

of the date of this notice or the date of an order by the Commission approving proposed rule change SR-FICC-2017-022, as modified by Amendment No. 1, whichever is later.

By the Commission.

**Eduardo A. Aleman,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83955; File No. SR-NSCC-2017-805]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of No Objection to an Advance Notice, as Modified by Amendment No. 1, To Adopt a Recovery & Wind-Down Plan and Related Rules

August 27, 2018.

On December 18, 2017, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-NSCC-2017-805 pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”)<sup>2</sup> to adopt a recovery and wind-down plan (“R&W Plan”) and related rules.<sup>3</sup> The advance

notice was published for comment in the **Federal Register** on January 30, 2018.<sup>4</sup> In that publication, the Commission also extended the review period of the advance notice for an additional 60 days, pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act.<sup>5</sup> On April 10, 2018, the Commission required additional information from NSCC pursuant to Section 806(e)(1)(D) of the Clearing Supervision Act,<sup>6</sup> which tolled the Commission’s period of review of the advance notice until 60 days from the date the information required by the Commission was received by the Commission.<sup>7</sup> On June 28, 2018, NSCC filed Amendment No. 1 to the advance notice to amend and replace in its entirety the advance notice as originally filed on December 18, 2017.<sup>8</sup> On July 6, 2018, the Commission received a response to its request for additional information in consideration of the advance notice, which, in turn, added a further 60-days to the review period pursuant to Section 806(e)(1)(E) and (G) of the Clearing Supervision Act.<sup>9</sup> The

Proposed Rule Change. Securities Exchange Act Release No. 83632 (July 13, 2018), 83 FR 34166 (July 19, 2018) (SR-NSCC-2017-017). NSCC submitted a courtesy copy of Amendment No. 1 to the Proposed Rule Change through the Commission’s electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the Proposed Rule Change has been publicly available on the Commission’s website at <https://www.sec.gov/rules/sro/nscc.htm> since June 29, 2018. The Commission did not receive any comments. The proposal, as set forth in both the advance notice and the Proposed Rule Change, each as modified by Amendments No. 1, shall not take effect until all required regulatory actions are completed.

<sup>4</sup> Securities Exchange Act Release No. 82581 (January 24, 2018), 83 FR 4327 (January 30, 2018) (SR-NSCC-2017-805) (“Notice”).

<sup>5</sup> Pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act, the Commission may extend the review period of an advance notice for an additional 60 days, if the changes proposed in the advance notice raise novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. 12 U.S.C. 5465(e)(1)(H). The Commission found that the advance notice raised novel and complex issues and, accordingly, extended the review period of the advance notice for an additional 60 days until April 17, 2018. See Notice, *supra* note 4.

<sup>6</sup> 12 U.S.C. 5465(e)(1)(D).

<sup>7</sup> See 12 U.S.C. 5465(e)(1)(E)(ii) and (G)(ii); see Memorandum from the Office of Clearance and Settlement Supervision, Division of Trading and Markets, titled “Commission’s Request for Additional Information,” available at <https://www.sec.gov/rules/sro/nscc-an.htm>.

<sup>8</sup> Securities Exchange Act Release No. 83745 (July 31, 2018), 83 FR 38329 (August 6, 2018) (SR-NSCC-2017-805). NSCC submitted a courtesy copy of Amendment No. 1 to the advance notice through the Commission’s electronic public comment letter mechanism. Accordingly, Amendment No. 1 to the advance notice has been publicly available on the Commission’s website at <https://www.sec.gov/rules/sro/nscc-an.htm> since June 29, 2018.

<sup>9</sup> 12 U.S.C. 5465(e)(1)(E) and (G); see Memorandum from the Office of Clearance and

Commission did not receive any comments. This publication serves as notice that the Commission does not object to the proposed changes set forth in the advance notice, as modified by Amendment No. 1 (hereinafter, “Advance Notice”).

### I. Description of the Advance Notice

In the Advance Notice, NSCC proposes to (1) adopt an R&W Plan; (2) amend NSCC’s Rules & Procedures (“Rules”)<sup>10</sup> to adopt Rule 41 (Corporation Default), Rule 42 (Wind-down of the Corporation), and Rule 60 (Market Disruption and Force Majeure) (each a “Proposed Rule” and, collectively, the “Proposed Rules”); and (3) re-number current Rule 42 (Wind-down of a Member, Fund Member or Insurance Carrier/Retirement Services Member) to Rule 40, which is currently reserved for future use.

NSCC states that the R&W Plan would be used by the Board of Directors of NSCC (“Board”) and management of NSCC in the event NSCC encounters scenarios that could potentially prevent it from being able to provide its critical services as a going concern.

