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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-81194; File Nos. SR-DTC-2017-004; SR-NSCC-2017-005; SR-FICC-2017-008]

Self-Regulatory Organizations; The Depository Trust Company; National Securities Clearing Corporation; Fixed Income Clearing Corporation; Notice of Filing Amendment No. 2, Notice of Filing Amendment No. 3, and Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Changes, as Previously Modified by Amendment No. 1, to Adopt the Clearing Agency Liquidity Risk Management Framework
July 24, 2017

I. Introduction

On April 6, 2017, The Depository Trust Company (“DTC”), National Securities Clearing Corporation (“NSCC”), and Fixed Income Clearing Corporation (“FICC,” each a “Clearing Agency,” and collectively, the “Clearing Agencies”), filed with the Securities and Exchange Commission (“Commission”) proposed rule changes SR-DTC-2017-004, SR-NSCC-2017-005, and SR-FICC-2017-008, respectively, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² On April 13, 2017, the Clearing Agencies each filed Amendment No. 1 to their respective proposed rule changes. Amendment No. 1 made technical corrections to each Exhibit 5 of the proposed rule change filings. The proposed rule changes, as modified in each instance by Amendment No. 1, were published for comment in the Federal Register on April 25, 2017.³ On June 7, 2017, the Commission designated a longer period for Commission Action on the proposed rule changes, as amended in each instance by

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 80489 (April 19, 2017), 82 FR 19120 (April 25, 2017) (SR-DTC-2017-004, SR-NSCC-2017-005, SR-FICC-2017-008) (“Notice”).

Amendment No. 1.⁴ As of July 20, 2017, the Commission did not receive any comment letters on the proposed rule changes, as amended.

On July 20, 2017, the Clearing Agencies each filed Amendment No. 2 to their respective proposed rule changes, as previously modified by Amendment No. 1. On July 21, 2017, the Clearing Agencies each filed Amendment No. 3 to their respective proposed rule changes to supersede and replace Amendment No. 2 in its entirety, due to a technical defect of Amendment No. 2. Pursuant to Section 19(b)(1) of the Exchange Act⁵ and Rule 19b-4 thereunder,⁶ notice is hereby given that the Commission is publishing this notice to solicit comments on the proposed rule changes, as modified by Amendment No. 3, from interested persons (hereinafter, “Proposed Rule Changes.”). Additionally, this order institutes proceedings under Section 19(b)(2)(B) of the Act⁷ to determine whether to approve or disapprove the Proposed Rule Changes.

II. Description of the Proposed Rule Changes

The Clearing Agencies propose to adopt the Clearing Agency Liquidity Risk Management Framework (“Framework”) of the Clearing Agencies, which would set forth the Clearing Agencies’ (A) liquidity resources, and (B) liquidity risk management practices, to include measurement and monitoring of their respective liquidity risks.⁸ More specifically, the Framework would describe FICC and NSCC’s liquidity risk management strategy and objectives, which are to maintain sufficient liquid resources in order to meet the potential amount

⁴ Securities Exchange Act Release No. 80877 (June 7, 2017), 82 FR 27094 (June 13, 2017) (SR-DTC-2017-004, SR-NSCC-2017-005, SR-FICC-2017-008).

⁵ 15 U.S.C. 78s(b)(1).

⁶ 17 CFR 240.19b-4.

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ Notice, 82 at 19120-19121.

of funding required to settle outstanding transactions of a defaulting Member, or affiliated family (“Affiliated Family”) of Members, in a timely manner.⁹ For DTC, the Framework would describe how DTC’s liquidity management strategy and controls are designed to maintain sufficient available liquid resources to complete system-wide settlement on each business day with a high degree of confidence notwithstanding the failure to settle of a Participant or Affiliated Family of Participants.¹⁰ The Framework would also state that DTC operates on a fully collateralized basis.¹¹

In addition, the Framework would outline the regulatory requirements that would be applicable to each Clearing Agency with respect to liquidity risk management.¹² The Framework would be owned and managed by the Liquidity Product Risk Unit (“LPRU”) of DTCC.¹³ Although the Clearing Agencies would consider the Framework to be a rule of each Clearing Agency, the Proposed Rule Changes do not require any changes to the Rules, By-laws and Organization Certificate of DTC (“DTC Rules”), the Rulebook of GSD (“GSD Rules”), the

⁹ FICC and NSCC refer to their participants as “Members,” while DTC refers to its participants as “Participants.” These terms are defined in the rules of each of the Clearing Agencies. Supra note 4. Notice, 82 at 19121.

¹⁰ Notice, 82 at 19121.

¹¹ Id.

¹² Id.

