

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–96786; File No. SR–NSCC–2022–005]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change, as Modified by Amendment Nos. 1, 2, and 3, To Revise the Excess Capital Premium Charge

February 1, 2023.

#### I. Introduction

On May 20, 2022, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR–NSCC–2022–005 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 June 8, 2022,<sup>3</sup> and the Commission has received comments regarding the proposed rule change.<sup>4</sup>

On July 11, 2022, 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 disapprove the proposed rule change.<sup>6</sup> On September 1, 2022, the Commission instituted 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.<sup>8</sup>

On July 6, 2022, NSCC filed a partial amendment (“Amendment No. 2”) to modify the proposed rule change.<sup>9</sup> On November 28, 2022, NSCC filed another amendment (“Amendment No. 3”) to modify the proposed rule change.<sup>10</sup> On

December 1, 2022, the Commission published notice of filing of Amendment Nos. 2 and 3 and of an extension to the action date for the proposed rule change.<sup>11</sup>

For the reasons discussed below, the Commission is approving the proposed rule change, as modified by Amendment Nos. 1, 2 and 3 (hereinafter, “proposed rule change”).

#### II. Description of the Proposed Rule Change<sup>12</sup>

NSCC provides clearing, settlement, risk management, central counterparty services, and a guarantee of completion for virtually all broker-to-broker trades involving equity securities, corporate and municipal debt securities, and unit investment trust transactions in the U.S. markets. A key tool that NSCC uses to manage its credit exposure to its members is collecting an appropriate Required Fund Deposit (*i.e.*, margin) from each member.<sup>13</sup> A member’s margin is designed to mitigate potential losses to NSCC associated with liquidation of the member’s portfolio in the event of that member’s default.<sup>14</sup> The aggregate of all NSCC members’ margin deposits (together with certain other deposits required under the Rules) constitutes NSCC’s Clearing Fund, which NSCC would access should a member default and that member’s margin, upon liquidation, be insufficient to satisfy NSCC’s losses.<sup>15</sup>

A member’s margin consists of a number of applicable components, each of which addresses specific risks faced by NSCC.<sup>16</sup> Many of those components are designed to measure risks presented by the net unsettled positions a member submits to NSCC to be cleared and settled; however, certain components, often referred to as margin “add-ons,” measure and mitigate other risks that NSCC may face, such as credit risks.

clarified the particular circumstances in which NSCC would retain the ability to waive the excess capital premium charge, rather than remove NSCC’s discretion to waive or reduce the charge as was initially proposed in the proposed rule change.

<sup>11</sup> Securities Exchange Act Release No. 96426 (Dec. 1, 2022), 87 FR 75105 (Dec. 7, 2022) (“Amended Notice”).

<sup>12</sup> Capitalized terms not defined herein are defined in NSCC’s Rules and Procedures (“Rules”), available at [http://dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

<sup>13</sup> See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules, *supra* note 12.

<sup>14</sup> Under NSCC’s Rules, a default would generally be referred to as a “cease to act” and could encompass a number of circumstances, such as a member’s failure to make a margin deposit in a timely fashion. See Rule 46 (Restrictions on Access to Services), *supra* note 12.

<sup>15</sup> See *id.*

<sup>16</sup> See Procedure XV, *supra* note 12.

NSCC’s excess capital premium (“ECP”) is one such add-on that makes up part of the margin that a member must pay to NSCC. The purpose of this charge is to mitigate the heightened default risk a member could pose to NSCC if it operates with lower capital levels relative to its margin requirements.<sup>17</sup> Put another way, the ECP charge operates to collect additional margin if a member’s exposure to NSCC based on its clearing activity is out of proportion to its capital.

As described in more detail below, the ECP charge applies when a specified portion of a member’s required margin exceeds its capital by a ratio of more than 1.0 (defined in the Rules as the “Excess Capital Ratio”).<sup>18</sup> When the charge applies, NSCC determines its amount by multiplying the member’s capital by this ratio, with the resulting amount serving as the add-on charge.

NSCC’s proposal would change both the calculation methodology and governance of the ECP charge in its Rules. With respect to the calculation of the charge, NSCC proposes to: (1) use the volatility charge of a member’s margin requirement to compare a member’s applicable capital amounts, as opposed to the current methodology which uses a specific “calculated amount” identified in the Rules; (2) when calculating the ECP charge, for members that are broker-dealers, use net capital amounts rather than excess net capital, and for all other members, use equity capital in the calculation of the ECP charge; and (3) establish a cap of 2.0 for the Excess Capital Ratio that is used in calculating a member’s ECP charge. With respect to governance, NSCC proposes to: (1) identify the particular circumstances in which NSCC has the ability to waive the charge, including the information that NSCC would review in deciding whether to waive the ECP charge as well as the governance around the application of such waiver; and (2) provide that NSCC may calculate the charge based on updated capital information.

