SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–90181; File No. SR–NSCC–2020–016]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, To Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Risk Charge in the VaR Charge

October 14, 2020.

On July 30, 2020, National Securities Clearing Corporation (''NSCC'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] proposed rule change SR–NSCC–2020–016 to add two new charges to NSCC's margin methodology.[3] On August 13, 2020, NSCC filed Amendment No. 1 to the proposed rule change, to make clarifications and corrections to the proposed rule change.[4] The proposed rule change, as modified by Amendment No. 1, was published for public comment in the **Federal Register** on August 20, 2020.[5] The Commission has received comment letters on the proposed rule change, as modified by Amendment No. 1.[6]

On August 27, 2020, NSCC filed Amendment No. 2 to the proposed rule change to provide additional data for the Commission to consider in analyzing the proposed rule change.[7] The proposed rule change, as modified by Amendment Nos. 1 and 2, is hereinafter referred to as the ''Proposed Rule Change.'' On October 2, 2020, pursuant to Section 19(b)(2) of the Act,[8] the Commission designated a longer period within which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change.[9] The Commission is publishing this notice to solicit comments on Amendment No. 2 from interested persons and, for the reasons discussed below, to approve the Proposed Rule Change on an accelerated basis.

I. Description of the Proposed Rule Change

First, the Proposed Rule Change would revise NSCC's Rules and Procedures (''Rules'') [10] to introduce the Margin Liquidity Adjustment Charge (''MLA Charge'') as an additional margin component. Second, the Proposed Rule Change would revise the Rules to add a bid-ask spread risk charge (''Bid-Ask Spread Charge'') to NSCC's margin calculations.

A. Background

NSCC provides central counterparty (''CCP'') services, including clearing, settlement, risk management, and a guarantee of completion for virtually all broker-to-broker trades involving equity securities, corporate and municipal debt securities, and certain other securities. In its role as a CCP, a key tool that NSCC uses to manage its credit exposure to its members is determining and collecting an appropriate Required Fund Deposit (*i.e.,* margin) for each member.[11] The aggregate of all members' Required Fund Deposits (together with certain other deposits required under the Rules) constitutes NSCC's Clearing Fund, which NSCC would access should a defaulted member's own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that member's portfolio.[12]

Each member's Required Fund Deposit consists of a number of applicable components, which are calculated to address specific risks that the member's portfolio presents to NSCC.[13] Generally, the largest component of a member's Required Fund Deposit is the volatility charge, which is intended to capture the risks related to the movement of market prices associated with the securities in a member's portfolio.[14] NSCC's methodology for calculating the volatility charge of the Required Fund Deposit depends on the type of security. For most securities (*e.g.,* equity securities), NSCC calculates the volatility charge 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 largest non-index position in a portfolio that exceeds a concentration threshold, which addresses concentration risk that the largest non-index position can present within a member's portfolio, and (3) a portfolio margin floor calculation based on the market values of the long and short positions in the portfolio, which addresses risks that might not be adequately addressed with the other volatility charge calculations.[15] For certain other securities (*e.g.,* corporate and municipal bonds), NSCC's Rules apply a haircut-based volatility charge that is calculated by multiplying the absolute value of the positions by a percentage.[16] The volatility charge is designed to calculate the potential losses on a portfolio over a three-day period of risk assumed necessary to liquidate the portfolio, within a 99 percent confidence level.[17]

NSCC states that it regularly assesses market and liquidity risks as such risks relate to its margin methodology to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market.[18] NSCC states

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

[2] 17 CFR 240.19b–4.

[3] NSCC also filed the proposals contained in the proposed rule change as advance notice SR–NSCC–2020–804 with the Commission pursuant to Section 806(e)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (''Clearing Supervision Act''), 12 U.S.C. 5465(e)(1), and Rule 19b–4(n)(1)(i) of the Act, 17 CFR 240.19b–4(n)(1)(i).

[4] Amendment No. 1 made clarifications and corrections to the description of the proposed rule change and Exhibits 3 and 5 of the filing. On August 13, 2020, NSCC filed Amendment No. 1 to the advance notice to make similar clarifications and corrections to the advance notice.

[5] Securities Exchange Act Release No. 89558 (August 14, 2020), 85 FR 51521 (August 20, 2020) (''Notice''). The advance notice, as modified by Amendment No. 1, was published for public comment in the **Federal Register** on September 4, 2020. Securities Exchange Act Release No. 89719 (September 1, 2020), 85 FR 55332 (September 4, 2020) (File No. SR–NSCC–2020–804). The comment period for the advance notice, as modified by Amendment No. 1 closed on September 21, 2020, and the Commission received no comments.

[6] Comments received are *available at https://www.sec.gov/comments/sr-nscc-2020-016/srnscc2020016.htm.*

[7] In Amendment No. 2, NSCC updated Exhibit 3 to the proposed rule change to include impact analysis data with respect to the proposed rule change. NSCC filed Exhibit 3 as a confidential exhibit to the proposed rule change pursuant to 17 CFR 240.24b–2. On August 27, 2020, NSCC filed Amendment No. 2 to the advance notice to provide similar additional data for the Commission's consideration. The advance notice, as amended by Amendment Nos. 1 and 2, is hereinafter referred to as the ''Advance Notice.'' On October 2, 2020, the Commission published notice of filing of Amendment No. 2 and notice of no objection to the Advance Notice. Securities Exchange Act Release No. 90034 (September 28, 2020), 85 FR 62342 (October 2, 2020) (File No. SR–NSCC–2020–804).

[8] 15 U.S.C. 78s(b)(2).

[9] Securities Exchange Act Release No. 90084 (October 2, 2020), 85 FR 63607 (October 8, 2020).

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

[11] *See* Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules (''Procedure XV''), *supra* note 10.

[12] *See id.*

[13] *See id.*

[14] *See id.*

[15] *See id.; see also* Securities Exchange Act Release No. 82780 (February 26, 2018), 83 FR 9035 (March 2, 2018) (File No. SR–NSCC–2017–808); Securities Exchange Act Release No. 82781 (February 26, 2018), 83 FR 9042 (March 2, 2018) (File No. SR–NSCC–2017–020).

[16] *See id.*

[17] *See* Notice, *supra* note 5 at 51522.

[18] *See id.*

that the proposed MLA Charge and Bid-Ask Spread Charge are necessary for NSCC to effectively account for risks associated with certain types and attributes of member portfolios.[19]

B. Margin Liquidity Adjustment Charge

NSCC's current margin methodology does not account for the risk of a potential increase in costs that NSCC could incur when liquidating a defaulted member's portfolio that contains a concentration of large positions, as compared to the overall market, in a particular security or group of securities sharing a similar risk profile.[20] In a member default, liquidating such large positions within a potentially compressed timeframe [21] (*e.g.,* in a fire sale) could have an impact on the underlying market, resulting in price moves that increase NSCC's risk of incurring additional liquidation costs. Therefore, NSCC designed the MLA Charge to address this specific risk.[22]

The MLA Charge would be based on comparing the market value of member portfolio positions in specified asset groups [23] to the available trading volume of those asset groups. If the market value of a member's positions in a certain asset group is large in comparison to the available trading volume of that asset group,[24] then it is more likely that NSCC would have to manage reduced marketability and increased liquidation costs for those positions during a member default scenario. Specifically, NSCC's margin methodology would assume for each asset group that a certain share of the market can be liquidated without price impact.[25] Aggregate positions in an asset group which exceed this share are generally considered as large and would therefore incur application of the MLA Charge to anticipate and address those increased costs.

