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 the Exchange. 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–MEMX–2020–09* and should be submitted on or before October 23, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[20]

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2020–21768 Filed 10–1–20; 8:45 am]

BILLING CODE 8011–01–P

[20] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–90034; File No. SR–NSCC–2020–804]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Amendment No. 2 and Notice of No Objection to Advance Notice, as Modified by Amendment Nos. 1 and 2, To Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Risk Charge in the VaR Charge

September 28, 2020.

On July 30, 2020, National Securities Clearing Corporation (''NSCC'') filed with the Securities and Exchange Commission (''Commission'') advance notice SR–NSCC–2020–804 pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (''Clearing Supervision Act''),[1] and Rule 19b–4(n)(1)(i) [2] under the Securities Exchange Act of 1934 (''Exchange Act'') [3] to add two new charges to NSCC's margin methodology. On August 13, 2020, NSCC filed Amendment No. 1 to the advance notice, to make clarifications and corrections to the advance notice.[4] The advance notice, as modified by Amendment No. 1, was published for public comment in the **Federal Register** on September 4, 2020,[5] and the Commission has received no comments regarding the changes proposed in the advance notice as modified by Amendment No. 1. On September 10, 2020, the Commission received one comment letter on NSCC's related Proposed Rule Change.[6] To the extent that the comment letter on the Proposed Rule Change is relevant to the Advance Notice, it is discussed below.[7] On August 27, 2020, NSCC filed Amendment No. 2 to the advance notice to provide additional data for the Commission to consider in analyzing the advance notice.[8] The advance notice, as modified by Amendment Nos. 1 and 2, is hereinafter referred to as the ''Advance Notice.'' The Commission is publishing this notice to solicit comments on Amendment No. 2 from interested persons and, for the reasons discussed below, is hereby providing notice of no objection to the Advance Notice.

[1] 12 U.S.C. 5465(e)(1).

[2] 17 CFR 240.19b–4(n)(1)(i).

[3] 15 U.S.C. 78a *et seq.*

[4] Amendment No. 1 made clarifications and corrections to the description of the advance notice and Exhibits 3 and 5 of the filing.

[5] Securities Exchange Act Release No. 89719 (September 1, 2020), 85 FR 55332 (September 4, 2020) (File No. SR–NSCC–2020–804) (''Notice of Filing''). On July 30, 2020, NSCC also filed a related proposed rule change (SR–NSCC–2020–016) with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b–4 thereunder. On August 13, 2020, NSCC filed Amendment No. 1 to the proposed rule change to make similar clarifications and corrections to the proposed rule change. *See* 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b–4 respectively. The proposed rule change, as amended by Amendment No. 1, was published in the **Federal Register** on August 20, 2020. Securities Exchange Act Release No. 89558 (August 14, 2020), 85 FR 51521 (August 20, 2020). On August 27, 2020, NSCC filed Amendment No. 2 to the proposed rule change to provide similar additional data for the Commission's consideration. The proposed rule change, as amended by Amendment Nos. 1 and 2, is hereinafter referred to as the ''Proposed Rule Change.'' In the Proposed Rule Change, NSCC seeks approval of proposed changes to its rules necessary to implement the Advance Notice. The comment period for the related Proposed Rule Change filing closed on September 10, 2020, and the Commission received no comments.

[6] See letter from Cass Sanford, Associated General Counsel, OTC Markets Group (September 10, 2020) (''OTC Letter''), available at *https://www.sec.gov/comments/sr-nscc-2020-016/srnscc2020016-7757533-223234.pdf.*

[7] As the proposals contained in the Advance Notice were also filed as a proposed rule change, all public comments received on the proposal are considered regardless of whether the comments are submitted on the Proposed Rule Change or the Advance Notice.

[8] In Amendment No. 2, NSCC updated Exhibit 3 to the advance notice to include impact analysis data with respect to the proposals in the advance notice. NSCC filed Exhibit 3 as a confidential exhibit to the advance notice pursuant to 17 CFR 240.24b–2.