NSCC has estimated the potential impacts of the proposal during the period of June 1, 2020 through December 31, 2021. The study showed that the proposal would have had no impact to NSCC’s overall or member-level margin coverage, that is, that

<sup>17</sup> See Securities Exchange Act Release No. 54457 (Sept. 15, 2006), 71 FR 55239 (Sept. 21, 2006) (SR–FICC–2006–03 and SR–NSCC–2006–03) (approving the ECP charge as a new component of the margin methodology).

<sup>18</sup> See Section I(B)(2) of Procedure XV, *supra* note 12.

<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. 95026 (June 2, 2022), 87 FR 34913 (June 8, 2022) (“Notice”). The Notice referred to an incorrect filing date of May 30, 2022; however, the proposal was filed on May 20, 2022, as indicated here. Moreover, the Notice reflected the filing of Amendment No. 1, which made a correction to Exhibit 5 of the filing, specifically, to insert an additional cross-reference into a proposed definition that had been omitted.

<sup>4</sup> Comments are available at <https://www.sec.gov/comments/sr-nscc-2022-005/srnscc2022005.htm>.

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

<sup>6</sup> Securities Exchange Act Release No. 95245 (July 11, 2022), 87 FR 42523 (July 15, 2022).

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

<sup>8</sup> Securities Exchange Act Release No. 95656 (Sept. 1, 2022), 87 FR 55058 (Sept. 8, 2022).

<sup>9</sup> Amendment No. 2 partially amended the proposed rule change to update the description of the impact of the proposal. In Amendment No. 2, NSCC also provided a revised version of the confidential impact study that it included as Exhibit 3a to the proposed rule change.

<sup>10</sup> Amendment No. 3 amended and replaced the proposed rule change in its entirety. Specifically, it

NSCC would continue to collect margin that would cover its credit exposures to its members under the proposal. Further, the study showed that the proposal would have reduced the number of ECP charges that would have been triggered by the calculation by 65 percent, from 347 ECP charges triggered for 19 members to 122 ECP charges triggered for 14 members. The total aggregate amount that would have been triggered by the proposed calculation if the proposal was effective during that time would have been reduced from \$51.31 billion (the actual total amount of ECP charges triggered by the current calculation during that period) to approximately \$17.44 billion (the total amount of ECP charges that would have been triggered during that time by the proposed calculation), with the average amount per member reducing from \$147.9 million to approximately \$143.0 million.<sup>19</sup>

#### A. Current Calculation and Governance of the ECP Charge

NSCC's current methodology for determining applicability of the ECP charge is as follows. First, NSCC determines the member's "Calculated Amount," pursuant to the Rules. The Calculated Amount is designed to represent the member's margin requirements to NSCC resulting from its unsettled positions, and it is made up of a number of the components of a member's margin.<sup>20</sup> NSCC then divides the member's Calculated Amount by its current capital amount, which is the amount reported to NSCC pursuant to its ongoing membership standards.<sup>21</sup>

<sup>19</sup> See Amended Notice, *supra* note 11, 87 FR 75111. NSCC also submitted more detailed results of the impact study as confidential Exhibit 3 to the proposed rule change. NSCC requested confidential treatment of Exhibit 3 pursuant to 17 CFR 240.24b-2.

<sup>20</sup> Specifically, the Rules define the Calculated Amount as a member's Required Fund Deposit excluding any applicable special charge, margin requirement differential charge, coverage component charge or margin liquidity adjustment charge, plus any additional amounts the member is required to deposit to the Clearing Fund either due to being placed on the Watch List or as an assurance of financial responsibility or operational capability. These various margin components and other concepts are described in the NSCC Rules. See Procedure XV, Sections I(A)(1)(c) and (2)(c) (special charge), I(A)(1)(e) and (2)(d) (margin requirement differential), I(A)(1)(f) and (2)(e) (coverage component), and I(A)(1)(g) and (2)(f) (margin liquidity adjustment charge), *supra* note 12; see also Rule 15, Section 2b(iv), *supra* note 12 (setting forth NSCC's authority to require adequate assurances of a member's financial responsibility).