For each position in a market capitalization subgroup of the equities asset group, NSCC would calculate the market impact cost by multiplying four components: (1) An impact cost coefficient that is a multiple of the one-day market volatility of that subgroup and is designed to measure impact costs, (2) the gross market value of the position in that subgroup, (3) the square root of the gross market value of the position in that subgroup in the portfolio divided by an assumed percentage of the average daily trading volume of that subgroup, and (4) a measurement of the relative weight of the position in that subgroup of the portfolio. With respect to the fourth component, NSCC states that this measurement would include aggregating the weight of each CUSIP in that position relative to the weight of that CUSIP in the subgroup, such that a portfolio with fewer positions in a subgroup would have a higher measure of concentration for that subgroup.[26]

For each position in the municipal bond, corporate bond, Illiquid Securities and UIT asset groups, and for positions in the treasury ETP and other ETP subgroups of the equities asset group, NSCC would calculate the market impact cost by multiplying three components: (1) An impact cost coefficient that is a multiple of the one-day market volatility of that asset group or subgroup, (2) the gross market value of the position in that asset group or subgroup, and (3) the square root of the gross market value of the position in that asset group or subgroup in the portfolio divided by an assumed percentage of the average daily trading volume of that subgroup.[27]

For each asset group or subgroup, NSCC would compare the calculated market impact cost to a portion of the volatility charge that is allocated to positions in that asset group or subgroup.[28] If the ratio of the calculated market impact cost to the applicable one-day volatility charge is greater than a threshold, NSCC would apply an MLA Charge to that asset group or subgroup.[29] If the ratio of these two amounts is equal to or less than this threshold, NSCC would not apply an MLA Charge to that asset group or subgroup. The threshold would be based on an estimate of the market impact cost that is incorporated into the calculation of the applicable one-day volatility charge, such that NSCC would only apply an MLA Charge when the calculated market impact cost exceeds this threshold.

When applicable, an MLA Charge for each asset group or subgroup would be calculated as a proportion of the product of (1) the amount by which the ratio of the calculated market impact cost to the applicable one-day volatility charge exceeds the threshold, and (2) the one-day volatility charge allocated to that asset group or subgroup.

For each portfolio, NSCC would total the MLA Charges for positions in each of the subgroups of the equities asset group to determine an MLA Charge for the positions in the equities asset group. NSCC would then total the MLA Charge for positions in the equities asset group together with each of the MLA Charges for positions in the other asset groups to determine a total MLA Charge for a member.

In certain circumstances, NSCC may be able to partially mitigate the risks that the MLA Charge is designed to address by extending the time period for liquidating a defaulted member's portfolio beyond the three day period. Accordingly, the Proposed Rule Change also describes a method that NSCC would use to reduce a member's total MLA Charge when the volatility charge component of the member's margin increases beyond a specified point. Specifically, NSCC would reduce the member's MLA Charge where the market impact cost of a particular portfolio, calculated as part of determining the MLA Charge, would be large relative to the one-day volatility

[19] *See id.*

[20] *See* Notice, *supra* note 5 at 51522–23.

[21] NSCC's risk models assume the liquidation occurs over a period of three business days. *See* Notice, *supra* note 5 at 51523.

[22] *See id.*

[23] The specified asset groups would include (1) equities (excluding equities defined as Illiquid Securities pursuant to the Rules), (2) Illiquid Securities, (3) unit investment trusts, or UITs, (4) municipal bonds (including municipal bond exchange-traded products, or ''ETPs''), and (5) corporate bonds (including corporate bond ETPs). NSCC would then further segment the equities asset group into the following subgroups: (i) Micro-capitalization equities, (ii) small capitalization equities, (iii) medium capitalization equities, (iv) large capitalization equities, (v) treasury ETPs, and (vi) all other ETPs. *See id.*

[24] NSCC states that it would determine average daily trading volume by reviewing data that is made publicly available by the Securities Industry and Financial Markets Association (''SIFMA''), at *https://www.sifma.org/resources/archive/research/statistics. See id.*

[25] NSCC would establish the particular share for each asset group or subgroup based on empirical research which includes the simulation of asset liquidation over different time horizons. *See* Notice, *supra* note 5 at 51523–25.

[26] NSCC would calculate the relative weight by dividing the absolute market value of a single CUSIP in the member's portfolio by the total absolute market value of that portfolio. *See* Notice, *supra* note 5 at 51523–24.

[27] *See supra* note 24.

[28] For purposes of this calculation, NSCC would use a portion of the applicable volatility charge that is based on a one-day assumed period of risk and calculated by applying a simple square-root of time scaling, referred to in this advance notice as ''one-day volatility charge.'' *See* Notice, *supra* note 5 at 51524. Any changes that NSCC deems appropriate to this assumed period of risk 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''). *See* Securities Exchange Act Release Nos. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File No. SR–NSCC–2017–008); 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR–NSCC–2018–009); 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File No. SR–NSCC–2020–008).

[29] NSCC would set the initial threshold at 0.4, because approximately 40 percent of the one-day volatility charge currently addresses market impact costs. NSCC would review this threshold from time to time and any changes that NSCC deems appropriate would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. *See id.*

charge for that portfolio (*i.e.,* a portion of the three-day assumed margin period of risk). When the ratio of calculated market impact cost to the one-day volatility charge is lower, NSCC would not adjust the MLA Charge. However, as the ratio gets higher, NSCC would reduce the MLA Charge. NSCC designed this reduction mechanism to avoid assessing unnecessarily large MLA Charges.[30]

On a daily basis, NSCC would calculate the final MLA Charge for each member (if applicable), to be included as a component of each member's Required Fund Deposit.

Finally, NSCC would amend the Rules to add the MLA Charge to the list of Clearing Fund components that are excluded from the calculation of the Excess Capital Premium charge.[31] The Excess Capital Premium is imposed on a member when the member's Required Fund Deposit exceeds its excess net capital. NSCC states that including the MLA Charge in the calculation of the Excess Capital Premium could lead to more frequent and unnecessary Excess Capital Premium charges, which is not the intended purpose of the Excess Capital Premium charge and could place an unnecessary burden on members.[32]

C. Bid-Ask Spread Charge

The bid-ask spread refers to the difference between the observed market price that a buyer is willing to pay for a security and the observed market price at which a seller is willing to sell that security. NSCC faces the risk of potential bid-ask spread transaction costs when liquidating the securities in a defaulted member's portfolio. However, NSCC's current margin methodology does not account for this risk of potential bid-ask spread transaction costs to NSCC in connection with liquidating a defaulted member's portfolio. Therefore, NSCC designed the Bid-Ask Spread Charge to address this deficiency in its current margin methodology.

The Bid-Ask Spread Charge would be haircut-based and tailored to different groups of assets that share similar bid-ask spread characteristics. NSCC would assign each asset group a specified bid-ask spread haircut rate (measured in basis points (''bps'')) that would be applied to the gross market value of the portfolio's positions in that particular asset group. NSCC would calculate the product of the gross market value of the portfolio's positions in a particular asset group and the applicable basis point charge to obtain the bid-ask spread risk charge for these positions. NSCC would total the applicable bid-ask spread risk charges for each asset group in a member's portfolio to calculate the member's final Bid-Ask Spread Charge.

NSCC determined the proposed initial haircut rates based on an analysis of bid-ask spread transaction costs using (1) the results of NSCC's annual member default simulation and (2) market data sourced from a third-party data vendor. NSCC's proposed initial haircut rates are listed in the table below:

Asset group	Haircut (bps)
Large and medium capitalization equities	5.0
Small capitalization equities	12.3
Micro-capitalization equities	23.1
ETPs	1.5

NSCC proposes to review the haircut rates annually.[33] Based on analyses of recent years' simulation exercises, NSCC does not anticipate that these haircut rates would change significantly year over year.[34] NSCC may also adjust the haircut rates following its annual model validation review, to the extent the results of that review indicate the current haircut rates are not adequate to address the risk presented by transaction costs from a bid-ask spread.[35]

D. Description of Amendment No. 2

In Amendment No. 2, NSCC updated Exhibit 3 to the Proposed Rule Change to include impact analysis data with respect to the Proposed Rule Change. Specifically, Amendment No. 2 includes impact studies for various time periods detailing the average and maximum MLA and Bid-Ask Charges for each member, by both percentage and amount. NSCC filed Exhibit 3 as a confidential exhibit to the Proposed Rule Change pursuant to 17 CFR 240.24b–2.