NSCC states that the Proposed Rules are designed to (1) facilitate the implementation of the R&W Plan when necessary and, in particular, allow NSCC to effectuate its strategy for winding down and transferring its business; (2) provide Members and Limited Members with transparency around critical provisions of the R&W Plan that relate to their rights, responsibilities and obligations; and (3) provide NSCC with the legal basis to implement those provisions of the R&W Plan when necessary.

#### A. NSCC R&W Plan

The R&W Plan would be structured to provide a roadmap, define the strategy, and identify the tools available to NSCC to either (i) recover, in the event it experiences losses that exceed its prefunded resources (such strategies and tools referred to herein as the “Recovery Plan”) or (ii) wind-down its business in a manner designed to permit the continuation of its critical services in the event that such recovery efforts are not successful (such strategies and tools referred to herein as the “Wind-down Plan”).

The R&W Plan would identify (i) the recovery tools available to NSCC to address the risks of (a) uncovered losses

Settlement Supervision, Division of Trading and Markets, titled “Response to the Commission’s Request for Additional Information,” available at <https://www.sec.gov/rules/sro/nscc-an.htm>.

<sup>10</sup> Capitalized terms used herein and not otherwise defined herein are defined in the Rules.

or liquidity shortfalls resulting from the default of one or more Members, and (b) losses arising from non-default events, such as damage to its physical assets, a cyber-attack, or custody and investment losses, and (ii) the strategy for implementation of such tools. The R&W Plan would also establish the strategy and framework for the orderly wind-down of NSCC and the transfer of its business in the remote event the implementation of the available recovery tools does not successfully return NSCC to financial viability.

As discussed in greater detail below, the R&W Plan would provide, among other matters, (i) an overview of the business of NSCC and its parent, The Depository Trust & Clearing Corporation (“DTCC”);<sup>11</sup> (ii) an analysis of NSCC’s intercompany arrangements and critical links to other financial market infrastructure (“FMI”); (iii) a description of NSCC’s services, and the criteria used to determine which services are considered critical; (iv) a description of the NSCC and DTCC governance structure; (v) a description of the governance around the overall recovery and wind-down program; (vi) a discussion of tools available to NSCC to mitigate credit/market<sup>12</sup> risks and liquidity risks, including recovery indicators and triggers, and the governance around management of a stress event along a Crisis Continuum timeline; (vii) a discussion of potential non-default losses and the resources available to NSCC to address such losses, including recovery triggers and tools to mitigate such losses; (viii) an analysis of the recovery tools’ characteristics, including how they are designed to be comprehensive, effective, and transparent, how the tools provide incentives to Members to, among other things, control and monitor the risks they may present to NSCC, and how NSCC seeks to minimize the negative consequences of executing its recovery tools; and (ix) the framework and approach for the orderly wind-down and transfer of NSCC’s business, including an estimate of the time and

costs to effect a recovery or orderly wind-down of NSCC.

Certain recovery tools that would be identified in the R&W Plan are based in the Rules (including the Proposed Rules); therefore, descriptions of those tools in the R&W Plan would include descriptions of, and reference to, the applicable Rules and any related internal policies and procedures. Other recovery tools that would be identified in the R&W Plan are based in contractual arrangements to which NSCC is a party, including, for example, existing committed or pre-arranged liquidity arrangements. Further, the R&W Plan would state that NSCC may develop further supporting internal guidelines and materials that may provide operational support for matters described in the R&W Plan, and that such documents would be supplemental and subordinate to the R&W Plan.

NSCC states that many of the tools available to NSCC that would be described in the R&W Plan are NSCC’s existing, business-as-usual risk management and Member default management tools, which would continue to be applied in scenarios of increasing stress. In addition to these existing, business-as-usual tools, the R&W Plan would describe NSCC’s other principal recovery tools, which include, for example, (i) identifying, monitoring and managing general business risk and holding sufficient liquid net assets funded by equity (“LNA”) to cover potential general business losses pursuant to the Clearing Agency Policy on Capital Requirements (“Capital Policy”),<sup>13</sup> (ii) maintaining the Clearing Agency Capital Replenishment Plan (“Replenishment Plan”) as a viable plan for the replenishment of capital should NSCC’s equity fall close to or below the amount being held pursuant to the Capital Policy,<sup>14</sup> and (iii) the process for the allocation of losses among Members, as provided in Rule 4 (Clearing Fund).<sup>15</sup> The R&W Plan would provide governance around the selection and implementation of the recovery tool or tools most relevant to mitigate a stress scenario and any applicable loss or liquidity shortfall.