<sup>21</sup> Members that are broker-dealers are required to maintain a certain level of excess net capital, and bank members are required to maintain a certain level of equity capital as a requirement for continued membership with NSCC. See Addendum B, *supra* note 12. Members are required to provide NSCC with financial information, including

Next, if the member's Calculated Amount divided by the applicable capital amount (referred to as the member's Excess Capital Ratio) is greater than 1.0, NSCC may require that member to make an ECP charge.<sup>22</sup> The applicable ECP charge is the product of (1) the amount by which a member's Calculated Amount exceeds its applicable capital amount, multiplied by (2) the member's Excess Capital Ratio. However, NSCC has the authority to collect a lower ECP charge than the amount calculated pursuant to the Rules or to determine not to collect the ECP charge from a member at all, and it may return all or a portion of a collected ECP charge if it believes the imposition or maintenance of the ECP charge is not necessary or appropriate.<sup>23</sup>

The Rules describe some circumstances when NSCC may determine not to collect an ECP charge from a member, which includes, for example, when an ECP charge results from trading activity for which the member submits later offsetting activity that lowers its Required Fund Deposit.<sup>24</sup> The discretion to adjust, waive or return an ECP charge was designed to allow NSCC to determine when a calculated ECP charge may not be necessary or appropriate to mitigate the risks it was designed to address.<sup>25</sup>

#### B. Amendments to the Calculation of the ECP Charge

*Use Members' Volatility Component Instead of the Calculated Amount.* NSCC proposes to replace the Calculated Amount with the amount collected as that member's volatility component of its margin for purposes of determining the applicability of the ECP charge. The volatility component measures the market price volatility of a member's portfolio,<sup>26</sup> and it usually comprises the largest portion of a member's margin.

Currently, determining a member's Calculated Amount requires a more complicated calculation, as it uses a member's margin, but excludes certain components and includes other deposits. The proposal would simplify

information regarding members' current capital amounts, on a regular basis, and NSCC uses these reported capital amounts in the calculation of the ECP charge. See Rule 2B, Section 2, *supra* note 12.

<sup>22</sup> Section I(B)(2) of Procedure XV, *supra* note 12.

<sup>23</sup> *Id.*

<sup>24</sup> See footnote 7 of Procedure XV, *supra* note 12.

<sup>25</sup> See note 17 *supra*.

<sup>26</sup> See Sections I(A)(1)(a)(i)–(iii) and (2)(a)(i)–(iii) of Procedure XV of the Rules, *supra* note 12. NSCC has two methodologies for calculating the volatility component—a model-based volatility-at-risk, or VaR, charge, and a haircut-based calculation, for certain positions that are excluded from the VaR charge calculation.

this calculation by using only the volatility component. NSCC states that one of the tools it provides to its members is a calculator that allows them to determine their potential volatility charge based on trading activity, and that, therefore, this proposed change would make the calculation of the ECP charge both clearer and more predictable for members.<sup>27</sup>

*Use Net Capital for Broker-Dealer Members and Equity Capital for All Other Members in the Calculation of the ECP Charge.*<sup>28</sup> NSCC is proposing to use net capital, rather than excess net capital, for broker-dealer members when calculating the ECP charge. NSCC states that this revision would align the capital measures used for broker-dealer members and other members, which would result in more consistent calculations of the ECP charge across different types of members.<sup>29</sup> NSCC also states that using net capital rather than excess net capital would provide NSCC with a better measure of the increased default risks presented when a broker-dealer member operates at low net capital levels relative to its margin requirements.<sup>30</sup>

In addition, NSCC is proposing to provide that, for all members that are not broker-dealers, it would use equity capital in calculating the ECP charge, rather than the capital amount set forth in NSCC's membership standards.<sup>31</sup>

<sup>27</sup> Amended Notice, *supra* note 11, 87 FR at 75108.

<sup>28</sup> To effectuate these changes, NSCC proposes to adopt revised and new defined terms. Specifically, NSCC would include a new defined term for "Equity Capital" and revise a defined term for "Net Capital." The proposal would also revise the Rules describing the calculation of the ECP charge and identifying membership qualifications, to use the new and/or revised defined terms, as appropriate. In addition, NSCC would identify the reporting requirements that NSCC relies on to obtain the capital information for members.

<sup>29</sup> Amended Notice, *supra* note 11, 87 FR at 75108.

<sup>30</sup> See *id.* NSCC states that this approach would be consistent with the rationale for the Commission's amendments to Rule 15c3-1 under the Act, which were designed to promote a broker-dealer's capital quality and require the maintenance of "net capital" (i.e., capital in excess of liabilities) in specified amounts as determined by the type of business conducted. *Id.* (citing 17 CFR 240.15c3-1; Securities Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51823 (Aug. 21, 2013) (File No. S7-08-07)). NSCC believes that Rule 15c3-1 provides an effective process of separating liquid and illiquid assets and computing a broker-dealer's regulatory net capital that should replace NSCC's existing practice of using excess net capital in the calculation of the ECP charge. *Id.*

<sup>31</sup> NSCC's Rules identify the applicable capital measures as follows: for bank members, equity capital; for members that are trust companies and not banks, consolidated capital; and for other legal entities that are members, an amount determined by NSCC. See Section 1.B of Addendum B, *supra* note 12.