II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act[36] directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. After careful consideration, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NSCC. In particular, the Commission finds that the Proposed Rule Change is consistent with Sections 17A(b)(3)(F) and (b)(3)(I)[37] of the Act and Rules 17Ad–22(e)(4) and (e)(6) thereunder.[38]

A. Consistency With Section 17A(b)(3)(F)

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency, such as NSCC, be designed to promote the prompt and accurate clearance and settlement of securities transactions, assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest.[39] The Commission believes that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act.

First, as described above in Section I.A and B, NSCC's current margin methodology does not account for the potential increase in market impact costs that NSCC could incur when liquidating a defaulted member's portfolio where the portfolio contains a concentration of large positions in a particular security or group of securities sharing a similar risk profile. In addition, as described above in Section I.C, NSCC's margin methodology does not account for the risk of potential bid-ask spread transaction costs when liquidating the securities in a defaulted member's portfolio. NSCC proposes to address these risks by adding the MLA Charge and Bid-Ask Spread Charge, respectively, to its margin methodology.[40]

NSCC designed the MLA Charge and Bid-Ask Spread Charge to ensure that NSCC collects margin amounts sufficient to manage NSCC's risk of incurring costs associated with liquidating defaulted member portfolios. Based on its review of the Proposed Rule Change, including confidential

[30] *See* Notice, *supra* note 5 at 51524.

[31] *See* Section I.(B)(2) of Procedure XV, *supra* note 10.

[32] *See* Notice, *supra* note 5 at 51524.

[33] *See* Notice, *supra* note 5 at 51525.

[34] *See id.*

[35] All proposed changes to the haircuts would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. *See supra* note 28.

[36] 15 U.S.C. 78s(b)(2)(C).

[37] 15 U.S.C. 78q-1(b)(3)(F) and (b)(3)(I).

[38] 17 CFR 240.17Ad–22(e)(4) and (e)(6).

[39] 15 U.S.C. 78q-1(b)(3)(F).

[40] The Commission notes that the other clearing agencies it regulates have charges to account for these types of risks in their margin methodologies, and that addressing these types of risks has received a great deal of industry focus in recent years.

Exhibit 3 thereto,[41] the Commission understands that the proposed MLA Charge and Bid-Ask Spread Charge would generally provide NSCC with additional resources to manage potential losses arising out of a member default. As discussed above, NSCC designed the MLA Charge and Bid-Ask Spread Charge, respectively, to reflect two distinct and specific risks presented to NSCC: (1) The risk associated with liquidating a defaulted member's portfolio that holds concentrated positions in securities sharing similar risk profiles; as well as (2) the risks associated with the bid-ask spread costs relevant to the securities in the defaulted member's portfolio. As a result, any margin increases that result from the MLA and the Bid-Ask Spread Charges are limited to address those respective risks. This targeted increase in available financial resources should decrease the likelihood that losses arising out of a member default stemming from the liquidation of concentrated positions or bid-ask spreads would cause NSCC to exhaust its financial resources and threaten the operation of its critical clearance and settlement services. Accordingly, the Commission believes that the Proposed Rule Change should help NSCC to continue providing prompt and accurate clearance and settlement of securities transactions in the event of a member default.

Second, as discussed above, in a member default scenario, NSCC would access its Clearing Fund should the defaulted member's own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that member's portfolio. NSCC proposes to add the MLA Charge and Bid-Ask Spread Charge to its margin methodology to augment its ability to manage the potential costs of liquidating a defaulted member's portfolio by collecting additional margin to cover such costs. This, in turn, could reduce the possibility that NSCC would need to mutualize among the non-defaulting members a loss arising out of the close-out process. Reducing the potential for loss mutualization could, in turn, reduce the potential knock-on effects to non-defaulting members, their customers, and NSCC arising out of a member default. Accordingly, the Commission believes the Proposed Rule Change would promote the safeguarding of securities and funds which are in the custody or control of NSCC or for which NSCC is responsible, consistent with Section 17A(b)(3)(F) of the Act.

One commenter argues that the Proposed Rule Change is not in the public interest and would harm investors and small businesses by dampening small business capital formation and liquidity and discouraging trading activity, as discussed more fully below.[42] The Commission disagrees that the proposal is not in the public interest. The Commission believes that the proposal should help protect investors and the public interest by mitigating some of the risks presented by NSCC as a CCP. Because a defaulting member could place stresses on NSCC with respect to NSCC's ability to meet its clearance and settlement obligations upon which the broader financial system relies, it is important that NSCC has a strong margin methodology to limit NSCC's credit risk exposure in the event of a member default. As described above, the Proposed Rule Change would add two charges specifically designed to address risks that are not currently addressed in NSCC's margin methodology related to: (1) The potential costs that NSCC may incur when liquidating a portfolio that is concentrated in a particular security or group of securities with a similar risk profile, and (2) the potential costs that NSCC may incur to cover the bid-ask spread when liquidating a portfolio. These changes should help ensure that NSCC collects sufficient margin that is more commensurate with the risks associated with the potential concentration and bid-ask spread liquidation costs identified above, and thus more effectively cover its credit exposures to its members. By collecting margin that more accurately reflects the risk characteristics of such portfolios and the bid-ask spreads of securities they contain (*i.e.,* the potential associated costs of liquidating such portfolios), NSCC would be in a better position to absorb and contain the spread of any losses that might arise from a member default. Therefore, the proposal is designed to reduce the possibility that NSCC would need to call for additional resources from non-defaulting members due to a member default, which could inhibit the ability of these non-defaulting members to facilitate securities transactions. Accordingly, the Commission believes that the proposal is designed to protect investors and the public interest by mitigating some of the risks presented by NSCC as a CCP.[43]

One commenter asserts that the proposal dampens capital formation and liquidity and that firms and investors would stop participating in trades because of the proposal.[44] Specifically, the commenter states that broker-dealers would not be able to trade securities issued by small companies because the ''insurance requirement'' would be too high. In addition, the commenter states that investors would be dissuaded from trading in such securities. Overall, the commenter argues that the Proposed Rule Change is inconsistent with the Commission's mission of facilitating capital formation.

First, with respect to the comment regarding liquidity and capital formation, the Commission believes that limiting NSCC's exposure to its members by allowing NSCC to collect margin to address the two risks that are not currently addressed would benefit members due to NSCC's decreased exposure to losses resulting from a member default. Effectively mitigating such risks would, in turn, reduce the likelihood that NSCC would have to call on its members to contribute additional resources, which otherwise could be used by its members to facilitate securities transactions thereby providing liquidity to the securities markets. Thus, the Commission believes that NSCC's proposal, by helping non-defaulting members preserve their financial resources, could promote liquidity provision in such circumstances because these resources would be available to facilitate securities transactions.

Nevertheless, the Commission acknowledges that the proposal could result in an increase in the margin required to be collected from a member, which, in turn, may result in such member incurring additional costs to access needed liquidity. Despite these potential impacts, the Commission is not persuaded that the Proposed Rule Change would have a negative effect on small business capital formation such that it would be inconsistent with the public interest or, more broadly, the Commission's mission. To the extent that members incur funding costs

[41] Specifically, the confidential Exhibit 3 submitted by NSCC includes, among other things, impact studies for various time periods detailing the average and maximum MLA and Bid-Ask Spread Charges for each member, by both percentage and amount, a detailed methodology describing the calculation of the MLA and Bid-Ask Spread Charges, and information regarding how NSCC determined the appropriate methodology.