The development of the R&W Plan is facilitated by the Office of Recovery & Resolution Planning (“R&R Team”) of DTCC.<sup>16</sup> The R&R Team reports to the

DTCC Management Committee (“Management Committee”) and is responsible for maintaining the R&W Plan and for the development and ongoing maintenance of the overall recovery and wind-down planning process. The Board, or such committees as may be delegated authority by the Board from time to time pursuant to its charter, would review and approve the R&W Plan biennially, and would also review and approve any changes that are proposed to the R&W Plan outside of the biennial review.

As discussed in greater detail below, the Proposed Rules would define the procedures that may be employed in the event of NSCC’s default and its wind-down, and would provide for NSCC’s authority to take certain actions on the occurrence of a Market Disruption Event, as defined therein. NSCC states that the Proposed Rules are designed to provide Members and Limited Members with transparency and certainty with respect to these matters. NSCC also states that the Proposed Rules are designed to facilitate the implementation of the R&W Plan, particularly NSCC’s strategy for winding down and transferring its business, and are designed to provide NSCC with the legal basis to implement those aspects of the R&W Plan.

#### 1. Business Overview, Critical Services, and Governance

The introduction to the R&W Plan would identify the document’s purpose and its regulatory background, and would outline a summary of the R&W Plan. The stated purpose of the R&W Plan is that it is to be used by the Board and NSCC management in the event NSCC encounters scenarios that could potentially prevent it from being able to provide its critical services as a going concern.

The R&W Plan would describe DTCC’s business profile, provide a summary of NSCC’s services, and identify the intercompany arrangements and links between NSCC and other entities, including other FMIs. NSCC states that the overview section would provide a context for the R&W Plan by describing NSCC’s business, organizational structure and critical links to other entities. NSCC also states that by providing this context, this section would facilitate the analysis of the potential impact of utilizing the recovery tools set forth in later sections of the Recovery Plan, and the analysis

<sup>11</sup> DTCC is a user-owned and user-governed holding company and is the parent company of NSCC and its affiliates, The Depository Trust Company (“DTCC”) and Fixed Income Clearing Corporation (“FICC”), and, together with NSCC and DTCC, the “Clearing Agencies”). The R&W Plan would describe how corporate support services are provided to NSCC from DTCC and DTCC’s other subsidiaries through intercompany agreements under a shared services model.

<sup>12</sup> NSCC states that it uses the term “credit/market” risks in the R&W Plan because NSCC monitors its credit exposure to its Members by managing the market risks of each Member’s unsettled portfolio through the collection of the Clearing Fund. See *infra* note 21.

<sup>13</sup> See Securities Exchange Act Release No. 81105 (July 7, 2017), 82 FR 32399 (July 13, 2017) (SR-DTCC-2017-003, SR-FICC-2017-007, SR-NSCC-2017-004).

<sup>14</sup> See *id.*

<sup>15</sup> See *supra* note 10.

<sup>16</sup> DTCC operates on a shared services model with respect to NSCC and its other subsidiaries. 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 subsidiary, including NSCC.

of the factors that would be addressed in implementing the Wind-down Plan.

The R&W Plan would provide a description of established links between NSCC and other FMIs, including The Options Clearing Corporation (“OCC”), CDS Clearing and Depository Services Inc. (“CDS”), and DTC. NSCC states that this section of the R&W Plan, which identifies and briefly describes NSCC’s established links, is designed to provide a mapping of critical connections and dependencies that may need to be relied on or otherwise addressed in connection with the implementation of either the Recovery Plan or the Wind-down Plan.

The R&W Plan would define the criteria for classifying certain of NSCC’s services as “critical,” and would identify those critical services and the rationale for their classification. This section of the R&W Plan would provide an analysis of the potential systemic impact from a service disruption, which NSCC states is important for evaluating how the recovery tools and the wind-down strategy would facilitate and provide for the continuation of NSCC’s critical services to the markets it serves. The criteria that would be used to identify an NSCC service or function as critical would include (1) whether there is a lack of alternative providers or products; (2) whether failure of the service could impact NSCC’s ability to perform its central counterparty services; (3) whether failure of the service could impact NSCC’s ability to perform its netting services, and the availability of market liquidity; and (4) whether the service is interconnected with other participants and processes within the U.S. financial system, for example, with other FMIs, settlement banks, broker-dealers, and exchanges. The R&W Plan would then list each of those services, functions or activities that NSCC has identified as “critical” based on the applicability of these four criteria. The R&W Plan would also include a non-exhaustive list of NSCC services that are not deemed critical.

NSCC states that the evaluation of which services provided by NSCC are deemed critical is important for purposes of determining how the R&W Plan would facilitate the continuity of those services. While NSCC’s Wind-down Plan would provide for the transfer of all critical services to a transferee in the event NSCC’s wind-down is implemented, it would anticipate that any non-critical services that are ancillary and beneficial to a critical service, or that otherwise have substantial user demand from the continuing membership, would also be transferred.