Currently, for all members that are not banks, non-bank trusts or broker-dealers (which generally include, for example, exchanges and registered clearing agencies), NSCC uses those members' reported equity capital in the calculation of the ECP charge. Therefore, in practice, the ECP charge is calculated for the majority of members that are not broker-dealers using their equity capital, and this proposed change is not expected to have a material impact on the collection of ECP charges.<sup>32</sup> NSCC states that the proposal would simplify the calculation of the ECP charge for members that are not broker-dealers by providing that NSCC would use equity capital rather than use different measures that are based on other membership requirements, and that it would also create consistency across members.<sup>33</sup>

*Establish a Cap for the Excess Capital Ratio.* NSCC is proposing to set a maximum amount of the Excess Capital Ratio that is used in calculating members' ECP charge of 2.0. Specifically, the Excess Capital Ratio is the multiplier that is applied to the difference between a member's volatility charge and its applicable capital measure. Currently, the Rules do not include any cap on the Excess Capital Ratio.

NSCC states that capping the multiplier would allow it to address the risks it faces without imposing an overly burdensome ECP charge.<sup>34</sup> NSCC further states that, historically, the Excess Capital Ratio has rarely exceeded 2.0 in the calculation of members' ECP charges, and in cases when 2.0 was exceeded NSCC typically exercised the discretion provided to it in the Rules to reduce the applicable charge, which was appropriate because NSCC believes it is able to mitigate the risks presented to it by a member's lower capital levels by collecting an ECP charge calculated with an Excess Capital Ratio that is at or below 2.0.<sup>35</sup> NSCC also states that this proposed change would provide members with more clarity and transparency, by allowing them to predict and estimate the maximum amount of their potential ECP charge.<sup>36</sup>

### C. Changes Regarding Governance of the ECP Charge

*NSCC's Ability to Waive the ECP Charge.* NSCC would also revise its Rules to specify particular

circumstances in which NSCC retains the ability to waive the ECP charge. NSCC states that the proposed changes to the calculation of the ECP charge would, taken together, eliminate most circumstances in which NSCC would have exercised this discretion. For example, the proposal to cap the Excess Capital Ratio at 2.0 and the proposal to specify that NSCC may calculate an ECP charge based on updated capital amounts (as described below), both address the most common circumstances when NSCC has either waived or reduced the ECP charge in the past.<sup>37</sup>

However, NSCC believes that there may still be circumstances when it may not be necessary or appropriate to collect an ECP charge from a member, for example, in certain exigent circumstances when NSCC observes unexpected changes in market volatility or trading volumes.<sup>38</sup> Therefore, NSCC is proposing to retain discretion to waive an ECP charge in certain defined circumstances and to specify the approval required to apply such discretion.

As proposed, NSCC's Rules would describe the exigent circumstances in which NSCC would retain the ability to waive an ECP charge as those when NSCC, in its sole discretion, observes extreme market conditions or other unexpected changes in factors such as market volatility, trading volumes or other similar factors. As noted above, NSCC states that, based on a review of past data, the proposed changes to the calculation of the ECP charge would otherwise eliminate most prior instances when an ECP charge was waived.<sup>39</sup>

NSCC also states that there have been instances, particularly in recent years, when NSCC has waived the ECP charge in circumstances that would fall within the proposed identification of exigent circumstances, and that the ECP charge would have been triggered in such

circumstances, even as amended by this proposed rule change. Such instances occurred multiple times in recent years, including, for example, during the extreme market volatility experienced in early 2020 related to the global outbreak of the COVID-19 coronavirus and the meme stock market event in early 2021.<sup>40</sup> Further, NSCC believes there remains some ongoing possibility that an unexpected increase in market volatility, for example, could cause a relative increase in a member's volatility charge, which may, in turn, trigger an ECP charge, even under the proposal.<sup>41</sup>

In such circumstances, under the proposal, NSCC would determine if the ECP charge being triggered at that time is not primarily caused by the risk presented by a member's capital levels and whether NSCC can effectively address the risk exposure presented by that member without the collection of the ECP charge. Alternatively, NSCC may determine, based on its review of the information available to it, that the ECP charge was appropriately triggered by a member's capital position or trading activity and was not driven primarily by the prevailing market conditions or other exigent circumstances. Therefore, NSCC believes it is appropriate to retain a certain amount of discretion to review an ECP charge that is triggered in such circumstances to determine whether a waiver of the ECP charge may be appropriate.<sup>42</sup>

In addition to defining the circumstances in which NSCC may waive the ECP charge, the proposed changes would also describe the review NSCC would conduct in deciding to waive the charge in the exigent circumstances, the information NSCC would consider in such review, and the approval required to waive the ECP charge. More specifically, the proposed rule change provides that NSCC would review all relevant facts and other information available to it at the time of its decision, including the degree to which a member's capital position and trading activity compare or correlate to the prevailing exigent circumstances and whether NSCC can effectively address the risk exposure presented by a member without the collection of the ECP charge from that member. For example, as noted above, if NSCC believes, based on its review of the relevant circumstances, that the risk exposure presented by a member is driven by the unexpected increase in

<sup>37</sup> *Id.* at 75109–10.

