

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-89145; File No. SR-NSCC-2020-003)

June 24, 2020

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a 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

I. Introduction

On March 16, 2020, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-NSCC-2020-003 ("Proposed Rule Change") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The Proposed Rule Change was published for comment in the Federal Register on March 31, 2020.<sup>3</sup> The Commission has received comment letters on the Proposed Rule Change.<sup>4</sup> On May

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 88474 (March 25, 2020), 85 Fed. Reg. 17910 (March 31, 2020) (SR-NSCC-2020-003) ("Notice"). NSCC also filed the proposal contained in the Proposed Rule Change as advance notice SR-FICC-2020-802 ("Advance Notice") 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); 17 CFR 240.19b-4(n)(1)(i). Notice of filing of the Advance Notice was published for comment in the Federal Register on April 15, 2020. Securities Exchange Act Release No. 88615 (April 9, 2020), 85 Fed. Reg. 21037 (April 15, 2020) (SR-NSCC-2020-802). The proposal contained in the Proposed Rule Change and the Advance Notice shall not take effect until all regulatory actions required with respect to the proposal are completed.

<sup>4</sup> Letter from Christopher R. Doubek, CEO, Alpine Securities Corporation (April 21, 2020); Letter from John Busacca, Founder, Securities Industry Professional

21, 2020, pursuant to Section 19(b)(2) of the Act,<sup>5</sup> 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.<sup>6</sup> This order institutes proceedings, pursuant to Section 19(b)(2)(B) of the Act,<sup>7</sup> to determine whether to approve or disapprove the Proposed Rule Change.

## II. Summary of the Proposed Rule Change

As described in the Notice,<sup>8</sup> NSCC proposes to (1) revise the definition of Illiquid Security, (2) apply a haircut-based volatility charge specifically applicable to Illiquid Securities and unit investment trusts (“UITs”), (3) eliminate the current Illiquid Charge, and (4) make other confirming changes.

### A. Proposed Definition of Illiquid Security

NSCC’s proposed definition of an Illiquid Security includes three categories of securities. The first category of the proposed definition of an Illiquid Security would include any security that is not listed on a specified securities exchange. For purposes of

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Association (April 23, 2020); Letter from Charles F. Lek, Lek Securities Corporation (April 30, 2020); Letter from James C. Snow, President/CCO, Wilson-Davis & Co., Inc., all available at <https://www.sec.gov/comments/sr-nsc-2020-003/srnsc2020003.htm>.

<sup>5</sup> 15 U.S.C. 78s(b)(2).

<sup>6</sup> Securities Exchange Act Release No. 88885 (May 15, 2020), 85 Fed. Reg. 31007 (May 21, 2020) (SR-NSCC-2020-003).

<sup>7</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>8</sup> The description of the Proposed Rule Change is based on the statements prepared by NSCC in the Notice. See Notice, *supra* note 3. Capitalized terms used herein and not otherwise defined herein are defined in NSCC’s Rules & Procedures, available at [www.dtcc.com/~media/Files/Downloads/legal/rules/nsc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf).

this definition, NSCC’s Rules would define a “specified securities exchange” as a national securities exchange that has established listing services and is covered by industry pricing and data vendors. The second category of the proposed definition of an Illiquid Security would include any security that (1) is listed on a specified securities exchange, (2) either (i) has a market capitalization that is considered by NSCC to be a micro-capitalization as of the last business day or the prior month, or (ii) is an American depositary receipt, and (3) the median of its calculated illiquidity ratio of the prior six months exceeds certain threshold that would be determined by NSCC pursuant to certain criteria. The third category of the proposed definition of an Illiquid Security would include any security that is listed on a specified securities exchange and, as determined by NSCC on a monthly basis, has fewer than 31 business days of trading history over the past 153 business days on such exchange.