I. The Advance Notice

First, the proposals in the Advance Notice would revise NSCC's Rules and Procedures (''Rules'') [9] to introduce the Margin Liquidity Adjustment Charge (''MLA Charge'') as an additional margin component. Second, the proposals in the Advance Notice would revise the Rules to add a bid-ask spread risk charge (''Bid-Ask Spread Charge'') to NSCC's margin calculations.

A. Background

NSCC provides central counterparty (''CCP'') services, including clearing, settlement, risk management, and a guarantee of completion for virtually all broker-to-broker trades involving equity securities, corporate and municipal debt securities, and certain other securities. In its role as a CCP, a key tool that NSCC uses to manage its credit exposure to its members by determining and collecting an appropriate Required Fund Deposit (*i.e.,* margin) for each member.[10] The aggregate of all members' Required Fund Deposits (together with certain other deposits required under the Rules) constitutes NSCC's Clearing Fund, which NSCC would access should a defaulted member's own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that member's portfolio.[11]

Each member's Required Fund Deposit consists of a number of applicable components, which are calculated to address specific risks that the member's portfolio presents to NSCC.[12] Generally, the largest component of a member's Required Fund Deposit is the volatility charge, which is intended to capture the risks related to the movement of market prices associated with the securities in a member's portfolio.[13] NSCC's methodology for calculating the

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

[10] *See* Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules (''Procedure XV''), *supra* note 8.

[11] *See id.*

[12] *See id.*

[13] *See id.*

volatility charge of the Required Fund Deposit depends on the type of security. For most securities, (*e.g.,* equity securities), NSCC calculates the volatility charge as the greater of (1) the larger of two separate calculations that utilize a parametric Value at Risk (''VaR'') model, (2) a gap risk measure calculation based on the largest non-index position in a portfolio that exceeds a concentration threshold, which addresses concentration risk that the largest non-index position can present within a member's portfolio, and (3) a portfolio margin floor calculation based on the market values of the long and short positions in the portfolio, which addresses risks that might not be adequately addressed with the other volatility charge calculations.[14] For certain other securities (*e.g.,* corporate and municipal bonds), NSCC's Rules apply a haircut-based volatility charge that is calculated by multiplying the absolute value of the positions by a percentage.[15] The volatility charge is designed to calculate the potential losses on a portfolio over a three-day period of risk assumed necessary to liquidate the portfolio, within a 99 percent confidence level.[16]

NSCC states that it regularly assesses market and liquidity risks as such risks relate to its margin methodology to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market.[17] NSCC states that the proposed MLA Charge and Bid-Ask Spread Charge are necessary for NSCC to effectively account for risks associated with certain types and attributes of member portfolios.[18]

B. Margin Liquidity Adjustment Charge

NSCC's current margin methodology does not account for the risk of a potential increase in market impact costs that NSCC could incur when liquidating a defaulted member's portfolio that contains a concentration of large positions, as compared to the overall market, in a particular security or group of securities sharing a similar risk profile.[19] In a member default, liquidating such large positions within a potentially compressed timeframe [20] (*i.e.,* in a fire sale) could have an impact on the underlying market, resulting in price moves that increases NSCC's risk of incurring additional liquidation costs. Therefore, NSCC designed the MLA Charge to address this specific risk.[21]

The MLA Charge would be based on comparing the market value of member portfolio positions in specified asset groups [22] to the available trading volume of those asset groups. If the market value of a member's positions in a certain asset group is large in comparison to the available trading volume of that asset group,[23] then it is more likely that NSCC would have to manage reduced marketability and increased liquidation costs for those positions during a member default scenario. Specifically, NSCC's margin methodology assumes for each asset group that a certain share of the market can be liquidated without price impact.[24] Aggregate positions in an asset group which exceed this share are generally considered as large and would therefore incur application of the MLA Charge to anticipate and address those increased costs.