<sup>38</sup> *Id.*

<sup>39</sup> Specifically, over the impact study period, NSCC waived and adjusted calculated ECP charges by \$38.80 billion. NSCC waived a total of 33 ECP charges that totaled approximately \$26.12 billion. Under the proposal, however, 14 of these charges would have been collected from members (although the amount would have been reduced), totaling \$6.46 billion, 14 charges would not have been triggered as the calculated ECP ratio was below 1.0, and NSCC would have waived 5 of the ECP charges, mainly following receipt of updated financial information. NSCC adjusted the amount of 16 ECP charges by a total of approximately \$12.69 billion. Under the proposal, 7 of these charges would have been still collected, totaling \$6.48 billion, and 9 charges would not have been triggered as the calculated ECP ratio was below 1.0. *See id.* at 75111. *See also supra* note 17.

<sup>32</sup> Amended Notice, *supra* note 11, 87 FR at 75108.

<sup>33</sup> *Id.* at 75109.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>40</sup> Amended Notice, *supra* note 11, 87 FR at 75109–10.

<sup>41</sup> *Id.* at 75110.

<sup>42</sup> *Id.*

market volatility and not by a member's capital levels, NSCC may determine that it is appropriate to address such risk through the collection of a special charge from that member rather than an ECP charge.<sup>43</sup>

Finally, the proposed rule change would specify the governance around a decision to waive an ECP charge, by identifying the level of NSCC officer who would be authorized to apply a waiver and by requiring that the decision be documented in a written report that is made available upon request to the affected member.<sup>44</sup>

*NSCC's Ability to Consider Updated Capital Information.* Under the proposal, NSCC would provide that it may calculate the ECP charge based on updated capital information. As described above, NSCC would use the net capital or equity capital amounts that are reported on members' most recent financial reporting or financial statements delivered to NSCC in connection with the ongoing membership reporting requirements. Under the proposal, if a member's capital amounts change between the dates when it submits these financial reports, it may provide NSCC with updated capital information for purposes of calculating the ECP charge.

NSCC is proposing to retain some discretion in when it would accept updated capital information for this purpose. For example, NSCC may require a member to provide documentation of the circumstances that caused a change in capital information, and if adequate evidence is not available or NSCC does not believe the evidence sufficiently verifies that the member's capital position has changed, NSCC would continue to calculate the ECP charge for that member based on the prior capital information available to NSCC until the next financial reporting or financial statements are delivered. NSCC believes it is appropriate to retain some discretion to allow NSCC to determine if updated capital information is adequately verified before it agrees to rely on that information for this calculation.<sup>45</sup>

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>46</sup> 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 carefully considering the proposed rule change, 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 Section 17A(b)(3)(F)<sup>47</sup> of the Act and Rules 17Ad-22(e)(6)(i) and (e)(23)(ii) thereunder.<sup>48</sup>

#### A. Consistency With Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to, among other things, 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, and protect investors and promote the public interest.<sup>49</sup>

The Commission believes that the proposed changes to the calculation of the ECP charge described in section II.B above should allow NSCC to ensure that it continues to collect margin sufficient to address the heightened default risk presented by a member operating with lower capital levels relative to its margin requirements. Based on its review of the proposed rule change, including the detailed impact analysis submitted as a confidential exhibit,<sup>50</sup> the Commission understands that NSCC's margin coverage would not be impacted by this change and that NSCC would continue to collect sufficient margin to manage its potential exposure to its members.

In addition, the Commission believes that the proposed changes to the calculation of the ECP charge described in section II.B should result in a simplified and more straight-forward method for calculating the ECP charge,

based on understandable metrics with which NSCC's members are familiar. For example, using a member's volatility charge, which is an established aspect of the overall margin requirements identified in NSCC's Rules, as opposed to the Calculated Amount that involves both including and excluding various margin components, is clearer and more predictable while still consistent with the purpose of the ECP charge. Similarly, using net capital and equity capital for broker-dealer members and all other members, respectively, in the calculation of the ECP charge would result in a more consistent calculation across different types of members.<sup>51</sup> Moreover, capping the Excess Capital Ratio at 2.0 would be an appropriate balance between addressing the heightened default risk without imposing overly burdensome ECP charges.