[42] Letter from James C. Snow, President/CCO, Wilson-Davis & Co., Inc. (received September 30, 2020) at 1 (''Wilson-Davis Letter'').

[43] *See* Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786, 70849 (October 13, 2016) (''While central clearing generally benefits the markets in which it is available, clearing agencies can pose substantial risk to the financial system as a whole, due in part to the fact that central clearing concentrates risk in the clearing agency.'').

[44] Wilson-Davis Letter at 4–5.

associated with additional margin, they may choose to distribute these costs across transactions in all securities for which they make markets rather than allocate those costs only to transactions in securities that require additional margin. Thus, the fact that members have flexibility in how they allocate costs could mitigate negative impacts, if any, on the liquidity and capital formation of a particular subset of issuers.

Both the MLA Charge and the Bid-Ask Spread Charge would apply to all securities cleared and settled at NSCC and would not be directed to any particular group of securities. The MLA Charge would only apply to portfolios where the market value of a member's positions in a certain asset group is large in comparison to the available trading volume of that asset group. Thus, the application of the charge depends on the particular mix of securities within the specified asset groups in a member's portfolio and does not depend solely on the presence of particular types of securities. The Bid-Ask Spread Charge would apply to all the securities in a member's portfolio and would not apply only to a particular type of security. The Commission acknowledges that the haircuts that would determine the Bid-Ask Spread Charge would, in part, consider the nature of the security, with the highest haircut percentages applicable to micro-cap and small-cap securities. However, based on its consideration of NSCC's determination of the haircut schedule, as informed by NSCC's analysis of bid-ask spread transaction costs using (1) the results of NSCC's annual member default simulation, and (2) market data sourced from a third-party data vendor, the Commission believes that the haircut schedule is appropriate given that such securities likely would exhibit larger bid-ask spreads, making the higher haircut more conservative and consistent with NSCC's regulatory requirements to collect margin commensurate with the risks presented by the securities.

Further, the Commission is not persuaded by the commenter's generalized statements on the potential impact on small business capital formation that could result from implementation of the Proposed Rule Change, which are lacking any specific data or analysis in support thereof. The Commission acknowledges the possibility that, as the commenter asserted, issuers of securities in smaller companies may experience a reduction in liquidity because of the increased margin requirements applicable to transactions in such securities. Nevertheless, the Commission believes that small business issuers that are more liquid could benefit from greater access to capital to the extent that the proposal leads to a net increase in demand for more liquid securities and a net decrease in demand for less liquid securities. Further, the Commission does not agree with the commenter that investors would be dissuaded from trading in such securities. The Commission is aware of research suggesting that the stock prices of smaller companies fall in response to a reduction in liquidity until such securities provide an adequate desired return for investors.[45] Thus, as long as stock prices can adjust to reflect the reduced liquidity, affected small issuers may still be able to attract capital from investors, albeit at a higher cost that appropriately reflects the risks inherent in the clearance and settlement of the securities they issue. Moreover, to the extent that investment decisions are driven by other factors, such as the future prospects of specific companies, there might be no decrease in access to capital or little change in cost.

In addition, the commenter's arguments ignore the potential benefits to small businesses when their securities are eligible for central clearing by NSCC. As do other clearing agencies, NSCC provides a number of services that mitigate risk, reduce costs, and enhance processing efficiencies for the securities markets, market participants, issuers (including small issuers), and investors. By reducing NSCC's risk exposure to its members and thus the likelihood of its failure, the proposal helps ensure that NSCC would continue to provide such services, which would benefit securities markets, market participants, issuers (including small issuers), and investors. Thus, the commenter does not take into account any potential positive impacts on small business capital formation that may arise as a result of the Proposed Rule Change.

Second, the Commission is not persuaded that the Proposed Rule Change will not protect investors solely because of the potential for increased costs. The Commission notes that although the proposal may result in an increase in margin requirements for particular portfolios (as a result of the MLA Charge) and to reflect the bid-ask spread (as a result of the Bid-Ask Spread Charge), such an increase is designed to allow NSCC to reduce the risks when liquidating a portfolio in the event of a member default. As a result, NSCC should be more resilient so that it can satisfy its obligations as a CCP, which facilitates the protection of investors by helping to ensure that investors receive the proceeds from their securities transactions. In addition, as discussed earlier, the Commission believes that the proposal should help protect investors and the public interest by mitigating some of the risks presented by NSCC as a CCP.

Therefore, notwithstanding the potential unspecified impact on capital formation in smaller and less liquid markets, as described above, the Commission believes that, in light of the potential benefits to investors arising from the Proposed Rule Change and the overall improved risk management at NSCC, the Proposed Rule Change is designed to protect investors and the public interest, consistent with Section 17A(b)(3)(F) of the Act.

Finally, one commenter asserted that the Proposed Rule Change would add impediments to the national system for clearance and settlement because it would create more complicated algorithms that slow the clearance process, burdens settlement and harms investors, firms and small businesses.[46] Based on the Commission's review of the materials that NSCC has filed in connection with this Proposed Rule Change and its general knowledge of the information technology systems and infrastructure in place at NSCC, the Commission concludes that the Proposed Rule Change would not slow the clearance and settlement process at NSCC. The Proposed Rule Change is designed to enable NSCC to address two risks that are not currently reflected in its margin methodology. The proposal introduces the MLA Charge as an additional margin component, and adds a Bid-Ask Spread Charge to NSCC's margin calculations. The Commission believes that these new margin charges will better enable NSCC to establish a risk-based margin system that (1) considers and produces margin levels commensurate with the risks associated with liquidating member portfolios in a default scenario, including decreased marketability of a portfolio's securities due to large positions in securities sharing similar risk profiles and bid-ask transaction costs, and (2) uses an appropriate method for measuring credit exposure that accounts for such risk factors and portfolio effects.[47] The operation of the risk-based margin

[45] *See, e.g.,* Viral Acharya and Lasse H. Pedersen, 2005, Asset pricing with liquidity risk, *Journal of Financial Economics* 77(2) 375–410.

[46] *Id.* at 1, 5.

[47] *See* Securities Exchange Act Release No. 90034 (September 28, 2020), 85 FR 62342 (October 2, 2020) (File No. SR–NSCC–2020–804).

system, as amended by the proposal, would not interfere with the clearance and settlement of securities transactions. As a result, the proposal should not slow the clearance process, burden settlement or harm investors, firms and small businesses. Instead, the Proposed Rule Change should help ensure that NSCC will continue to perform its vital role to settle transactions on time and at their agreed upon terms in the event of a member default, which will better protect investors, firms, small businesses, and the broader financial system. Moreover, the Commission does not believe that the Proposed Rule Change would impose any additional impediments on the national system of clearance and settlement; the fact that the application of the revised margin methodology may, in some instances, result in increased margin requirements (as discussed in more detail in Section II.B below) does not constitute the imposition of such an impediment.

The commenter also argues that the Proposed Rule Change is an ineffective attempt by NSCC to address its credit risks.[48] The commenter argues that NSCC could address the risk directly by modifying the settlement timeline. According to the commenter, if the NSCC proposed rules that would eliminate the two-day settlement cycle in favor of immediate, same-day electronic settlement, the market risk exposure would be eliminated. The Commission disagrees with the commenter. The securities industry transitioned to the current two-day settlement cycle on September 5, 2017, only after a multi-year, industry-wide initiative[49] and the Commission's amendment of Rule 15c6–1.[50] Therefore, the commenter's suggestion that NSCC could unilaterally shorten the current two-day settlement to a same-day settlement cycle is not a feasible alternative to the Proposed Rule Change.