The R&W Plan would describe the governance structure of both DTCC and NSCC. This section of the R&W Plan would identify the ownership and governance model of these entities at both the Board and management levels. The R&W Plan would state that the stages of escalation required to manage recovery under the Recovery Plan or to invoke NSCC’s wind-down under the Wind-down Plan would range from relevant business line managers up to the Board through NSCC’s governance structure. The R&W Plan would then identify the parties responsible for certain activities under both the Recovery Plan and the Wind-down Plan, and would describe their respective roles. The R&W Plan would identify the Risk Committee of the Board (“Board Risk Committee”) as being responsible for oversight of risk management activities at NSCC, which include focusing on both oversight of risk management systems and processes designed to identify and manage various risks faced by NSCC as well as oversight of NSCC’s efforts to mitigate systemic risks that could impact those markets and the broader financial system.<sup>17</sup> The R&W Plan would identify the DTCC Management Risk Committee (“Management Risk Committee”) as primarily responsible for general, day-to-day risk management through delegated authority from the Board Risk Committee. The R&W Plan would state that the Management Risk Committee has delegated specific day-to-day risk management, including management of risks addressed through margining systems and related activities, to the DTCC Group Chief Risk Office (“GCRO”), which works with staff within the DTCC Financial Risk Management group. Finally, the R&W Plan would describe the role of the Management Committee, which provides overall direction for all aspects of NSCC’s business, technology, and operations and the functional areas that support these activities.

The R&W Plan would describe the governance of recovery efforts in response to both default losses and non-default losses under the Recovery Plan, identifying the groups responsible for those recovery efforts. Specifically, the R&W Plan would state that the Management Risk Committee provides oversight of actions relating to the default of a Member, which would be reported and escalated to it through the

GCRO, and the Management Committee provides oversight of actions relating to non-default events that could result in a loss, which would be reported and escalated to it from the DTCC Chief Financial Officer (“CFO”) and the DTCC Treasury group that reports to the CFO, and from other relevant subject matter experts based on the nature and circumstances of the non-default event.<sup>18</sup> More generally, the R&W Plan would state that the type of loss and the nature and circumstances of the events that lead to the loss would dictate the components of governance to address that loss, including the escalation path to authorize those actions. Both the Recovery Plan and the Wind-down Plan would describe the governance of escalations, decisions, and actions under each of those plans.

Finally, the R&W Plan would describe the role of the R&R Team in managing the overall recovery and wind-down program and plans for each of the Clearing Agencies.

## 2. NSCC Recovery Plan

NSCC states that the Recovery Plan is intended to be a roadmap of those actions that NSCC may employ to monitor and, as needed, stabilize its financial condition. NSCC also states that as each event that could lead to a financial loss could be unique in its circumstances, NSCC proposes that the Recovery Plan would not be prescriptive and would permit NSCC to maintain flexibility in its use of identified tools and in the sequence in which such tools are used, subject to any conditions in the Rules or the contractual arrangement on which such tool is based. NSCC’s Recovery Plan would consist of (1) a description of the risk management surveillance, tools, and governance that NSCC would employ across evolving stress scenarios that it may face as it transitions through a Crisis Continuum, described below; (2) a description of NSCC’s risk of losses that may result from non-default events, and the financial resources and recovery tools available to NSCC to manage those risks and any resulting losses; and (3) an evaluation of the characteristics of the recovery tools that may be used in response to either default losses or non-default losses. In all cases, NSCC states

<sup>17</sup> The DTCC, DTC, NSCC, FICC Risk Committee Charter is available at <http://www.dtcc.com/~media/Files/Downloads/legal/policy-and-compliance/DTCC-BOD-Risk-Committee-Charter.pdf>.

<sup>18</sup> The R&W Plan would state that these groups would be involved to address how to mitigate the financial impact of non-default losses, and in recommending mitigating actions, the Management Committee would consider information and recommendations from relevant subject matter experts based on the nature and circumstances of the non-default event. Any necessary operational response to these events, however, would be managed in accordance with applicable incident response/business continuity process.

that it would act in accordance with the Rules, within the governance structure described in the R&W Plan, and in accordance with applicable regulatory oversight to address each situation to best protect NSCC, Members, and the markets in which it operates.