Together, by improving the consistency and predictability of the ECP charge, the proposed enhancements would also improve NSCC's ability to collect margin amounts that reflect the risks posed by its members such that, in the event of member default, NSCC's operations would not be disrupted, and non-defaulting members would not be exposed to losses they cannot anticipate or control. In this way, the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible, consistent with Section 17A(b)(3)(F) of the Act.<sup>52</sup>

The Commission believes that the proposed changes set forth in both

<sup>51</sup> One commenter asserted that NSCC should also consider the member's ability to pay for customer trades by settlement. Letter from John S. Markle, VP and Deputy General Counsel, Robinhood Inc., at 3–4 (Aug. 3, 2022), available at <https://www.sec.gov/comments/sr-nsc-2022-005/srnscc2022005-20135431-306323.pdf> (“Robinhood Letter”). However, NSCC does not have access to that information as part of its normal course. The Commission therefore does not believe that it would be appropriate for NSCC to include that as part of the ECP charge calculation. However, this would not prohibit NSCC from considering that fact as part of its consideration of whether to waive an ECP charge. Similarly, the commenter asserted that NSCC should include a member's committed lines of credit in its determination of the member's capital. *Id.* at 4. However, the Commission believes that NSCC's stated desire to align the capital used for purposes of determining the ECP charge with the existing capital standards required for members is reasonable because it allows for consistency between different aspects of the Rules. In addition, the Commission believes that NSCC could, as part of its consideration whether to waive an ECP charge, consider such additional sources of funding if appropriate.

<sup>52</sup> 15 U.S.C. 78q–1(b)(3)(F).

<sup>43</sup> See Section I(A)(1)(c) and (2)(c) of Procedure XV, *supra* note 12 (allowing NSCC to collect, as part of margin “[a]n additional payment (‘special charge’) . . . in view of price fluctuations in or volatility or lack of liquidity of any security”).

<sup>44</sup> NSCC also states that it would update its internal procedures to include waivers of the ECP charge in its regular updates to the Commission. Amended Notice, *supra* note 11, 87 FR at 75110 n.37.

<sup>45</sup> *Id.* at 75110.

<sup>46</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>47</sup> 15 U.S.C. 78q–1(b)(3)(F).

<sup>48</sup> 17 CFR 240.17Ad-22(e)(6)(i) and (e)(23)(ii).

<sup>49</sup> 15 U.S.C. 78q–1(b)(3)(F).

<sup>50</sup> See note 19 *supra*. The confidential analysis identified, on a member-by-member basis, the number of backtesting deficiencies during the impact study period.

sections II.B and II.C should improve transparency and understanding of the NSCC's governance and application of the ECP charge. For example, NSCC's proposal would describe the exigent circumstances in which NSCC may waive the ECP charge, describe what information NSCC would consider when determining whether to waive the charge, and specify the approval necessary to waive the charge.<sup>53</sup> Moreover, using commonly understood inputs as the determinants of the ECP charge (*i.e.*, using the volatility charge instead of the Calculated Amount and using net capital and equity capital instead of the current standards) and capping the Excess Capital Ratio at 2.0 should help members better anticipate and plan for a potential ECP charge. Through its client portal, NSCC provides regularly updated information to members about their volatility charges, such that a member should be able to better calculate and understand its potential ECP charge by using that information in conjunction with their capital, while also considering how the proposed cap on the Excess Capital Ratio would affect any eventual charge.<sup>54</sup>

Taken together, these proposed changes should help NSCC's members better anticipate their required margin because of the use of simplified inputs to the calculation of the ECP charge and

the imposition of a cap on the applicable Excess Capital Ratio. This improved understanding of the potential margin requirements should, in turn, facilitate prompt and accurate clearance and settlement by removing potential ambiguity or confusion about a member's obligations to NSCC. Similarly, the Commission believes that the improved transparency provided by this proposed rule change both with respect to a member's margin obligations and the process by which NSCC would consider waiver of an ECP charge should provide members and the public with more clarity about the nature and application of the ECP charge and resolve potential ambiguity about when the ECP charge would or would not apply, which is consistent with promoting the public interest.