¹³ The parent company of the Clearing Agencies is The Depository Trust & Clearing Corporation (“DTCC”). DTCC operates on a shared services model with respect to the Clearing Agencies. Most corporate functions are established and managed on an enterprise-wide basis pursuant to intercompany agreements under which it is generally DTCC that provides a relevant service to a Clearing Agency. Id.

Clearing Rules of MBSD (“MBSD Rules”), or the Rules & Procedures of NSCC (“NSCC Rules”), as the Framework would be a standalone document.¹⁴

The Clearing Agencies each filed Amendment No. 3 to the proposed rule changes, as previously modified, in order to clarify the three types of scenarios used in daily liquidity sufficiency testing to measure each Clearing Agency’s available liquidity resources, as described below.

A. Liquidity Resources

The Framework would address how each of the Clearing Agencies meets its requirement to hold qualifying liquid resources, as defined by Rule 17Ad-22(a)(14) under the Act,¹⁵ sufficient to meet its minimum liquidity resource requirement in each relevant currency for which it has payment obligations owed to its Members or Participants, as applicable.¹⁶ The Framework also would identify each of the qualifying liquid resources available to each Clearing Agency. Such qualifying liquid resources include, for example, (1) deposits to the Clearing Agencies’ respective Clearing Funds, or, for DTC, its Participants Fund, made by Members or Participants pursuant to the respective rules;¹⁷ (2) for DTC and NSCC, an annual committed credit facility;¹⁸

¹⁴ Available at <http://www.dtcc.com/en/legal/rules-and-procedures>. FICC is comprised of two divisions: the Government Securities Division (“GSD”) and the Mortgage-Backed Securities Division (“MBSD”). Notice, 82 at 19120.

¹⁵ 17 CFR 240.17Ad-22(a)(14).

¹⁶ Notice, 82 at 19121.

¹⁷ DTC Rule 4 (Participants Fund and Participants Investment), GSD Rule 4 (Clearing Fund and Loss Allocation), MBSD Rule 4 (Clearing Fund and Loss Allocation), NSCC Rule 4 (Clearing Fund). Supra note 8. Notice, 82 at 19121.

¹⁸ See Securities Exchange Act Release No. 77750 (April 29, 2016), 81 FR 27181 (May 5, 2016) (SR-DTC-2016-801, SR-NSCC-2016-801). Notice, 82 at 19121.

(3) for NSCC, its Members' Supplemental Liquidity Deposits;¹⁹ and (4) for GSD and MBSD, a rule-based Capped Contingency Liquidity Facility ("CCLF") program.²⁰ The Framework also would state that the Clearing Agencies may have access to other available liquidity resources that may not meet the definition of qualifying liquid resources.²¹

B. Liquidity Measurement and Monitoring

The Framework would describe the manner in which FICC and NSCC measure and monitor the sufficiency of their respective qualifying liquid resources to meet the cash settlement obligations of their respective largest Affiliated Family, through daily liquidity studies, across a range of stress scenarios.²² The Framework would state that FICC and NSCC would perform daily liquidity sufficiency testing using three types of scenarios: (1) normal market scenarios, as a baseline reference point to assess other stress assumptions;²³ (2) scenarios designed to meet the requirements set forth in Rule 17Ad-22(e)(7)(i) ;²⁴ and (3) scenarios designed to meet the

¹⁹ NSCC Rule 4A (Supplemental Liquidity Deposits). Supra note 8. Notice, 82 at 19121.

²⁰ MBSD Rule 17, Section 2a (Procedures for When the Corporation Ceases to Act). Supra note 8. GSD has filed a proposed rule change and related advance notice to adopt a CCLF program. See Securities Exchange Act Release No. 80234 (March 14, 2017), 82 FR 14401 (March 20, 2017) (SR-FICC-2017-002). The Notice of No Objection to Advance Notice Filing to Implement the Capped Contingency Liquidity Facility in the Government Securities Division Rulebook was issued. Securities Exchange Act Release No. 81054 (June 29, 2017), 82 FR 13876 (March 15, 2017) (SR-FICC-2017-802). Upon Commission approval of this proposed rule change, GSD's CCLF program will become a qualifying liquid resource of GSD. Notice, 82 at 19121.

²¹ Notice, 82 at 19121.

²² Id.

²³ Id.