B. Consistency With Section 17A(b)(3)(I) of the Act

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the Act.[51] This provision does not require the Commission to find that a proposed rule change represents the least anti-competitive means of achieving the goal. Rather, it requires the Commission to balance the competitive considerations against other relevant policy goals of the Act.[52]

Both commenters argue that the Proposed Rule Change would disproportionately impact member firms with lower operating margins or higher costs of capital.[53] The Commission acknowledges that the Proposed Rule Change could entail increased margin charges to some members, including members that invest in concentrated positions in securities sharing a common risk profile and members that invest in securities that have larger bid-ask spreads, which may include microcap and small cap securities. Nevertheless, as discussed above, the Proposed Rule Change would calculate the MLA Charge and Bid-Ask Spread Charge based on the composition of a member's portfolio, regardless of member size or type, and the charges would not target or apply solely to Illiquid Securities or securities with a smaller market capitalization. Instead, as discussed above in Sections I.B and I.C, both the MLA and Bid-Ask Spread Charges would serve to address particular potential costs that NSCC may incur when liquidating a portfolio in a member default. To the extent a particular member's margin would increase under the Proposed Rule Change, that increase would be based on the mix of securities that make up the member's portfolio and NSCC's requirement to collect margin to appropriately address the associated risks, which it currently does not do.

In addition, the Commission acknowledges that the impact of increased margin requirements may present higher costs to some members relative to others due to a number of factors, such as access to liquidity resources, cost of capital, business model, and applicable regulatory requirements. These higher relative burdens may weaken certain members' competitive positions relative to other members. However, some members, particularly those most affected by the change, may respond to increased margin requirements by adjusting their liquidity management and business models, such as by holding less concentrated positions or shifting liquidity provision towards securities that are less likely to incur the proposed charges.[54] Such effects may mitigate competitive effects on members. Moreover, the Commission also notes that NSCC is required to manage the risk presented by each member by establishing a risk-based margin system.[55] NSCC's members include a large and diverse population of entities. By participating in NSCC, each member is subject to the same margin methodology which is designed to satisfy NSCC's regulatory obligation to manage the risk presented by its members.

Moreover, the Commission believes that the Proposed Rule Change would not impose a burden on competition that is not necessary or appropriate in furtherance of the Act. As discussed above, NSCC faces the risk of liquidation costs when a member's portfolio contains large positions in securities sharing similar risk profiles. Similarly, NSCC faces the risk of costs that would materialize in connection with the bid-ask spread of the securities in a member's portfolio. Such costs are currently unaccounted for in NSCC's current margin methodology. NSCC has provided impact analyses demonstrating that the Proposed Rule Change would result in margin levels that better reflect the risks associated with (1) concentrated large positions in securities sharing a similar risk profile, and (2) bid-ask spread transaction costs than NSCC's current margin methodology. Since certain securities and portfolio compositions present NSCC with unique liquidation risks, the Commission believes it is appropriate

[48] Wilson-Davis Letter at 4.

[49] *See* Securities Exchange Act Release No. 78962 (September 28, 2016), 81 FR 69240, 69254 (October 5, 2016) (''Discussion of Current Efforts To Shorten the Settlement Cycle in the U.S.'').

[50] *See* Securities Exchange Act Release No. 80295 (March 22, 2017), 82 FR 15564 (March 29, 2017).

[51] 15 U.S.C. 78q–1(b)(3)(I).

[52] *See* Bradford National Clearing Corp., 590 F.2d 1085, 1105 (D.C. Cir. 1978).

[53] *See* Wilson-Davis Letter at 4–5; Letter from Cass Sanford, Associated General Counsel, OTC Markets Group (September 11, 2020) at 2 (''OTC Letter''). One commenter further states that the Proposed Rule Change would double its required margin, based on an impact study it received from NSCC. (Wilson-Davis Letter at 2.) The commenter states that the impact study covered only one quarter of information and concludes that NSCC is making this decision based solely on that analysis. NSCC responds that the impact study cited in the Wilson-Davis Letter did not include any potential impacts of the Proposed Rule Change because that impact study was provided by NSCC to Wilson-Davis in connection with the separate Illiquid Securities Proposal. NSCC states that it conducted member outreach in August 2020, providing members with, among other things, an impact study on the Proposed Rule Change based on data from the first quarter of 2020. NSCC further states that the data show a total margin increase to NSCC members by an average of 5.3% from the proposed MLA Charge and by an average of 3.6% from the proposed Bid-Ask Spread Charge. *See* Letter from Timothy J. Cuddihy, Managing Director, DTCC Financial Risk Management (October 7, 2020) (''NSCC Letter'') at 2. Additionally, the confidential materials filed by NSCC as part of the Proposed Rule Change include an analysis of the impacts of both charges, by member, over the year-long time period June 2019 through May 2020. Based on the Commission's review of the impact analysis, the Proposed Rule Change would not cause any NSCC member's volatility charge to double.

[54] *See* Section II.A *infra* (discussing capital formation).

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

for NSCC to require members holding such securities or portfolio compositions to provide margin amounts commensurate with the identified risks. Thus, the Commission believes that the MLA Charge and Bid-Ask Spread Charge are margin requirements that represent an appropriate response to the risk characteristics of members' portfolio holdings, and not an undue burden on competition. Accordingly, the Commission believes that the Proposed Rule Change would help NSCC better maintain sufficient financial resources to cover its credit exposures to each member in full with a high degree of confidence. By helping NSCC to better manage its credit exposure, the Proposed Rule Change would help NSCC better mitigate the potential losses to NSCC associated with liquidating a member's portfolio in the event of a member default, in furtherance of NSCC's obligations under Section 17A(b)(3)(F) of the Act.

Additionally, the Commission notes that in order to avoid excessive MLA Charges, NSCC has identified circumstances that would warrant reducing a member's MLA Charge when NSCC could otherwise partially mitigate the relevant risks by extending the time period for liquidating a defaulted member's portfolio beyond the three day period. The Commission views this specific contemplation by NSCC of a targeted reduction in the MLA Charge as a feature of the Proposed Rule Change that demonstrates an approach towards managing the relevant risks through appropriate (*i.e.,* not simply ''larger'') margin requirements.

Therefore, for the reasons stated above, the Commission believes that the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(I) of the Act [56] because any competitive burden imposed by the proposal is necessary or appropriate in furtherance of the Act.

C. Consistency With Rule 17Ad–22(e)(4)(i)

Rule 17Ad–22(e)(4)(i) requires 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.[57]

As described above in Section I.A and B, NSCC's current margin methodology does not account for the risk of a potential increase in market impact costs that NSCC could incur when liquidating a defaulted member's portfolio where the portfolio contains a large position in securities sharing similar risk profiles. Additionally, as described above, NSCC's current margin methodology does not account for the risk of potential bid-ask spread transaction costs when liquidating the securities in a defaulted member's portfolio. NSCC proposes to address such risks by adding the MLA Charge and Bid-Ask Spread Charge to its margin methodology. Adding these margin charges to NSCC's margin methodology should better enable NSCC to collect margin amounts commensurate with the risk attributes of a broader range of its members' portfolios than NSCC's current margin methodology. Specifically, the MLA Charge should better enable NSCC to manage the risk of increased costs to NSCC associated with the decreased marketability of a defaulted member's portfolio where the portfolio contains a large position in securities sharing similar risk profiles. Additionally, since NSCC's current margin methodology does not account for bid-ask spread transaction costs associated with liquidating a defaulted member's portfolio, the Bid-Ask Spread Charge should enable NSCC to manage such risks and costs.