(i) Managing Member Default Losses and Liquidity Needs Through the Crisis Continuum

The Recovery Plan would describe the risk management surveillance, tools, and governance that NSCC may employ across an increasing stress environment, which is referred to as the Crisis Continuum. This description would identify those tools that can be employed to mitigate losses, and mitigate or minimize liquidity needs, as the market environment becomes increasingly stressed. The phases of the Crisis Continuum would include (1) a stable market phase, (2) a stress market phase, (3) a phase commencing with NSCC's decision to cease to act for a Member or Affiliated Family of Members<sup>19</sup> (referred to in the R&W Plan as the "Member default phase"), and (4) a recovery phase. In the R&W Plan, the term "cease to act" and the events that may lead to such decision are used within the context of Rule 46 of the Rules.<sup>20</sup> Further, the R&W Plan would, for purposes of the R&W Plan, use the following terms: (1) "Member default" to refer to the event or events that precipitate NSCC ceasing to act for a Member or an Affiliated Family; (2) "Defaulting Member" to refer to a Member for which NSCC has ceased to act; and (3) "Member Default Losses" to refer to losses that arise out of or relate to the Member default (including any losses that arise from liquidation of that Member's portfolio), and to distinguish such losses from those that arise out of the business or other events not related to a Member default, which are separately addressed in the R&W Plan.

NSCC states that the Recovery Plan would provide context to its roadmap through this Crisis Continuum by describing NSCC's ongoing management of credit, market, and liquidity risk, and its existing process for measuring and reporting its risks as they align with established thresholds for its tolerance of those risks. NSCC also states that the Recovery Plan would discuss the management of credit/market risk and liquidity exposures together because the tools that address these risks can be deployed either separately or in a

coordinated approach in order to address both exposures. NSCC states that it manages these risk exposures collectively to limit their overall impact on NSCC and its membership. NSCC states that as part of its market risk management strategy, NSCC manages its credit exposure to Members by determining the appropriate Required Deposits to the Clearing Fund and monitoring its sufficiency, as provided for in the Rules.<sup>21</sup> NSCC states that it manages its liquidity risks with an objective of maintaining sufficient resources to be able to fulfill obligations that have been guaranteed by NSCC in the event of a Member default that presents the largest aggregate liquidity exposure to NSCC over the settlement cycle.<sup>22</sup>

The Recovery Plan would outline the metrics and indicators that NSCC has developed to evaluate a stress situation against established risk tolerance thresholds. Each risk mitigation tool identified in the Recovery Plan would include a description of the escalation thresholds that allow for effective and timely reporting to the appropriate internal management staff and committees, or to the Board. NSCC states that the Recovery Plan is designed to make clear that these tools and escalation protocols would be calibrated across each phase of the Crisis Continuum. The Recovery Plan would also establish that NSCC would retain the flexibility to deploy such tools either separately or in a coordinated approach, and to use other alternatives to these actions and tools as necessitated by the circumstances of a particular Member default, in accordance with the Rules. Therefore, NSCC states that the Recovery Plan would both provide NSCC with a roadmap to follow within each phase of

<sup>21</sup> See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters), *supra* note 10. NSCC states that because it does not maintain a guaranty fund separate and apart from the Clearing Fund it collects from Members, NSCC monitors its credit exposure to its Members by managing the market risks of each Member's unsettled portfolio through the collection of the Clearing Fund. The aggregate of all Members' Required Fund Deposits comprises the Clearing Fund that represents NSCC's prefunded resources to address uncovered loss exposures, as provided for in Rule 4 (Clearing Fund). Therefore, NSCC states that its market risk management strategy is designed to comply with Rule 17Ad-22(e)(4) under the Act, where these risks are referred to as "credit risks." See 17 CFR 240.17Ad-22(e)(4).

<sup>22</sup> NSCC's liquidity risk management strategy, including the manner in which NSCC utilizes its liquidity tools, is described in the Clearing Agency Liquidity Risk Management Framework. See Securities Exchange Act Release No. 82377 (December 21, 2017), 82 FR 61617 (December 28, 2017) (SR-DTC-2017-004, SR-FICC-2017-008, SR-NSCC-2017-005).

the Crisis Continuum, and would permit it to adjust its risk management measures to address the unique circumstances of each event.

The Recovery Plan would describe the conditions that mark each phase of the Crisis Continuum, and would identify actions that NSCC could take as it transitions through each phase in order to both prevent losses from materializing through active risk management, and to restore the financial health of NSCC during a period of stress.

The stable market phase of the Crisis Continuum would describe active risk management activities in the normal course of business. These activities would include (1) routine monitoring of margin adequacy through daily review of back testing and stress testing results that review the adequacy of NSCC's margin calculations, and escalation of those results to internal and Board committees;<sup>23</sup> and (2) routine monitoring of liquidity adequacy through review of daily liquidity studies that measure sufficiency of available liquidity resources to meet cash settlement obligations of the Member that would generate the largest aggregate payment obligation.<sup>24</sup>

The Recovery Plan would describe some of the indicators of the stress market phase of the Crisis Continuum, which would include, for example, volatility in market prices of certain assets where there is increased uncertainty among market participants about the fundamental value of those assets. This phase would involve general market stresses, when no Member default would be imminent. Within the description of this phase, the Recovery Plan would provide that NSCC may take targeted, routine risk management measures as necessary and as permitted by the Rules.