²⁴ 17 CFR 240.17Ad-22(e)(7)(i).

requirements set forth in Rule 17Ad-22(e)(7)(vi).²⁵ The Framework would describe the manner in which scenarios reflecting these three sets of conditions are developed and selected for testing.²⁶ The Framework would also describe how the summary results of certain scenario analyses are escalated to Clearing Agency management on at least a monthly basis, and how these results are used to evaluate the adequacy of the liquidity resources of FICC or NSCC.²⁷

With respect to DTC's measurement of the sufficiency of its liquidity resources, the Framework would set forth that DTC's risk management tools, including the Collateral Monitor and Net Debit Cap,²⁸ limit DTC's liquidity exposure and, thus, DTC's liquidity requirement in default scenarios.²⁹ The Framework would describe how these risk management tools enable DTC to regularly test the sufficiency of its liquid resources on an intraday and end-of-day basis and adjust to stressed circumstances during a settlement day to protect DTC and its Participants against liquidity exposure under normal and stressed market conditions.³⁰

The Framework would describe how the Clearing Agencies review the limits of outstanding investments and collateral held (if applicable) of each Clearing Agency's investment counterparties, and conduct formal reviews of the reliability of their qualified liquidity providers

²⁵ 17 CFR 240.17Ad-22(e)(7)(vi).

²⁶ Notice, 82 at 19121.

²⁷ Id.

²⁸ "Collateral Monitor" and "Net Debit Cap" are defined in DTC Rule 1, Section 1 (Definitions), and their calculations are further provided for in the DTC Settlement Service Guide of the DTC Rules. Supra note 8.

²⁹ Notice, 82 at 19121.

³⁰ Id.

in extreme but plausible market conditions.³¹ The Framework would further describe how the Clearing Agencies undertake due diligence with respect to their liquidity providers, and how NSCC and DTC conduct operational testing with their committed credit facility lenders at least annually.³²

The Framework would describe how the Clearing Agencies would address foreseeable liquidity shortfalls that would not be covered by their existing liquid resources, and would describe how their existing qualified liquid resources may be replenished.³³ The Framework would state that the Clearing Agencies' liquidity risk models are subject to independent model validation on at least an annual basis.³⁴ The Framework would describe the manner in which Clearing Agency liquidity risks are assessed and escalated through liquidity risk management controls that include a statement of risk tolerances that are specific to liquidity risk ("Liquidity Risk Tolerance Statement"), and an operational risk profile of LPRU, which contains consolidated risk and control data.³⁵ Finally, the Framework would state that the Liquidity Risk Tolerance Statement is reviewed by management within the LPRU annually, and is escalated to the Risk Committee of the Boards for review and approval at least annually.³⁶

³¹ Id.

³² Id.

³³ Id.

³⁴ Id.

³⁵ Notice, 82 at 19121-19122.

³⁶ Notice, 82 at 19122.

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

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act,³⁷ to determine whether the Proposed Rule Changes should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the Proposed Rule Changes. As noted above, 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 Changes, and provide arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Changes.

Pursuant to Section 19(b)(2)(B) of the Act,³⁸ 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 Changes' consistency with the Act and the rules thereunder. Specifically, the Commission believes that the Proposed Rule Changes raise questions as to whether they are consistent with (i) Section 17A(b)(3)(F) of the Act,³⁹ which requires, in part, that the rules of the Clearing Agencies be 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 the Clearing Agencies or for which they are responsible, and (ii) Rule 17Ad-22(e)(7) under the Act, which requires, in general, that each covered clearing agency establish,

³⁷ 15 U.S.C. 78s(b)(2)(B).

³⁸ Id.

³⁹ 15 U.S.C. 78q-1(b)(3)(F).

implement, maintain and enforce written policies and procedures reasonably designed to, among other things effectively measure, monitor, and manage the liquidity risks that arise in or are borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity.⁴⁰

IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the Proposed Rule Changes. In particular, the Commission invites the written views of interested persons concerning whether the Proposed Rule Changes are consistent with Section 17A(b)(3)(F) of the Act,⁴¹ Rule 17Ad-22(e)(7) under the Act,⁴² or any other provision of the Act, rules, and regulations thereunder.

Interested persons are invited to submit written data, views, and arguments regarding whether the Proposed Rule Changes should be approved or disapproved on or before [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 on or before [INSERT DATE 35 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

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

⁴⁰ 17 CFR 240.17Ad-22(e)(7).

⁴¹ 15 U.S.C. 78q-1(b)(3)(F).

⁴² 17 CFR 240.17Ad-22(e)(7).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-DTC-2017-004, SR-NSCC-2017-005, or SR-FICC-2017-008 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-DTC-2017-004, SR-NSCC-2017-005, or SR-FICC-2017-008. One of these file numbers 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 Changes that are filed with the Commission, and all written communications relating to the Proposed Rule Changes between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Clearing Agencies, and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-DTC-2017-004, SR-NSCC-2017-005, or SR-FICC-2017-008 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]. If comments are received, any rebuttal comments should be submitted on or before [INSERT 35 DAYS FROM THE DATE OF PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴³

Eduardo A. Aleman
Assistant Secretary

⁴³ 17 CFR 200.30-3(a)(12).