One commenter suggests that the Proposed Rule Change is duplicative of a separate NSCC proposal regarding Illiquid Securities that is currently pending before the Commission.[58] The commenter argues that since both proposals include provisions that would affect margin levels with respect to Illiquid Securities, both proposals appear to address the same concerns. Therefore, the commenter suggests that instead of approving the Proposed Rule Change, the Commission should consolidate NSCC's associated Advance Notice together with the Illiquid Securities Proposal and extend the public comment period before the Commission makes a substantive determination. The Commission disagrees with the commenter. The Proposed Rule Change (and NSCC's associated Advance Notice) and the Illiquid Securities Proposal deal with separate and distinguishable aspects of NSCC's margin methodology, even if there is a group of Illiquid Securities to which both proposals would apply. The Illiquid Securities Proposal is designed to amend the method by which NSCC determines the appropriate volatility component of margin for a particular security, *i.e.,* calculate appropriate margin to cover potential losses on a portfolio using historical, mid-point securities prices. The Proposed Rule Change is designed to address two specific risks that are not captured directly by historical mid-point security price movements that may arise specifically during the liquidation of a member's portfolio in the event of a default: (1) The potential added costs of liquidating large concentrated positions in a limited period of time, and (2) bid-ask spread transactions costs.

Specifically, the Illiquid Securities Proposal seeks to, among other things, more accurately identify securities that exhibit illiquid characteristics for margin purposes and to establish a separate haircut-based method for determining the margin for Illiquid Securities. NSCC's methodology for calculating the volatility component of a member's margin depends on the type of securities in the member's portfolio. As stated above, for most securities (*e.g.,* equity securities), NSCC calculates the volatility component using, among other things, a parametric VaR model, and the volatility component typically constitutes the largest portion of a member's required margin. However, securities with illiquid characteristics generally incur a wider degree of price variability and are less amenable to statistical analysis, and, as such, may merit a more conservative margining approach through a haircut-based method. The proposed haircut-based method is more conservative because it does not allow for inter-asset risk offsetting in the way that the VaR model does.

Accordingly, for certain securities that are less amenable to the statistical analysis provided in the VaR model, including Illiquid Securities, NSCC currently calculates a haircut-based volatility component by multiplying the absolute value of a member's positions in such securities by a certain percentage. NSCC's pending Illiquid Securities Proposal would, among other things, establish a separate haircut-based method for determining the volatility component of the margin for Illiquid Securities. Thus, the Illiquid Securities Proposal would alter the way in which NSCC determines the appropriate margin for Illiquid Securities.

In contrast, the Proposed Rule Change is not designed to define what

[56] 15 U.S.C. 78q–1(b)(3)(I).

[57] 17 CFR 240.17Ad–22(e)(4)(i).

[58] OTC Markets Letter at 1–2 (citing Securities Exchange Act Release No. 88615 (April 9, 2020), 85 FR 21037 (April 15, 2020) (SR–NSCC–2020–802) (''Illiquid Securities Proposal'')).

constitutes an Illiquid Security under NSCC's Rules, and it would not alter the methodology by which NSCC determines the volatility component of the margin for any particular securities, including Illiquid Securities. Instead, with respect to the MLA Charge, the Proposed Rule Change relates to a new margin charge add-on that, if triggered, applies to all securities cleared at NSCC (*i.e.,* not solely to Illiquid Securities), and the proposed add-on is distinct from the underlying margin otherwise collected for all securities (including Illiquid Securities). Rather than addressing the volatility component of margin and the potential losses on a portfolio, as does the Illiquid Securities Proposal, the Proposed Rule Change is designed to address the discrete risks of a default liquidation scenario associated with (1) concentrated large positions in any type of security or group of securities sharing a similar risk profile, and (2) bid-ask spread transaction costs that are currently unaccounted for in NSCC's margin methodology. Moreover, the MLA Charge would not automatically be applied based on the security or type of security that is held; instead, it would only apply to concentrated positions that could be difficult to liquidate in a limited time in the event of a default. Because the Proposed Rule Change and the Illiquid Securities Proposal address wholly separate and distinct aspects of NSCC's margin methodology, the Commission disagrees with the commenter that the two proposals should be consolidated or otherwise disposed of together.

The Commission believes that adding the MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology should enable NSCC to more effectively identify, measure, monitor, and manage its credit exposures in connection with liquidating a defaulted member's portfolio that may give rise to (1) decreased marketability due to large positions of securities sharing similar risk profiles, and (2) bid-ask spread transaction costs. Accordingly, the Commission believes that adding the MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology would be consistent with Rule 17Ad–22(e)(4)(i) because these new margin charges should better enable NSCC to maintain sufficient financial resources to cover NSCC's credit exposure to its members fully with a high degree of confidence.[59]

D. Consistency With Rules 17Ad–22(e)(6)

Rule 17Ad–22(e)(6)(i) requires 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.[60] Rule 17Ad–22(e)(6)(v) requires 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.[61]

As described above in Section I.A and B, NSCC's current margin methodology does not account for the potential increase in market impact costs when liquidating a defaulted member's portfolio where the portfolio contains a large position in securities sharing similar risk profiles. NSCC proposes to address this risk by adding the MLA Charge to its margin methodologies. To avoid excessive MLA Charges and ensure margin requirements are commensurate with the relevant risks, NSCC also contemplates reducing a member's MLA Charge when NSCC could otherwise partially mitigate the relevant risks by extending the time period for liquidating a defaulted member's portfolio beyond the three day period.

Additionally, as described above in Section I.C, NSCC's current margin methodology does not account for the risk of incurring bid-ask spread transaction costs when liquidating the securities in a defaulted member's portfolio. NSCC proposes to address this risk by adding the Bid-Ask Spread Charge to its margin methodology. Adding the MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology should better enable NSCC to collect margin amounts commensurate with the risk attributes of its members' portfolios than NSCC's current margin methodology. Specifically, the MLA Charge should better enable NSCC to manage the risk of increased costs to NSCC associated with the decreased marketability of a defaulted member's portfolio where the portfolio contains a large position in securities sharing similar risk profiles. Moreover, the proposal to reduce the MLA Charge when NSCC could otherwise partially mitigate the relevant risks demonstrates how the proposal provides an appropriate method for measuring credit exposure, in that it seeks to take into account the particular circumstances related to a particular portfolio when determining the MLA Charge. Additionally, since NSCC's current margin methodology does not account for bid-ask spread transaction costs associated with liquidating a defaulted member's portfolio, the Bid-Ask Spread Charge should enable NSCC to manage such risks.

Accordingly, the Commission believes that adding the MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology would be consistent with Rules 17Ad–22(e)(6)(i) and (v) because these new margin charges should better enable NSCC to establish a risk-based margin system that (1) considers and produces relevant margin levels commensurate with the risks associated with liquidating member portfolios in a default scenario, including decreased marketability of a portfolio's securities due to large positions in securities sharing similar risk profiles and bid-ask transaction costs, and (2) uses an appropriate method for measuring credit exposure that accounts for such risk factors and portfolio effects.[62]

One commenter argues that the Proposed Rule Change would burden members with margin requirements that are not commensurate with NSCC's actual risks, as evidenced by the lack of recent settlement losses, and instead are designed to mitigate imaginary risks.[63] In addition, the commenter argues that NSCC has not provided evidence of the need for the Proposed Rule Change, again citing the lack of recent settlement losses. However, as discussed above, the Commission believes that the proposed changes to NSCC's margin methodology would enable it to collect margin appropriately tailored to two particular risks that are not currently addressed in the existing margin methodology. The Commission does not agree that the fact that NSCC has not suffered recent settlement losses obviates the need for the Proposed Rule Change. Rule 17Ad–22(e)(6)(iii) requires 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, calculates margin

[59] *Id.*

[60] 17 CFR 240.17Ad–22(e)(6)(i).

[61] 17 CFR 240.17Ad–22(e)(6)(v).

[62] 17 CFR 240.17Ad–22(e)(6)(i) and (v).