For each position in a market capitalization subgroup of the equities asset group, NSCC would calculate the market impact cost by multiplying four components: (1) An impact cost coefficient that is a multiple of the one-day market volatility of that subgroup and is designed to measure impact costs, (2) the gross market value of the position in that subgroup, (3) the square root of the gross market value of the position in that subgroup in the portfolio divided by an assumed percentage of the average daily trading volume of that subgroup, and (4) a measurement of the relative weight of the position in that subgroup of the portfolio. With respect to the fourth component, NSCC states that this measurement would include aggregating the weight of each CUSIP in that position relative to the weight of that CUSIP in the subgroup, such that a portfolio with fewer positions in a subgroup would have a higher measure of concentration for that subgroup.[25]

For each position in the municipal bond, corporate bond, Illiquid Securities and UIT asset groups, and for positions in the treasury ETP and other ETP subgroups of the equities asset group, NSCC would calculate the market impact cost by multiplying three components: (1) An impact cost coefficient that is a multiple of the one-day market volatility of that asset group or subgroup, (2) the gross market value of the position in that asset group or subgroup, and (3) the square root of the gross market value of the position in that asset group or subgroup in the portfolio divided by an assumed percentage of the average daily trading volume of that subgroup.[26]

For each asset group or subgroup, NSCC would compare the calculated market impact cost to a portion of the volatility charge that is allocated to positions in that asset group or subgroup.[27] If the ratio of the calculated market impact cost to the applicable one-day volatility charge is greater than a threshold, NSCC would apply an MLA Charge to that asset group or subgroup.[28] If the ratio of these two

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

[15] *See id.*

[16] *See* Notice of Filing, *supra* note 5 at 55332, 34.

[17] *See* Notice of Filing, *supra* note 5 at 55333.

[18] *See id.*

[19] *See id.*

[20] NSCC's risk models assume the liquidation occurs over a period of three business days. *See* Notice of Filing, *supra* note 5 at 55333–34.

[21] *See* Notice of Filing, *supra* note 5 at 55333.

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

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

[24] NSCC would establish the particular share for each asset group or subgroup based on empirical research which includes the simulation of asset liquidation over different time horizons. *See* Notice of Filing, *supra* note 5 at 55333–34.

[25] NSCC would calculate the relative weight by dividing the absolute market value of a single CUSIP in the member's portfolio by the total absolute market value of that portfolio. *See* Notice of Filing, *supra* note 5 at 55334.

[26] *See supra* note 22.

[27] For purposes of this calculation, NSCC would use a portion of the applicable volatility charge that is based on a one-day assumed period of risk and calculated by applying a simple square-root of time scaling, referred to in this advance notice as ''one-day volatility charge.'' *See* Notice of Filing, *supra* note 5 at 55334. Any changes that NSCC deems appropriate to this assumed period of risk would be subject to NSCC's model risk management governance procedures set forth in the Clearing Agency Model Risk Management Framework (''Model Risk Management Framework''). *See* Securities Exchange Act Release Nos. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File No. SR–NSCC–2017–008); 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR–NSCC–2018–009); 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File No. SR–NSCC–2020–008).

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

amounts is equal to or less than this threshold, NSCC would not apply an MLA Charge to that asset group or subgroup. The threshold would be based on an estimate of the market impact cost that is incorporated into the calculation of the applicable one-day volatility charge, such that NSCC would only apply an MLA Charge when the calculated market impact cost exceeds this threshold.

