

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-97171; File No. SR-NSCC-2022-015)

March 20, 2023

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Make Certain Enhancements to the Gap Risk Measure and the VaR Charge

I. Introduction

On December 2, 2022, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NSCC-2022-015 (the “Proposed Rule Change”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The Proposed Rule Change was published for comment in the Federal Register on December 21, 2022,³ and the Commission has received one comment regarding the changes proposed in the Proposed Rule Change.⁴

On January 24, 2023, pursuant to Section 19(b)(2) of the Act,⁵ 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.⁶ This order

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 96511 (Dec. 15, 2022), 87 FR 78157 (Dec. 21, 2022) (File No. SR-NSCC-2022-015) (“Notice of Filing”).

⁴ Comments are available at <https://www.sec.gov/comments/sr-nsc-2022-015/srnsc2022015.htm>.

⁵ 15 U.S.C. 78s(b)(2).

⁶ Securities Exchange Act Release No. 96740 (Jan. 24, 2023), 88 FR 5953 (Jan. 30, 2023) (SR-NSCC-2022-015).

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

II. Summary of the Proposed Rule Change

A key tool that NSCC uses to manage its respective credit exposures to its members is the daily collection of margin from each member, which is referred to as each member's Required Fund Deposit.⁸ The aggregated amount of all members' margin constitutes the Clearing Fund, which NSCC would access should a defaulted member's own margin be insufficient to satisfy losses to NSCC caused by the liquidation of that member's portfolio.

Each member's margin consists of a number of applicable components, each of which is calculated to address specific risks faced by NSCC.⁹ Generally, the largest portion of a member's margin is the volatility component, often referred to as the VaR Charge, which is designed to reflect the amount of money that could be lost on a portfolio over a given period within a 99th percentile level of confidence. Under NSCC's current rules, one of the potential methods of calculating the VaR Charge relies on a measure of gap risk.¹⁰ It does not accrue for all portfolios, but instead only serves as the VaR Charge

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ 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 the Rules, available at https://www.dtcc.com/-/media/Files/Downloads/legal/rules/nscc_rules.pdf.

⁹ See Procedure XV of the Rules, supra note 8.

¹⁰ Gap risk events have been generally understood as idiosyncratic issuer events (for example, earning reports, management changes, merger announcements, insolvency, or other unexpected, issuer-specific events) that cause a rapid shift in price volatility levels.

if it is the largest of three potential calculations.¹¹ The gap risk charge was designed to address the risk presented by a portfolio that is more susceptible to the effects of gap risk events, i.e., those portfolios holding positions that represent more than a certain percent of the entire portfolio's value, such that the event could impact the entire portfolio's value.¹²

To calculate the gap risk charge, NSCC multiplies the gross market value of the largest non-index net unsettled position in the portfolio by a gap risk haircut, which can be no less than 10 percent ("gap risk haircut").¹³ Currently, NSCC determines the gap risk haircut empirically as no less than the larger of the 1st and 99th percentiles of three-day returns of a set of CUSIPs that are subject to the VaR Charge pursuant to the Rules, giving equal rank to each to determine which has the highest movement over that three-day period. NSCC uses a look-back period of not less than ten years plus a one-year stress period, and if the one-year stress period overlaps with the look-back period, only the non-overlapping period would be combined with the look-back period. The resulting haircut is then rounded up to the nearest whole percentage and applied to the largest non-index net unsettled position to determine the gap risk charge.

¹¹ Specifically, the VaR Charge is the greatest of (1) the larger of two separate calculations based on different underlying estimates that utilize a parametric VaR model, which addresses the market risk of a member's portfolio (referred to as the core parametric estimation), (2) the gap risk calculation, 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 component calculations.

¹² See Section I(A)(1)(a)(i)II and I(A)(2)(a)(i)II of Procedure XV of the Rules, supra note 8. See also Exchange Act Release Nos. 82780 (Feb. 26, 2018), 83 FR 9035 (Mar. 2, 2018) (SR-NSCC-2017-808); 82781 (Feb. 26, 2018), 83 FR 9042 (Mar. 2, 2018) (SR-NSCC-2017-020) ("Initial Filing").

¹³ See Section I(A)(1)(a)(i)II and I(A)(2)(a)(i)II of Procedure XV, supra note 8.

As described in the Notice, NSCC proposes to modify Procedure XV (Clearing Fund Formula and Other Matters) of NSCC's Rules & Procedures ("Rules") to make the following changes to the gap risk charge: (1) make the gap risk charge an additive component of the member's total VaR Charge when it is applicable, rather than being applied as the applicable VaR Charge only when it is the largest of three separate calculations, (2) adjusting the gap risk charge to be based on the two largest positions in a portfolio, rather than based on the single largest position, (3) changing the floor of the gap risk haircut from 10 percent to 5 percent for the largest position, adding a floor of the gap risk haircut of 2.5 percent for the second largest position, and providing that gap risk haircuts would be determined based on backtesting and impact analysis, and (4) amending which ETF positions are excluded from the gap risk charge to more precisely include ETFs that are more prone to gap risk, i.e., are non-diversified.

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 Act¹⁴ 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, providing the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed

¹⁴ 15 U.S.C. 78s(b)(2)(B).

Rule Change.

Pursuant to Section 19(b)(2)(B) of the Act,¹⁵ 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,¹⁶ and the rules thereunder, including the following provisions:

- Section 17A(b)(3)(F) of the Act,¹⁷ which requires, among other things, that the rules of a clearing agency must be designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and to protect investors and the public interest; and
- Rule 17Ad-22(e)(4)(i) of the Act,¹⁸ which requires that 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

¹⁵ Id.

¹⁶ 15 U.S.C. 78q-1.

¹⁷ 15 U.S.C. 78q-1(b)(3)(F).

¹⁸ 17 CFR 240.17Ad-22(e)(4)(i).

confidence.

- Rule 17Ad-22(e)(6)(i) of the Act,¹⁹ which requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to cover, if the covered clearing agency provides central counterparty services, 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.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the Proposed Rule Change. In particular, the Commission invites the written views of interested persons concerning whether the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act,²⁰ and Rules 17Ad-22(e)(4)(i), (e)(6)(i) and (e)(23)(ii) of the Act,²¹ or any other provision of the Act, or the rules and regulations thereunder.

Interested persons are invited to submit written data, views, and arguments regarding whether the Proposed Rule Change should be approved or disapproved by

¹⁹ 17 CFR 240.17Ad-22(e)(6)(i).

²⁰ 15 U.S.C. 78q-1(b)(3)(F).

²¹ 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i) and (e)(23)(ii).

[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,²² in addition to any other comments they may wish to submit about the Proposed Rule Change.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NSCC-2022-015 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-2022-015. 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

²² See Notice, supra note 3.

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-2022-015 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.²³

Sherry R. Haywood
Assistant Secretary

²³ 17 CFR 200.30-3(a)(31).