Act, specifically Section 17A(b)(3)(F) of the Act,[64] because, as described above, the Rules must be designed to assure the safeguarding of securities and funds that are in NSCC's custody or control or which it is responsible.

More specifically, NSCC believes these proposed changes are necessary to support NSCC's compliance with Rules 17Ad–22(e)(4)(i) and Rule 17Ad–22(e)(6)(i) and (v) under the Act,[65] which require NSCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to (x) effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to

[59] *Id.*

[60] 17 CFR 240.17Ad–22(e)(6)(i).

[61] *Id.*

[62] 17 CFR 240.17Ad–22(e)(6)(v).

[63] *Id.*

[64] 15 U.S.C. 78q–1(b)(3)(F).

[65] 17 CFR 240.17Ad–22(e)(4)(i), (e)(6)(i), (e)(6)(v).

each participant fully with a high degree of confidence; (y) cover its credit exposures to its participants 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; and (z) cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.

As described above, NSCC believes implementing the proposed enhancements to its methodology for identifying Illiquid Securities and the calculation of the applicable volatility charge would improve the risk-based methodology that NSCC employs to measure risks related to securities that exhibit illiquid characteristics. The proposed change would introduce additional criteria for defining Illiquid Securities to improve NSCC's methodology for identifying securities that exhibit illiquid characteristics. The proposed change would also enhance the calculation of the applicable volatility component to address the unique risks presented by Members' Net Unsettled Positions in these securities, regardless of Member type, as described above. Therefore, NSCC believes that these proposed changes would better limit NSCC's credit exposures to Members, consistent with the requirements of Rules 17Ad–22(e)(4)(i) and Rule 17Ad–22(e)(6)(i) and (v) under the Act.

NSCC also believes that the above described burden on competition that could be created by the proposed changes would be appropriate in furtherance of the Act because such changes have been appropriately designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible, as described in detail above. The proposal would enable NSCC to produce margin levels more commensurate with the risks and particular attributes of each Member's portfolio. Specifically, the proposal to enhance the methodology for identifying Illiquid Securities and the calculation of the haircut-based volatility component applicable to these securities and UITs would improve the risk-based margining methodology that NSCC employs to set margin requirements and better limit NSCC's credit exposures to its Members. Impact studies indicate that the proposed methodology, by calculating a haircut-based volatility charge that addresses the risks presented by a security's price level or risk profile, would result in backtesting coverage that more appropriately addresses the risk of these securities. Therefore, because the proposed changes are designed to provide NSCC with a more appropriate and complete measure of the risks presented by Members' Net Unsettled Positions, NSCC believes the proposals are appropriately designed to meet its risk management goals and its regulatory obligations.

Therefore, as described above, NSCC believes the proposed changes are necessary and appropriate in furtherance of NSCC's obligations under the Act, specifically Section 17A(b)(3)(F) of the Act[66] and Rules 17Ad–22(e)(4)(i) and Rule 17Ad–22(e)(6)(i) and (e)(6)(v) under the Act.[67]

Because the proposal to eliminate the Illiquid Charge would remove this charge from the margining methodology as applied to all Members, when applicable, NSCC does not believe the proposed change to eliminate the Illiquid Charge would have any impact on competition. NSCC does not believe that the proposed changes in Section I.(A) of Procedure XV relating to securities whose volatility is less amenable to statistical analysis, securities whose volatility is amenable to generally accepted statistical analysis only in a complex manner, or to corporate and municipal bonds and long Net Unsettled Positions in Family-Issued Securities, would have any impact on competition as these changes would just add clarity and transparency to the Rules and not affect Member's rights and obligations.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

NSCC has not received or solicited any written comments relating to this proposal. 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.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

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:

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–NSCC–2020–003 on the subject line.

Paper Comments

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

All submissions should refer to File Number SR–NSCC–2020–003. 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 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 DTCC'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

[66] 15 U.S.C. 78q–1(b)(3)(F).