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

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

In certain circumstances, NSCC may be able to partially mitigate the risks that the MLA Charge is designed to address by extending the time period for liquidating a defaulted member's portfolio beyond the three day period. Accordingly, the Advance Notice also describes a method that NSCC would use to reduce a member's total MLA Charge when the volatility charge component of the member's margin increases beyond a specified point. Specifically, NSCC would reduce the member's MLA Charge where the market impact cost of a particular portfolio, calculated as part of determining the MLA Charge, would be large relative to the one-day volatility charge for that portfolio (*i.e.,* a portion of the three-day assumed margin period of risk). When the ratio of calculated market impact cost to the one-day volatility charge is lower, NSCC would not adjust the MLA Charge. However, as the ratio gets higher, NSCC would reduce the MLA Charge. NSCC designed this reduction mechanism to avoid assessing unnecessarily large MLA Charges.[29]

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

Finally, NSCC would amend the Rules to add the MLA Charge to the list of Clearing Fund components that are excluded from the calculation of the Excess Capital Premium charge.[30] The Excess Capital Premium is imposed on a member when the member's Required Fund Deposit exceeds its excess net capital. NSCC states that including the MLA Charge in the calculation of the Excess Capital Premium could lead to more frequent and unnecessary Excess Capital Premium charges, which is not the intended purpose of the Excess Capital Premium charge and could place an unnecessary burden on members.[31]

[29] *See* Notice of Filing, *supra* note 5 at 55334.

[30] *See* Section I.(B)(2) of Procedure XV, *supra* note 8.

[31] *See* Notice of Filing, *supra* note 5 at 55335.

C. Bid-Ask Spread Charge

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

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

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

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

NSCC proposes to review the haircut rates annually.[32] Based on analyses of recent years' simulation exercises, NSCC does not anticipate that these haircut rates would change significantly year over year.[33] NSCC may also adjust the haircut rates following its annual model validation review, to the extent the results of that review indicate the current haircut rates are not adequate to address the risk presented by transaction costs from a bid-ask spread.[34]

II. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the advance notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments

• Use the Commission's internet comment form (*http://www.sec.gov/rules/sro.shtml*); or

• Send an email to *rule-comments@sec.gov.* Please include File Number SR–NSCC–2020–804 on the subject line.

Paper Comments

Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

All submissions should refer to File Number SR–NSCC–2020–804. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than

[32] *See id.*

[33] *See id.*

[34] All proposed changes to the haircuts would be subject to NSCC's model risk management governance procedures set forth in the Model Risk Management Framework. *See supra* note 26.

those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of NSCC and NSCC's website at *https://www.dtcc.com/legal.*

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NSCC–2020–804 and should be submitted on or before October 19, 2020.

III. Discussion and Commission Findings

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: To mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs and strengthening the liquidity of SIFMUs.[35]

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe regulations containing risk management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency.[36] Section 805(b) of the Clearing Supervision Act provides the following objectives and principles for the Commission's risk management standards prescribed under Section 805(a):[37]

- to promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

Section 805(c) provides, in addition, that the Commission's risk management standards may address such areas as risk management and default policies and procedures, among others areas.[38]

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the ''Clearing Agency Rules'').[39] The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk management practices on an ongoing basis.[40] As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the proposal in the Advance Notice is consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,[41] and in the Clearing Agency Rules, in particular Rules 17Ad–22(e)(4) and (e)(6).[42]

A. Consistency With Section 805(b) of the Clearing Supervision Act

The Commission believes that the Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act. [43]

The Commission believes that adopting NSCC's proposed MLA Charge and Bid-Ask Spread Charge would be consistent with the promotion of robust risk management at NSCC. As described above in Section I.A and B, NSCC's current margin methodology does not account for the potential increase in market impact costs that NSCC could incur when liquidating a defaulted member's portfolio where the portfolio contains a concentration of large positions in a particular security or group of securities sharing a similar risk profile. Additionally, as described above in Section I.C, NSCC's margin methodology does not account for the risk of potential bid-ask spread transaction costs when liquidating the securities in a defaulted member's portfolio. NSCC proposes to address these respective risks by adding the MLA Charge and Bid-Ask Spread Charge to its margin methodology.[44]