Within the Member default phase of the Crisis Continuum, the Recovery Plan would provide a roadmap for the existing procedures that NSCC would follow in the event of a Member default and any decision by NSCC to cease to act for that Member.<sup>25</sup> The Recovery Plan would provide that the objectives of NSCC's actions upon a Member or Affiliated Family default are to (1) minimize losses and market exposure of

<sup>23</sup> NSCC's stress testing practices are described in the Clearing Agency Stress Testing Framework (Market Risk). See Securities Exchange Act Release No. 82638 (December 19, 2017), 82 FR 61082 (December 26, 2017) (SR-DTC-2017-005, SR-FICC-2017-009, SR-NSCC-2017-006).

<sup>24</sup> See *supra* note 22 (concerning NSCC's liquidity risk management strategy).

<sup>25</sup> See Rule 18 (Procedures for When the Corporation Declines or Ceases to Act) and Rule 46 (Restrictions on Access to Services), *supra* note 10.

<sup>19</sup> The R&W Plan would define an Affiliated Family of Members as a number of affiliated entities that are all Members of NSCC.

<sup>20</sup> See Rule 46 (Restrictions on Access to Services), *supra* note 10.

the affected Members and NSCC's non-Defaulting Members; and (2) to the extent practicable, minimize disturbances to the affected markets. The Recovery Plan would describe tools, actions, and related governance for both market risk monitoring and liquidity risk monitoring through this phase. Management of liquidity risk through this phase would involve ongoing monitoring of the adequacy of NSCC's liquidity resources, and the Recovery Plan would identify certain actions NSCC may deploy as it deems necessary to mitigate a potential liquidity shortfall. The Recovery Plan would state that, throughout this phase, relevant information would be escalated and reported to both internal management committees and the Board Risk Committee.

The Recovery Plan would also identify financial resources available to NSCC, pursuant to the Rules, to address losses arising out of a Member default. Specifically, Rule 4 (Clearing Fund) provides that losses remaining after application of the Defaulting Member's resources be satisfied first by applying a Corporate Contribution, and then, if necessary, by allocating remaining losses among the membership in accordance with Rule 4 (Clearing Fund).<sup>26</sup>

In order to provide for an effective and timely recovery, the Recovery Plan would describe the period of time that would occur near the end of the Member default phase, during which NSCC may experience stress events or observe early warning indicators that allow it to evaluate its options and prepare for the recovery phase (referred to in the R&W Plan as the Recovery Corridor). The Recovery Plan would then describe the recovery phase of the Crisis Continuum, which would begin on the date that NSCC issues the first Loss Allocation Notice of the second loss allocation round with respect to a given Event Period.<sup>27</sup> The recovery

phase would describe actions that NSCC may take to avoid entering into a wind down of its business.

NSCC states that it expects that significant deterioration of liquidity resources would cause it to enter the Recovery Corridor. Therefore, the R&W Plan would describe the actions NSCC may take aimed at replenishing those resources. Throughout the Recovery Corridor, NSCC would monitor the adequacy of its resources and the expected timing of replenishment of those resources, and would do so through the monitoring of certain corridor indicator metrics.

NSCC states that the majority of the corridor indicators, as identified in the Recovery Plan, relate directly to conditions that may require NSCC to adjust its strategy for hedging and liquidating a Defaulting Member's portfolio, and any such changes would include an assessment of the status of the corridor indicators. For each corridor indicator, the Recovery Plan would identify (1) measures of the indicator, (2) evaluations of the status of the indicator, (3) metrics for determining the status of the deterioration or improvement of the indicator, and (4) Corridor Actions, which are steps that may be taken to improve the status of the indicator,<sup>28</sup> as well as management escalations required to authorize those steps. NSCC states that because NSCC has never experienced the default of multiple Members, it has not, historically, measured the deterioration or improvements metrics of the corridor indicators. Therefore, NSCC states that these metrics were chosen based on the business judgment of NSCC management.

The Recovery Plan would also describe the reporting and escalation of the status of the corridor indicators throughout the Recovery Corridor. Significant deterioration of a corridor indicator, as measured by the metrics set out in the Recovery Plan, would be

escalated to the Board. NSCC management would review the corridor indicators and the related metrics at least annually, and would modify these metrics as necessary in light of observations from simulations of Member defaults and other analyses. Any proposed modifications would be reviewed by the Management Risk Committee and the Board Risk Committee. The Recovery Plan would estimate that NSCC may remain in the Recovery Corridor between one day and two weeks. NSCC states that this estimate is based on historical data observed in past Member defaults, the results of simulations of Member defaults, and periodic liquidity analyses conducted by NSCC. NSCC states that the actual length of a Recovery Corridor would vary based on actual market conditions observed at the time, and NSCC would expect the Recovery Corridor to be shorter in market conditions of increased stress.