[67] 17 CFR 240.17Ad–22(e)(4)(i), (e)(6)(i), (e)(6)(v).

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–2020–003 and should be submitted on or before April 21, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[68]

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2020–06617 Filed 3–30–20; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–88472; File No. SR–GEMX–2020–08]

Self-Regulatory Organizations; Nasdaq GEMX, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Options 3, Section 8, Opening

March 25, 2020.

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 March 24, 2020, Nasdaq GEMX, LLC (''GEMX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. 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

The Exchange proposes to amend GEMX Rules at Options 3, Section 8, titled ''Opening.''

The text of the proposed rule change is available on the Exchange's website at *http://nasdaqgemx.cchwallstreet.com/,* at the principal office of the Exchange, 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, the Exchange 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 Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to amend GEMX Rules at Options 3, Section 8, titled ''Opening.'' The Exchange proposes to rename this rule ''Options Opening Process.'' Specifically, the Exchange is proposing to amend the definition of ''market for the underlying security.''

Today Options 3, Section 8(a)(2) describes ''market for the underlying security'' as ''. . . either the primary listing market or the primary volume market (defined as the market with the most liquidity in that underlying security for the previous two calendar months), as determined by the Exchange by underlying and announced to the membership on the Exchange's website.''

The Exchange proposes to amend this definition by replacing the term ''primary volume market'' with ''an alternative market designated by the primary market.'' The Exchange anticipates that an alternative market would be necessary if the primary listing market were impaired.[3] In the event that a primary market is impaired and utilizes its designated alternative market, the Exchange would utilize that market as the underlying.[4] The Exchange further proposes an additional contingency. In the event that the primary market is unable to open, and an alternative market is not designated (and/or the designated alternative market does not open), the Exchange may utilize a non-primary market to open all underlying securities from the primary market. The Exchange will select the non-primary market with the most liquidity in the aggregate for all underlying securities that trade on the primary market for the previous two calendar months, excluding the primary and alternate markets. The Exchange notes that in order to open an option series it would require an equity market's underlying quote. If another equity market displays opening prices for the underlying security, the Exchange proposes to utilize those quotes. This proposed change to the current System would allow the Exchange to open in situations where the primary market is experiencing an issue and also where an alternative market designated by the primary market may not be designated by the primary market or is unable to open. The Exchange believes that this proposal would effectively provide the Exchange with additional opportunities to open the market and provide its members with a venue in which to transact options trading. The Exchange notes that utilizing a non-primary market with the most liquidity in the aggregate for all underlying securities for the previous two calendar months will ensure that the Exchange opens with quotes which are representative of the volume on that primary market. The Exchange believes that this proposal will enable it to open in the event that there are issues with the primary market or the alternate market assigned by the primary.

The Exchange also proposes to make a corresponding amendment to Options 3, Section 8(c)(2) to replace the reference to ''primary market'' with the defined term ''market for the underlying security.''

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[5] in general, and furthers the objectives of Section 6(b)(5) of the Act,[6] in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest by providing for alternative processes to determine the market for the underlying. The Exchange's proposal to amend the definition of ''market for the underlying security'' within Options 3, Section 8(a)(2) is consistent with the Act.

First, the Exchange's proposal would remove the concept of a primary volume market and replace that concept with an alternative market designated by the primary market. The Exchange notes that it is most likely the case that the primary market is the primary volume market, so this term offers no contingency in most cases. The primary market has the ability to designate an alternate primary market when the

[68] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] The Exchange notes that the primary listing market and the primary volume market as defined in GEMX's Rules could be the same market and therefore an alternative market is not available under the current Rule.

[4] For example, in the event that the New York Stock Exchange LLC was unable to open because of an issue with its market and it designated NYSE Arca, Inc. (''NYSE Arca'') as its alternative market, then GEMX would utilize NYSE Arca as the market for the underlying.

[5] 15 U.S.C. 78f(b).

[6] 15 U.S.C. 78f(b)(5).