For these reasons, the Commission therefore believes that the proposed changes are consistent with Section 17A(b)(3)(F) of the Act.<sup>55</sup>

#### *B. Consistency With Rule 17Ad-22(e)(6)(i)*

Rule 17Ad-22(e)(6)(i) under the Act 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.<sup>56</sup>

The Required Fund Deposits are made up of risk-based components (as margin) that are calculated and assessed daily to limit NSCC's exposures to members. NSCC's proposed changes to use the volatility charge rather than the Calculated Amount, and to use net capital and equity capital, as appropriate, in the calculation of the ECP charge would collectively make the calculation clearer and more predictable to members, while continuing to apply an appropriate risk-based charge designed to mitigate the risks presented to NSCC. Similarly, the proposal to cap the Excess Capital Ratio at 2.0 would allow NSCC to appropriately address the risks it faces without imposing an overly burdensome ECP charge and would reduce the circumstances in which NSCC may waive the charge, resulting in a more transparent margining methodology.<sup>57</sup> Finally, the

proposed rule change would clarify the exigent circumstances when NSCC may determine that it is appropriate to waive the ECP charge. Overall, these proposed changes would improve the effectiveness of the calculation of the ECP charge and, therefore, allow NSCC to more effectively address the increased default risks presented by members that operate with lower capital levels relative to their margin requirements.

Taken together, the proposed changes enhance the ability of the ECP charge to produce margin levels commensurate with the risks NSCC faces related to its members' operating capital levels. Therefore, the Commission believes that the proposed rule change is consistent with Rule 17Ad-22(e)(6)(i) under the Act.<sup>58</sup>

#### *C. Consistency With Rule 17Ad-22(e)(23)(ii)*

Rule 17Ad-22(e)(23)(ii) under the Act requires that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for providing sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in NSCC.<sup>59</sup>

As discussed above in section III.A, the Commission believes that the proposed changes set forth in both sections II.B and II.C should improve NSCC's members' ability to understand and estimate the potential magnitude of any ECP charge and to better anticipate when such a charge would apply and in what exigent circumstances NSCC would be able to waive the charge. The proposal would do this in several ways, including by simplifying and clarifying the inputs to the calculation of the ECP

such as 1.5. Robinhood Letter at 5. The commenter referenced statements that NSCC made in the proposed rule change, to argue that the ratio was not supported and that further analysis would be appropriate. *Id.* However, the Commission also reviewed the underlying impact analysis, submitted confidentially as part of the proposed rule change, *see* note 19 *supra*, which allows for a more detailed understanding of what the Excess Capital Ratio would have been under the proposal in each instance in which the ECP charge applied over the impact study period and, therefore, an understanding of how often the ratio would be, for example, between 1.5 and 2.0. Based on the confidential data submitted, there is very limited incidence of members having an Excess Capital Ratio between 1.5 and 2.0; using a ratio of 1.5 as suggested by the commenter, therefore, generally would not have a significant effect on the costs presented to members. The Commission therefore believes that the determination to use 2.0 is reasonable and represents an appropriate balance of addressing the risk presented and not being overly burdensome.

<sup>58</sup> *Id.*

<sup>59</sup> 17 CFR 240.17Ad-22(e)(23)(iii).

<sup>53</sup> The Commission received comments on this aspect of the proposal as it was initially filed, before Amendment No. 3, which are no longer relevant in light of the changes set forth in Amendment No. 3. *See* Robinhood Letter at 1–3; Letter from William Capuzzi, Chief Executive Officer, Apex Clearing Corporation, at 2 (Aug. 24, 2022), available at <https://www.sec.gov/comments/sr-nssc-2022-005/srnscc2022005-20137445-307938.pdf> (“Apex Letter”). Specifically, the commenters asserted that NSCC did not explain what would happen to members incurring an ECP charge if NSCC no longer had the discretion to waive the charge, as NSCC had proposed in the initial filing before Amendment No. 3. Because Amendment No. 3 reintroduced the ability to waive the ECP charge in specified exigent circumstances, the Commission believes that these comments are addressed by the amendment.

<sup>54</sup> Commenters also asserted that NSCC should provide a curative period for members to address any potential application of the ECP charge, for example, by increasing the available capital or taking other measures. *See* Robinhood Letter at 4–5; Apex Letter at 2. However, the Commission disagrees that such a curative period would be appropriate. The ECP charge is a part of a member's financial obligation to NSCC, payment of which is governed by NSCC's Rules, *see* Procedure XV, Section II(B), *supra* note 12, and is directly related to the exposure that the member poses to NSCC. Therefore, consistency in the timeframes for payment for the overall margin amount makes sense and helps NSCC to manage its exposure to its members. The Commission does not believe that the ECP charge necessitates a specific additional cure period, given that NSCC would still be obligated to guarantee the transactions of a defaulting member during the purported curative period.

<sup>55</sup> 15 U.S.C. 78q–1(b)(3)(F).

<sup>56</sup> 17 CFR 240.17Ad-22(e)(6)(i).