The Recovery Plan would outline steps by which NSCC may allocate its losses, which would occur when and in the order provided in Rule 4 (Clearing Fund).<sup>29</sup> The Recovery Plan would also identify tools that may be used to address foreseeable shortfalls of NSCC's liquidity resources following a Member default, and would provide that these tools may be used as appropriate during the Crisis Continuum to address liquidity shortfalls if they arise. NSCC states that the goal in managing NSCC's qualified liquidity resources is to maximize resource availability in an evolving stress situation, to maintain flexibility in the order and use of sources of liquidity, and to repay any third party lenders of liquidity in a timely manner. Additional voluntary or uncommitted tools to address potential liquidity shortfalls, which may supplement NSCC's other liquid resources described herein, would also be identified in the Recovery Plan. The Recovery Plan would state that, due to the extreme nature of a stress event that would cause NSCC to consider the use of these liquidity tools, the availability and capacity of these liquidity tools, and the willingness of counterparties to lend, cannot be accurately predicted and are dependent on the circumstances of the applicable stress period, including market price volatility, actual or perceived disruptions in financial markets, the costs to NSCC of utilizing these tools, and any potential impact on NSCC's credit rating.

The Recovery Plan would state that NSCC will have entered the recovery phase on the date that it issues the first

<sup>26</sup> Rule 4 (Clearing Fund) defines the amount NSCC would contribute to address a loss resulting from either a Member default or a non-default event as the Corporate Contribution. This amount is 50 percent of the General Business Risk Capital Requirement, which is calculated pursuant to the Capital Policy and which NSCC states is an amount sufficient to cover potential general business losses so that NSCC can continue operations and services as a going concern if those losses materialize, in an effort to comply with Rule 17Ad-22(e)(15) under the Act. See *supra* note 13 (concerning the Capital Policy); 17 CFR 240.17Ad-22(e)(15).

<sup>27</sup> As provided for in Rule 4 (Clearing Fund), the "Event Period" is the 10 Business Days beginning on (i) with respect to a Member default, the day on which NSCC notifies Members that it has ceased to act for a Member under the Rules, or (ii) with respect to a non-default loss, the day that NSCC notifies Members of the determination by the Board

that there is a non-default loss event. Rule 4 (Clearing Fund) defines a "round" as a series of loss allocations relating to an Event Period, and provides that the first Loss Allocation Notice in a first, second, or subsequent round shall expressly state that such notice reflects the beginning of a first, second, or subsequent round. The maximum allocable loss amount of a round is equal to the sum of the Loss Allocation Caps of those Members included in the round. See Rule 4 (Clearing Fund), *supra* note 10.

<sup>28</sup> The Corridor Actions that would be identified in the R&W Plan are designed to be indicative, but not prescriptive; therefore, if NSCC needs to consider alternative actions due to the applicable facts and circumstances, the escalation of those alternative actions would follow the same escalation protocol identified in the R&W Plan for the Corridor Indicator to which the action relates.

<sup>29</sup> See *supra* note 10.

Loss Allocation Notice of the second loss allocation round with respect to a given Event Period. The Recovery Plan would provide that, during the recovery phase, NSCC would continue and, as needed, enhance, the monitoring and remedial actions already described in connection with previous phases of the Crisis Continuum, and would remain in the recovery phase until its financial resources are expected to be or are fully replenished, or until the Wind-down Plan is triggered.

The Recovery Plan would describe governance for the actions and tools that may be employed within each phase of the Crisis Continuum, which would be dictated by the facts and circumstances applicable to the situation being addressed. Such facts and circumstances would be measured by the various indicators and metrics applicable to that phase of the Crisis Continuum, and would follow the relevant escalation protocols that would be described in the Recovery Plan. The Recovery Plan would also describe the governance procedures around a decision to cease to act for a Member, pursuant to the Rules, and around the management and oversight of the subsequent liquidation of the Defaulting Member's portfolio. The Recovery Plan would state that, overall, NSCC would retain flexibility in accordance with the Rules, its governance structure, and its regulatory oversight, to address a particular situation in order to best protect NSCC and the Members, and to meet the primary objectives, throughout the Crisis Continuum, of minimizing losses and, where consistent and practicable, minimizing disturbance to affected markets.