Specifically, the MLA Charge should better enable NSCC to manage the risk of incurring costs associated with the decreased marketability of a defaulted member's portfolio where the portfolio contains a large position in securities sharing similar risk profiles, resulting in potentially higher liquidation costs. To avoid excessive MLA Charges, NSCC has identified circumstances that would warrant reducing a member's MLA Charge when NSCC could otherwise partially mitigate the relevant risks by extending the time period for liquidating a defaulted member's portfolio beyond the three day period. The Commission views this targeted reduction in the MLA Charge as a feature of the proposal that demonstrates a robust approach towards managing the relevant risks through appropriate (*i.e.,* not simply ''larger'') margin requirements. Additionally, since NSCC's current margin methodology does not account for bid-ask spread transaction costs when liquidating a defaulted member's portfolio, the Bid-Ask Spread Charge should enable NSCC to manage such risks. Accordingly, the Commission believes that adopting the proposed MLA Charge and Bid-Ask Spread Charge would allow for measurement and targeted mitigation of risks and costs not captured elsewhere in NSCC's current margin methodology, and would therefore provide for more comprehensive management of risks in a member default scenario, consistent with the promotion of robust risk management.

The commenter argues that NSCC's Advance Notice fails to provide sufficient information to evaluate the necessity and impact of the proposal. Specifically, the commenter argues that the proposal provides no explanation as to why the current Clearing Fund

[35] *See* 12 U.S.C. 5461(b).

[36] 12 U.S.C. 5464(a)(2).

[37] 12 U.S.C. 5464(b).

[38] 12 U.S.C. 5464(c).

[39] 17 CFR 240.17Ad–22. *See* Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7–08–11). *See also* Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7–03–14) (''Covered Clearing Agency Standards''). NSCC is a ''covered clearing agency'' as defined in Rule 17Ad–22(a)(5).

[40] 17 CFR 240.17Ad–22.

[41] 12 U.S.C. 5464(b).

[42] 17 CFR 240.17Ad–22(e)(4) and (e)(6).

[43] One of the issues raised by the OTC Letter is directed at the Proposed Rule Change, will be addressed in that context. Specifically, OTC Markets Group argues that the proposal imposes an undue burden on competition, stating that the proposal would impose additional margin requirements for firms processing transactions in smaller and less liquid securities and disproportionately impact member firms with lower operating margins or higher costs of capital. That issue is relevant to the Commission's evaluation of the related Proposed Rule Change, which is conducted under the Exchange Act, but not to the Commission's evaluation of the Advance Notice, which, as discussed below in Section III.B, is conducted under the Clearing Supervision Act and generally considers whether the proposal will mitigate systemic risk and promote financial stability. Accordingly, concerns regarding burden on competition are not discussed herein but will be addressed in the Commission's review of the related Proposed Rule Change, as applicable, under the Exchange Act.

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

formula is inadequate or how the proposed methodology would limit NSCC's exposure in the event of a member default. The Commission disagrees. As described in the Notice and noted above, NSCC's current margin methodology does not account for the risk of a potential increase in market impact costs that NSCC could incur when liquidating a defaulted member's portfolio that contains a concentration of large positions, as compared to the overall market and account for this risk of potential bid-ask spread transaction costs in connection with liquidating a defaulted member's portfolio. As a result, NSCC's Advance Notice is designed to address these specific risks, that are currently unaddressed, and thus limit NSCC's exposure.

Furthermore, when considering the issues raised in the Advance Notice, the Commission thoroughly considered (1) NSCC's Advance Notice, including the supporting exhibits that provided, among other things, confidential impact analyses regarding the proposals in NSCC's Advance Notice;[45] (2) the OTC Letter; and (3) the Commission's own understanding of NSCC's margin methodology, with which the Commission has experience from its general supervision of NSCC. Based on its review of these materials, the Commission believes that, as set forth in the Notice of Filing, NSCC has done exactly what the commenter seeks, in that the proposal explains why the current methodology is inadequate (*i.e.,* it does not address these particular risks), and how the proposed methodology would address this issue (*i.e.,* by including add-on charges calibrated to address these particular risks).[46] Thus, notwithstanding the comments raised in the OTC Letter, the Commission believes that adopting the proposed MLA Charge and Bid-Ask Spread Charge would be consistent with the promotion of robust risk management at NSCC.