[63] Wilson-Davis Letter at 3, 5.

sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default.[64] Potential future exposure is, in turn, defined as the maximum exposure estimated to occur at a future point in time with an established single-tailed confidence level of at least 99 percent with respect to the estimated distribution of future exposure.[65] Thus, to be consistent with its regulatory requirements, NSCC must consider potential future exposure, which includes, among other things, losses associated with the liquidation of a defaulted member's portfolio. Based on its review and analysis of the Proposed Rule Change, including the confidential impact analyses demonstrating the overall effects that the proposed changes would have on the overall margin collected by NSCC and the confidential margin methodology (*i.e.,* the specific details of how NSCC would calculate its margin requirements under the proposed changes), in conjunction with the Commission's supervisory observations, the Commission believes that the proposed changes would better enable NSCC to collect margin commensurate with the different levels of risk that members pose to NSCC as a result of their particular portfolio, which is consistent with Rule 17Ad–22(e)(6)(i), and to calculate margin sufficient to cover its potential future exposure to its participants, which is consistent with Rule 17Ad–22(e)(6)(iii).

E. Consistency With Rules 17Ad–22(e)(23)(ii)

Rule 17Ad–22(e)(23)(ii)[66] requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency.

Both commenters argue that the Proposed Rule Change fails to provide sufficient information to evaluate the necessity and impact of the proposal.[67] Specifically, one commenter argues that the proposal provides no explanation as to why NSCC's current margin formula is inadequate or how the proposed methodology would limit NSCC's exposure in the event of a member default.[68] Another commenter stated that the Proposed Rule Change does not comply with Rule 17Ad–22(e)(23)(ii), asserting that NSCC has not performed the ''requisite analysis'' or gathered sufficient data to fully understand the impact of the proposal.[69]

The Commission disagrees with the commenters that the Proposed Rule Change does not provide sufficient information to understand the potential costs associated with participating in NSCC, based on the materials reflected in the Proposed Rule Change.[70] When considering the issues raised in the Proposed Rule Change, the Commission thoroughly reviewed (1) the Proposed Rule Change, including the supporting exhibits that provided, among other things, confidential impact analyses regarding the proposals in the Proposed Rule Change; (2) the comment letters; and (3) the Commission's own understanding of NSCC's margin methodology, with which the Commission has experience from its general supervision of NSCC. Based on its review of these materials, the Commission believes that, as described in the Notice, NSCC has done exactly what the commenters seek, in that the proposal explains why the current methodology is inadequate (*i.e.,* it does not address these particular risks), and how the proposed methodology would address this issue (*i.e.,* by including add-on charges designed to address these particular risks). As described in the Notice and noted above, NSCC's current margin methodology neither accounts for the risk of a potential increase in market impact costs that NSCC could incur when liquidating a defaulted member's portfolio that contains a concentration of large positions, as compared to the overall market, nor does NSCC's current margin methodology account for this risk of potential bid-ask spread transaction costs in connection with liquidating a defaulted member's portfolio. The Proposed Rule Change is designed to address these specific risks and limit NSCC's exposure in the event of a member default.

The Proposed Rule Change describes how NSCC would determine the MLA and Bid-Ask Spread Charges. For both charges, the Proposed Rule Change identifies the relevant asset groupings that NSCC would utilize. For the MLA Charge, NSCC has described how the charge would depend on whether a member holds large aggregate positions in an asset group. Thus, a member should be able to consider whether its positions would likely trigger the MLA Charge in light of the relevant holdings in its portfolio. For the Bid-Ask Spread Charge, NSCC has identified that the charge would be determined by application of a haircut and provided a schedule of the applicable haircuts. Thus, a member should be able to understand what the charge would be for a particular security. In addition, NSCC represented that in August 2020, NSCC provided all its Members with the results of an impact study regarding the potential impacts of both the Illiquid Securities Proposal and the MLA Proposal and clearly delineated between the impacts of these separate

[64] 17 CFR 240.17Ad–22(e)(6)(iii).

[65] 17 CFR 240.17Ad–22(a)(13).

[66] 17 CFR 240.17Ad–22(e)(23)(ii).

[67] *See* OTC Letter at 2; Wilson-Davis Letter at 1, 4–5.

[68] *See* OTC Letter at 2.

[69] *See* Wilson-Davis Letter at 2–3. Contrary to the commenter's implication, Rule 17Ad–22(e)(23) does not prescribe any specific data or analysis that a covered clearing agency, like NSCC, must perform when making changes to its margin methodology. Moreover, as discussed above in note 41, NSCC has provided confidential impact analyses covering a one-year time period to demonstrate the potential impact of the Proposed Rule Change on its members.

In addition, the commenter references Rule 17Ad–22(e)(23)(iii), which requires a covered clearing agency, like NSCC, to establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide basic transaction volume and values. *See* Wilson-Davis Letter at 2. However, the information described by the commenter would not constitute basic data on transaction volumes and values, as required by the rule, and instead would appear to refer to more detailed analysis of the impacts of particular margin methodologies. Moreover, NSCC publicly provides data on transaction volumes and values in its quantitative disclosures, which are available at *https://www.dtcc.com/legal/policy-and-compliance.*

[70] One commenter argues that the proposal is generally unclear, overly technical and complicated, inappropriately relies on information provided by NSCC to the Commission confidentially, and thus prevents the public from fully evaluating and providing meaningful comment on the proposal. As stated above, the Commission believes that the proposal adequately explains why the current methodology is inadequate (*i.e.,* it does not address certain specific risks), and how the proposed methodology would address this issue (*i.e.,* via the MLA Charge and Bid-Ask Spread Charge). Additionally, the Commission does not believe that the Proposed Rule Change is overly technical and complicated. The process of measuring the risks involved with various member portfolio compositions to determine appropriate margin levels is technical, complex, and does not distill into a simple formula. Instead, the process often must utilize sophisticated risk models and calculations. NSCC has described the methodology that it would use to determine the margin to address these specific risks with sufficient specificity to allow a member to understand the types of portfolios that would be subject to an additional MLA Charge and to understand the haircuts that would apply to determine the Bid-Ask Spread Charge.

Moreover, the Commission believes that NSCC appropriately submitted Exhibit 3 to the filing confidentially because it includes detailed member-level margin data and other proprietary information. Under its Rules, NSCC is not permitted to disclose member-level information. *See* Rule 49 of the Rules, supra note 10. NSCC requested confidential treatment of such materials and its underlying detailed methodology documentation, consistent with the applicable regulatory requirements. *See* 17 CFR 240.24b–2.

proposals.[71] NSCC also included a written summary of the MLA Proposal and offered to schedule a call to discuss these proposals and their potential impacts.[72] Moreover, NSCC has provided impact analyses demonstrating that the Proposed Rule Change would result in margin levels that better reflect the risks associated with (1) concentrated large positions in securities sharing a similar risk profile, and (2) bid-ask spread transaction costs than NSCC's current margin methodology. Accordingly, the Commission believes that NSCC has demonstrated the operation and impact of the Proposed Rule Change, *i.e.,* that it would help NSCC better maintain sufficient financial resources to cover its credit exposures to each member in full with a high degree of confidence.

Moreover, to provide transparency and assist members in understanding their margin requirements, NSCC maintains the NSCC Risk Management Reporting application on the Participant Browser Service (''PBS'') and the NSCC Risk Client Portal (''Portal''), which will include this Proposed Rule Change once it is implemented.[73] The PBS is a member-accessible website portal for accessing reports and other disclosures. The Risk Management Reporting application enables a member to view and download margin requirement information and component details, including issue-level margin information related to start of day volatility charges and mark-to-market, intraday exposure, and other components. Members are able to view and download spreadsheets that contain market amounts for current clearing positions and the associated volatility charges. In addition, NSCC represents that the Portal provides members the ability, for information purposes, to view and analyze certain risks relating to their portfolios, including calculators to assess the risks and margin impacts of certain activities and to compare their portfolios to historical and average values.