<sup>57</sup> One commenter asserted that NSCC should provide further support for capping the Excess Capital Ratio at 2.0, as opposed to a different figure

charge, capping the Excess Capital Ratio at 2.0, and by providing additional information regarding NSCC's ability to waive the charge.

Therefore, the Commission believes that these changes are consistent with Rule 17Ad-22(e)(23)(ii) under the Act.<sup>60</sup>

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1, 2, and 3, is consistent with the requirements of the Act, and in particular, the requirements of Section 17A of the Act<sup>61</sup> and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2)<sup>62</sup> of the Act, that the proposed rule change (SR-NSCC-2022-005), as modified by Amendment Nos. 1, 2, and 3, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>63</sup>

**Sherry R. Haywood,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-96787; File No. SR-ICEEU-2023-004]

### Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change Relating to Amendments to the ICE Clear Europe Counterparty Credit Risk Policy and Counterparty Credit Risk Procedures

February 1, 2023.

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> notice is hereby given that on January 20, 2023, ICE Clear Europe Limited ("ICE Clear Europe" or the "Clearing House") filed with the Securities and Exchange Commission ("Commission") the proposed rule changes described in Items I, II and III below, which Items have been prepared primarily by ICE Clear Europe. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

ICE Clear Europe Limited ("ICE Clear Europe" or the "Clearing House") proposes to modify its Counterparty Credit Risk Policy (the "CC Risk Policy") and Counterparty Credit Risk Procedures (the "CC Risk Procedures") to provide that the Clearing House's framework for monitoring counterparty credit risk covers links,<sup>3</sup> as defined in the Commission's standards for clearing agencies. The Clearing House also proposes to make certain further updates and clarifications to the CC Risk Procedures.<sup>4</sup>

#### II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

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

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

###### (a) Purpose

ICE Clear Europe is proposing to revise the CC Risk Policy in order to provide that the Clearing House's policies for monitoring counterparty credit risk apply to links, as defined in the Commission's regulations. ICE Clear Europe is also proposing to revise the CC Risk Procedures to make conforming updates in respect of links and to make certain other clarifications and enhancements.

###### I. Counterparty Credit Risk Policy

The amendments to the CC Risk Policy would include as part of the description of the Clearing House's counterparty credit risk the risk that a "link" defaults, leaving the Clearing

House to fund material contractual or operational arrangements. A definition of "link", based on the definition in Rule 17Ad-22(a)(8),<sup>5</sup> would be added. Conforming references to links would be added in relevant portions of the CC Risk Policy: the amendments would add that an objective of the CC Risk Policy is to minimize the risk of the Clearing House realizing a material loss due to a link defaulting, and that a means by which the Clearing House achieves this objective is to identify, monitor and manage risks from links. The amendments would also clarify the credit scoring with respect to links (which may use credit criteria other than those used with respect to CMs) and provide that for link counterparties whose credit scores are worse than a required threshold, a mitigating action that the Clearing House may take is to change its usage of links.

Non-substantive drafting and formatting updates would also be made.

###### II. CC Risk Procedures

The CC Risk Procedures, which supplement the CC Risk Policy, would be updated to make conforming changes to those discussed above with respect to links, including as to including the risk of a link default as a type of counterparty credit risk that Clearing House seeks to manage. The amendments would provide that in order to minimize counterparty credit risk, the Clearing House would identify, monitor and manage material risks from links as well as ensure that all counterparty risks are eliminated prior to off-boarding counterparties.

The amendments would remove a specific statement that FSPs must be legal entities in approved jurisdictions. Consistent with other ICE Clear Europe policies and current practice, the Clearing House legal department separately reviews and determines approved jurisdictions, and accordingly a reference to this process in the CC Risk Procedures is unnecessary. The amendments would also add a specific reference to Anti-Money Laundering and Know-Your-Customer screenings. These amendments would also state that agreements with FSPs are subject to review by the legal team, including analysis of legal risk relating to governing law and in that context jurisdiction. These changes are intended to more clearly reflect current practice of the Clearing House.

Similar to the changes in the CC Policy, the amendments would revise the discussion of credit scoring to reflect that the Clearing House may use related

<sup>60</sup> *Id.*

<sup>61</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>62</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>63</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> "Link" means "a set of contractual and operational arrangements between two or more clearing agencies, financial market utilities, or trading markets that connect them directly or indirectly for the purposes of participating in settlement, cross margining, expanding their services to additional instruments or participants, or for any other purposes material to their business." 17 CFR 240.17Ad-2(a)(8).

<sup>4</sup> Capitalized terms used but not defined herein have the meanings specified in the ICE Clear Europe Clearing Rules and the CC Risk Policy and CC Risk Procedures, as applicable.

<sup>5</sup> 17 CFR 240.17Ad-22(a)(8).