B. Proposed Haircut-Based Volatility Charge Specifically Applicable to Illiquid Securities and UITs

First, NSCC proposes to expressly exclude Illiquid Securities from calculating the volatility component of a Required Fund Deposit using a parametric Value at Risk (“VaR”) model and instead apply a haircut-based volatility charge specifically to Illiquid Securities. To determine the appropriate volatility charge, NSCC would group Illiquid Securities by price level. The haircut percentage applicable to each group of Illiquid Securities would be determined at least annually. The haircut percentage would be the highest of the following percentages: (1) 10%, (2) a percent benchmarked to be sufficient to cover the 99.5th percentile of the historical 3-day return of each group of Illiquid Securities in each Member’s portfolio, and (3) a percent benchmarked to be sufficient to cover the 99th percentile of the historical 3-day return of each group in each Member’s

portfolio after incorporating a fixed transaction cost equal to one-half of the estimated bid-ask spread. The look-back period for purposes of calibrating the applicable percentage would be no less than five years.

Second, NSCC proposes to expressly exclude UITs from calculating the volatility component of the Required Fund Deposit using a VaR model, and instead apply a haircut-based volatility charge specifically applicable to UITs. NSCC would review the haircut percentage used in this calculation at least annually. The haircut percentage applicable to UITs would be the highest of (1) 2%, and (2) the 99.5th percentile of the historical 3-day returns for the group of UITs within each Member's portfolio using a look-back period of no less than 5 years.

C. Proposed Elimination of the Illiquid Charge

NSCC proposes to eliminate the existing Illiquid Charge (and the corresponding definition of Illiquid Position), which may be imposed as an additional charge in the volatility component of a Required Fund Deposit that is applied to Illiquid Securities as securities that are less amenable to statistical analysis.

D. Proposed Conforming Changes

NSCC proposes to make two conforming changes to harmonize the Rules in light of the proposed amendments discussed above. First, the proposal would exclude municipal and corporate bonds that are less amenable to statistical analysis or amenable to statistical analysis only in a complex manner from the VaR Charge. Second, NSCC proposes to revise the Rules to clarify its current practice (i.e., that only long positions in Family-Issued Securities are excluded from the VaR Charge), and that short positions in

Family-Issued Securities would be subject to the haircut-based volatility charge because they would meet the proposed definition of Illiquid Securities.

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

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>9</sup> to determine whether the Proposed Rule Change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the Proposed Rule Change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the Proposed Rule Change, and provide the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>10</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the Proposed Rule Change's consistency with Section 17A of the Act,<sup>11</sup> and the rules thereunder, including the following provisions:

- Section 17A(b)(3)(F) of the Act,<sup>12</sup> which requires, among other things, that the

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<sup>9</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>10</sup> Id.

<sup>11</sup> 15 U.S.C. 78q-1.

<sup>12</sup> 15 U.S.C. 78q-1(b)(3)(F).

rules of a clearing agency must be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible and to protect investors and the public interest; and

- Rule 17Ad-22(e)(4)(i) under the Act,<sup>13</sup> which requires a covered clearing agency 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.
- Rule 17Ad-22(e)(23)(ii) under the Act,<sup>14</sup> which requires a covered clearing agency 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.

#### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the Proposed Rule Change. In particular, the Commission invites the written views of interested persons concerning whether the

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<sup>13</sup> 17 CFR 240.17Ad-22(e)(4)(i).

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

Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act,<sup>15</sup> Rule 17Ad-22(e)(4)(i) under the Act,<sup>16</sup> Rule 17Ad-22(e)(23)(ii) under the Act,<sup>17</sup> or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4(g) under the Act,<sup>18</sup> any request for an opportunity to make an oral presentation.<sup>19</sup>

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

The Commission asks that commenters address the sufficiency of NSCC's statements in support of the Proposed Rule Change, which are set forth in the Notice,<sup>20</sup> in

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

<sup>16</sup> 17 CFR 240.17Ad-22(e)(4)(i).

<sup>17</sup> 17 CFR 240.17Ad-23(e)(23)(ii).

<sup>18</sup> 17 CFR 240.19b-4(g).

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

<sup>20</sup> See Notice, supra note 3.

addition to any other comments they may wish to submit about the Proposed Rule Change.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto: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 20549-1090.

All submissions should refer to File Number SR-NSCC-2020-003. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Proposed Rule Change that are filed with the Commission, and all written communications relating to the Proposed Rule Change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the



principal office of NSCC and on 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 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 [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>21</sup> 17 CFR 200.30-3(a)(31).