NSCC further maintains the NSCC Client Calculator on the Portal that provides functionality for members to enter ''what-if'' position data and to recalculate their volatility charges to determine margin impact pre-trade. In other words, this calculator allows members to see the impact to the volatility charge if specific transactions are executed, or to anticipate the impact of an increase or decrease to a current clearing position. Using this calculator, members have the ability to download the Client Calculator portfolio detail to modify a current margin portfolio, upload the portfolio to run a margin calculation, and view position level outputs in order to make informed risk management and execution decisions.

Taken together, these tools should allow members to understand how these charges would affect their portfolios. Accordingly, notwithstanding the comments, the Commission believes that the Proposed Rule Change is not inconsistent with Rule 17Ad–22(e)(23)(ii).[74]

[71] NSCC Letter at 2.

[72] *Id.* More generally, NSCC stated that it routinely reaches out to members that may be impacted by its proposals. This outreach includes impact study results and an offer to discuss those results and the underlying proposal. *Id.*

[73] *See* Letter from Timothy J. Cuddihy, Managing Director DTCC Financial Risk Management, submitted in response to comments on the Illiquid Securities Proposal, available at, *https://www.sec.gov/comments/sr-nscc-2020-802/srnscc2020802.htm.*

[74] 17 CFR 240.17Ad–22(e)(23)(ii).

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning whether Amendment No. 2 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–2020–016 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–2020–016. 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 such filings will also be available for inspection and copying at the principal office of NSCC and NSCC's website at *https://www.dtcc.com/legal.*

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NSCC–2020–016 and should be submitted on or before November 10, 2020.

IV. Accelerated Approval of the Proposed Rule Change, as Modified by Amendment No. 2

The Commission finds good cause, pursuant to Section 19(b)(2)(C)(iii) of the Act,[75] to approve the Proposed Rule Change, as modified by Amendment Nos. 1 and 2, prior to the thirtieth day after the date of publication of Amendment No. 2 in the **Federal Register**. As noted above, in Amendment No. 2, NSCC updated the confidential Exhibit 3 to the Proposed Rule Change to include impact analysis data with respect to the Proposed Rule Change. Specifically, Amendment No. 2 includes impact studies for various time periods detailing the average and maximum MLA and Bid-Ask Charges for each member, by both percentage and amount. The Commission believes that the member-level data in Amendment No. 2 warrants confidential treatment. Amendment No. 2 neither modifies the Proposed Rule Change as originally published in any substantive manner, nor does Amendment No. 2 affect any rights or obligations of NSCC or its members. Instead, Amendment No. 2 provides the Commission with information necessary to evaluate whether the Proposed Rule Change is consistent with the Act. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2)(C)(iii) of the Act,[76] to approve the Proposed Rule Change, as modified by Amendment Nos. 1 and 2, prior to the thirtieth day after the date of publication of notice of Amendment No. 2 in the **Federal Register**.

V. Conclusion

On the basis of the foregoing, the Commission finds that the Proposed Rule Change, as modified by

[75] 15 U.S.C. 78s(b)(2)(C)(iii).

[76] *Id.*

Amendment Nos. 1 and 2, is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act [77] and the rules and regulations promulgated thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act [78] that Proposed Rule Change SR–NSCC–2020–016, as modified by Amendment Nos. 1 and 2, be, and hereby is, *approved* on an accelerated basis.[79]

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[80]

J. Matthew DeLesDernier,

Assistant Secretary.

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[77] 15 U.S.C. 78q–1.

[78] 15 U.S.C. 78s(b)(2).

[79] In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f). *See also* supra note 43 and accompanying text.

[80] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–90186; File No. SR–PEARL–2020–19]

Self-Regulatory Organizations; MIAX PEARL, LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend the MIAX PEARL Equities Fee Schedule To Adopt Connectivity Fees, Port Fees, a Technical Support Request Fee, and Historical Market Data Fee

October 14, 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 October 5, 2020, MIAX PEARL, LLC (''MIAX PEARL'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') a proposed rule change as described in Items I, II, and III 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 is filing a proposal to amend the MIAX PEARL Equities Fee Schedule (the ''Fee Schedule'') by adopting fees applicable to participants trading equity securities on and/or using services provided by MIAX PEARL Equities.[3] The proposed fees are scheduled to become operative September 25, 2020.

The text of the proposed rule change is available on the Exchange's website at *http://www.miaxoptions.com/rule-filings/pearl* at MIAX PEARL's principal office, and at the Commission's Public Reference Room.

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

[2] 17 CFR 240.19b–4.

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

On August 14, 2020, the Commission approved the Exchange's proposal to adopt rules governing the trading of equity securities, referred to as MIAX PEARL Equities.[4] The Exchange expects to launch MIAX PEARL Equities on September 25, 2020. The Exchange now proposes to adopt a Definitions section in the Fee Schedule as well as the following fees in anticipation of the launch of MIAX PEARL Equities: (1) Connectivity fees for Equity Members [5] and non-Members; (2) Port fees (together with the proposed connectivity fees, the ''Proposed Access Fees''); (3) a Technical Support Request fee; and (4) a fee for Historical Market Data (collectively, the ''Proposed Fees'').[6]

[3] *See* Exchange Rule 1901. The Exchange notes that it submitted a separate filing with the Commission pursuant to Section 19(b)(3)(A) of the Act to establish the Fee Schedule and adopt transaction fees. *See* SR–PEARL–2020–17 (filed September 24, 2020).

[4] *See* Securities Exchange Act Release No. 89563 (August 14, 2020), 85 FR 51510 (August 20, 2020) (SR–PEARL–2020–03) (Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, To Establish Rules Governing the Trading of Equity Securities) (''Approval Order'').

[5] The term ''Equity Member'' means a Member authorized by the Exchange to transact business on MIAX PEARL Equities. *See* Exchange Rule 1901.

[6] The Exchange initially filed the proposed fee changes on September 24, 2020 (SR–PEARL–2020–18). On October 5, 2020, the Exchange withdrew that filing and submitted this filing.

MIAX PEARL Equities, as a new entrant into the equity securities marketplace, has no revenues and no market share. The Exchange believes that exchanges, in setting fees of all types, should meet very high standards of transparency to demonstrate why each new fee or fee increase meets the requirements of the Act that fees be reasonable, equitably allocated, not unfairly discriminatory, and not create an undue burden on competition among members and markets. The Exchange believes this high standard is especially important when an exchange imposes various access fees for market participants to access an exchange's marketplace. The Exchange believes that it is important to demonstrate that these fees are based on its costs and reasonable business needs. Accordingly, the Exchange believes the Proposed Fees in general, and the Proposed Access Fees in particular, will allow the Exchange to offset a portion of the expenses the Exchange has and will incur and that the Exchange has provided sufficient transparency (as described below) into how the Exchange determined to charge such fees.

Definitions

The Exchange proposes to include a Definitions section at the beginning of the Fee Schedule, before the General Notes section. The purpose of the Definitions section is to provide market participants greater clarity and transparency regarding the applicability of fees and rebates by defining terms used within the Fee Schedule in a single location. The Exchange notes that other equities exchanges include Definitions sections in their respective fee schedules,[7] and the Exchange believes that including a Definitions section in the front of the Fee Schedule makes the Fee Schedule more user-friendly and makes the Fee Schedule more comprehensive.

Unless included in the Definition section, capitalized terms used in the Fee Schedule are defined in the MIAX PEARL Equities Rules. Each of the definitions proposed to be included in the Fee Schedule are based on definitions included in the existing MIAX PEARL fee schedule applicable to options or those of another exchange. The Exchange proposes to define the following terms in the Fee Schedule:

- ''Cross-connect'' occurs when the affected third-party system is sited at the same data center where MIAX

[7] *See* Cboe BZX Exchange, Inc. Fee Schedule, Definitions section; Cboe BYX Exchange, Inc., Definitions section; Cboe EDGA Exchange, Inc., Definitions section; Cboe EDGX Exchange, Inc., Definitions section.