Further, the Commission believes that adopting NSCC's proposed MLA Charge and Bid-Ask Spread Charge would be consistent with promoting safety and soundness at NSCC. NSCC designed the MLA Charge and Bid-Ask Spread Charge to ensure that NSCC collects margin amounts sufficient to manage NSCC's risk of incurring costs associated with liquidating defaulted member portfolios. The proposed MLA Charge and Bid-Ask Spread Charge would generally provide NSCC with additional resources to manage potential losses arising out of a member default. Such an increase in available financial resources would decrease the likelihood that losses arising out of a member default would exceed NSCC's resources and threaten the safety and soundness of NSCC's ongoing operations. Accordingly, the Commission believes that adding the proposed MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology would be consistent with promoting safety and soundness at NSCC.

Finally, the Commission believes that adopting NSCC's proposed MLA Charge and Bid-Ask Spread Charge would be consistent with reducing systemic risks and supporting the stability of the broader financial system. As discussed above, in a member default scenario, NSCC would access its Clearing Fund should the defaulted member's own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of that member's portfolio. NSCC proposes to add the MLA Charge and Bid-Ask Spread Charge to its margin methodology to better manage the potential costs of liquidating a defaulted member's portfolio. NSCC proposes to collect additional margin to cover such costs. This, in turn, could reduce the possibility that NSCC would need to mutualize among the non-defaulting members a loss arising out of the close-out process. Reducing the potential for loss mutualization could, in turn, reduce the potential knock-on effects to non-defaulting members, their customers, and the broader market arising out of a member default. Further, the Commission notes that, to the extent that the MLA Charge results in any reduction in members' large positions in securities with similar risk profiles, it could reduce the potential risk of adverse market impacts that can arise from liquidating those large positions. However, the Commission also notes that the proposal to reduce the MLA Charge when NSCC could otherwise partially mitigate the relevant risks would help ensure that NSCC would not impose the MLA Charge without an appropriate risk management basis. Accordingly, the Commission believes that NSCC's adoption of the proposed MLA Charge and Bid-Ask Spread Charge would be consistent with the reduction of systemic risk and supporting the stability of the broader financial system.

For the reasons stated above, the Commission believes the changes proposed in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act.[47]

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

Rule 17Ad–22(e)(4)(i) requires that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.[48]

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

[45] Specifically, the confidential Exhibit 3 submitted by NSCC includes, among other things, (1) impact studies for various time periods detailing the average and maximum MLA and Bid-Ask Charges for each member, by both percentage and amount, (2) a detailed methodology describing the calculation of the MLA and Bid-Ask Charges, and (3) information regarding how NSCC determined the appropriate methodology.

[46] Moreover, to the extent that the commenter argues that additional detail or information is necessary to enable the public to evaluate the proposal, the Commission disagrees. With respect to the MLA Charge, the Notice of Filing explains that concentrated positions would lead to application of the MLA Charge and provides sufficient information as to the components that would be used to make the determination of concentration to allow a Member to consider whether the MLA Charge would apply. With respect to the Bid-Ask Spread Charge, the Notice of Filing identifies the particular haircuts that would apply to all securities.

[47] 12 U.S.C. 5464(b).

[48] 17 CFR 240.17Ad–22(e)(4)(i).

should enable NSCC to manage such risks and costs.

The commenter suggests that the proposals in NSCC's Advance Notice are duplicative of a separate NSCC proposal regarding Illiquid Securities that is currently pending before the Commission.[49] The commenter argues that since both proposals include provisions that would apply to Illiquid Securities,[50] thereby potentially affecting their margin levels, both proposals appear to address the same concerns. Therefore, the commenter suggests that instead of approving NSCC's Advance Notice, the Commission should consolidate NSCC's Advance Notice together with the Illiquid Securities Proposal and extend the public comment period before the Commission makes a substantive determination.

The Commission disagrees with the comments raised in the OTC Letter. NSCC's Advance Notice and the Illiquid Securities Proposal deal with separate and distinguishable aspects of NSCC's margin methodology, even if there is a group of Illiquid Securities to which both proposals would apply. The Illiquid Securities Proposal is designed to amend the method by which NSCC determines the appropriate volatility component of margin for a particular thinly traded security, *i.e.,* calculate appropriate margin to cover potential losses on a portfolio using historical, mid-point securities prices. The Advance Notice is designed to address two specific risks that are not captured directly by historical mid-point security price movements and that are directed at additional costs that may arise during the liquidation of a Member's portfolio in the event of a default: (1) The potential added costs of liquidating large concentrated positions in a limited period of time and (2) bid-ask spread transactions costs.

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

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

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

The Commission believes that adding the MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology should enable NSCC to more effectively identify, measure, monitor, and manage its credit exposures in connection with liquidating a defaulted member's portfolio that may give rise to (1) decreased marketability due to large positions of securities sharing similar risk profiles, and (2) bid-ask spread transaction costs. Accordingly, the Commission believes that adding the MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology would be consistent with Rule 17Ad–22(e)(4)(i) because these new margin charges should better enable NSCC to maintain sufficient financial resources to cover NSCC's credit exposure to its members fully with a high degree of confidence.[51]

C. Consistency With Rules 17Ad–22(e)(6)(i) and (v)

Rule 17Ad–22(e)(6)(i) requires that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.[52] Rule 17Ad–22(e)(6)(v) requires that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.[53]

As described above in Section I.A and B, NSCC's current margin methodology does not account for the potential increase in market impact costs when liquidating a defaulted member's portfolio where the portfolio contains a large position in securities sharing

[49] Securities Exchange Act Release No. 88615 (April 9, 2020), 85 FR 21037 (April 15, 2020) (SR–NSCC–2020–802) (''Illiquid Securities Proposal'').

[50] Under NSCC's Rules, Illiquid Securities may include any security that meets the criteria set forth in the term's definition and would not necessarily be limited to securities with small or micro market capitalizations.

[51] *Id.*

[52] 17 CFR 240.17Ad–22(e)(6)(i).

[53] 17 CFR 240.17Ad–22(e)(6)(v).

similar risk profiles. NSCC proposes to address this risk by adding the MLA Charge to its margin methodologies. To avoid excessive MLA Charges and ensure margin requirements are commensurate with the relevant risks, NSCC also contemplates reducing a member's MLA Charge when NSCC could otherwise partially mitigate the relevant risks by extending the time period for liquidating a defaulted member's portfolio beyond the three day period.

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

Accordingly, the Commission believes that adding the MLA Charge and Bid-Ask Spread Charge to NSCC's margin methodology would be consistent with Rules 17Ad–22(e)(6)(i) and (v) because these new margin charges should better enable NSCC to establish a risk-based margin system that (1) considers and produces relevant margin levels commensurate with the risks associated with liquidating member portfolios in a default scenario, including decreased marketability of a portfolio's securities due to large positions in securities sharing similar risk profiles and bid-ask transaction costs, and (2) uses an appropriate method for measuring credit exposure that accounts for such risk factors and portfolio effects.[54]

IV. Conclusion

It is therefore noticed, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission *does not object* to Advance Notice (SR–NSCC–2020–804) and that NSCC is *authorized* to implement the proposed change as of the date of this notice or the date of an order by the Commission approving Proposed Rule Change SR–NSCC–2020–016, whichever is later.

By the Commission.

J. Matthew DeLesDernier,

Assistant Secretary.

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[54] 17 CFR 240.17Ad–22(e)(6)(i) and (v).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–90033; File No. SR–FICC–2020–802]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Amendment No. 2 and Notice of No Objection to Advance Notice, as Modified by Amendment Nos. 1 and 2, to Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Charge in the VaR Charges

September 28, 2020.

On July 30, 2020, Fixed Income Clearing Corporation (''FICC'') filed with the Securities and Exchange Commission (''Commission'') advance notice SR–FICC–2020–802 pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (''Clearing Supervision Act''),[1] and Rule 19b–4(n)(1)(i)[2] under the Securities Exchange Act of 1934 (''Exchange Act'')[3] to add two new charges to FICC's margin methodologies. On August 13, 2020, FICC filed Amendment No. 1 to the advance notice, to make clarifications and corrections to the advance notice.[4] The advance notice, as modified by Amendment No. 1, was published for public comment in the **Federal Register** on September 4, 2020,[5] and the Commission has received no comments regarding the changes proposed in the advance notice as modified by Amendment No. 1.[6] On August 27, 2020, FICC filed Amendment No. 2 to the advance notice to provide additional data for the Commission to consider in analyzing the advance notice.[7] The advance notice, as modified by Amendment Nos. 1 and 2, is hereinafter referred to as the ''Advance Notice.'' The Commission is publishing this notice to solicit comments on Amendment No. 2 from interested persons and, for the reasons discussed below, is hereby providing notice of no objection to the Advance Notice.

I. The Advance Notice

First, the proposals in the Advance Notice would revise the FICC Government Securities Division (''GSD'') Rulebook (''GSD Rules'') and FICC Mortgage-Backed Securities Division (''MBSD'') Clearing Rules (''MBSD Rules,'' and together with the GSD Rules, the ''Rules'')[8] to introduce the Margin Liquidity Adjustment Charge (''MLA Charge'') as an additional margin component. Second, the proposals in the Advance Notice would revise the Rules, GSD Methodology Document—GSD Initial Market Risk Margin Model (''GSD QRM Methodology Document''), and MBSD Methodology and Model

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[1] 12 U.S.C. 5465(e)(1).

[2] 17 CFR 240.19b–4(n)(1)(i).

[3] 15 U.S.C. 78a *et seq.*

[4] Amendment No. 1 made clarifications and corrections to the description of the advance notice and Exhibits 3 and 5 of the filing.

[5] Securities Exchange Act Release No. 89718 (September 1, 2020), 85 FR 55341 (September 4, 2020) (File No. SR–FICC–2020–802) (''Notice of Filing''). On July 30, 2020, FICC also filed a related proposed rule change (SR–FICC–2020–009) with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b–4 thereunder. On August 13, 2020, FICC filed Amendment No. 1 to the proposed rule change to make similar clarifications and corrections to the proposed rule change. *See* 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b–4 respectively. The proposed rule change, as amended by Amendment No. 1, was published in the **Federal Register** on August 20, 2020. Securities Exchange Act Release No. 89560 (August 14, 2020), 85 FR 51503 (August 20, 2020). On August 27, 2020, FICC filed Amendment No. 2 to the proposed rule change to provide similar additional data for the Commission's consideration. The proposed rule change, as amended by Amendment Nos. 1 and 2, is hereinafter referred to as the ''Proposed Rule Change.'' In the Proposed Rule Change, FICC seeks approval of proposed changes to its rules necessary to implement the Advance Notice. The comment period for the related Proposed Rule Change filing closed on September 10, 2020, and the Commission received no comments.

[6] As the proposals contained in the Advance Notice were also filed as a proposed rule change, all public comments received on the proposal are considered regardless of whether the comments are submitted on the Proposed Rule Change or the Advance Notice.

[7] In Amendment No. 2, FICC updated Exhibit 3 to the advance notice to include impact analysis data with respect to the proposals in the advance notice. FICC filed Exhibit 3 as a confidential exhibit to the advance notice pursuant to 17 CFR 240.24b–2.

[8] Capitalized terms not defined herein are defined in the Rules, *available at https://www.dtcc.com/legal/rules-and-procedures.aspx.*