#### (ii) Non-Default Losses

The Recovery Plan would outline how NSCC may address losses that result from events other than a Member default. While these matters are addressed in greater detail in other documents, this section of the R&W Plan would provide a roadmap to those documents and an outline for NSCC's approach to monitoring and managing losses that could result from a non-default event. The R&W Plan would first identify some of the risks NSCC faces that could lead to these losses, which include, for example, (1) the business and profit/loss risks of unexpected declines in revenue or growth of expenses; (2) the operational risks of disruptions to systems or processes that could lead to large losses, including those resulting from, for example, a cyber-attack; and (3) custody or investment risks that could lead to financial losses. The Recovery Plan

would describe NSCC's overall strategy for the management of these risks, which includes a "three lines of defense" approach to risk management that allows for comprehensive management of risk across the organization.<sup>30</sup> The Recovery Plan would also describe NSCC's approach to financial risk and capital management. The R&W Plan would identify key aspects of this approach, including, for example, an annual budget process, business line performance reviews with management, and regular review of capital requirements against LNA. These risk management strategies are collectively intended to allow NSCC to effectively identify, monitor, and manage risks of non-default losses.

The R&W Plan would identify the two categories of financial resources NSCC maintains to cover losses and expenses arising from non-default risks or events as (1) LNA, maintained, monitored, and managed pursuant to the Capital Policy, which include (a) amounts held in satisfaction of the General Business Risk Capital Requirement,<sup>31</sup> (b) the Corporate Contribution,<sup>32</sup> and (c) other amounts held in excess of NSCC's capital requirements pursuant to the Capital Policy; and (2) resources available pursuant to the loss allocation provisions of Rule 4 (Clearing Fund).<sup>33</sup>

The R&W Plan would address the process by which the CFO and the DTCC Treasury group would determine which available LNA resources are most appropriate to cover a loss that is caused by a non-default event. This determination involves an evaluation of a number of factors, including the current and expected size of the loss, the expected time horizon over when

the loss or additional expenses would materialize, the current and projected available LNA, and the likelihood LNA could be successfully replenished pursuant to the Replenishment Plan, if triggered.<sup>34</sup> Finally the R&W Plan would discuss how NSCC would apply its resources to address losses resulting from a non-default event, including the order of resources it would apply if the loss or liability exceeds NSCC's excess LNA amounts, or is large relative thereto, and the Board has declared the event a Declared Non-Default Loss Event pursuant to Rule 4 (Clearing Fund).<sup>35</sup>

The R&W Plan would also describe proposed Rule 60 (Market Disruption and Force Majeure), which NSCC is proposing to adopt in the Rules. NSCC states that this Proposed Rule is designed to provide transparency around how NSCC would address extraordinary events that may occur outside its control. Specifically, the Proposed Rule would define a Market Disruption Event and the governance around a determination that such an event has occurred. The Proposed Rule would also describe NSCC's authority to take actions during the pendency of a Market Disruption Event that it deems appropriate to address such an event and facilitate the continuation of its services, if practicable.

The R&W Plan would describe the interaction between the Proposed Rule and NSCC's existing processes and procedures addressing business continuity management and disaster recovery (generally, the "BCM/DR procedures"). NSCC states that the intent is to make clear that the Proposed Rule is designed to support those BCM/DR procedures and to address circumstances that may be exogenous to NSCC and not necessarily addressed by the BCM/DR procedures. Finally, the R&W Plan would describe that, because the operation of the Proposed Rule is specific to each applicable Market Disruption Event, the Proposed Rule does not define a time limit on its application. However, the R&W Plan would note that actions authorized by the Proposed Rule would be limited to the pendency of the applicable Market Disruption Event, as made clear in the Proposed Rule. NSCC states that, overall, the Proposed Rule is designed to mitigate risks caused by Market Disruption Events and, thereby, minimize the risk of financial loss that may result from such events.

<sup>30</sup> NSCC states that the "three lines of defense" approach to risk management includes (1) a first line of defense comprised of the various business lines and functional units that support the products and services offered by NSCC; (2) a second line of defense comprised of control functions that support NSCC, including the risk management, legal and compliance areas; and (3) a third line of defense, which is performed by an internal audit group. The Clearing Agency Risk Management Framework includes a description of this "three lines of defense" approach to risk management, and addresses how NSCC comprehensively manages various risks, including operational, general business, investment, custody, and other risks that arise in or are borne by it. Securities Exchange Act Release No. 81635 (September 15, 2017), 82 FR 44224 (September 21, 2017) (SR-DTC-2017-013, SR-FICC-2017-016, SR-NSCC-2017-012). The Clearing Agency Operational Risk Management Framework describes the manner in which NSCC manages operational risks, as defined therein. Securities Exchange Act Release No. 81745 (September 28, 2017), 82 FR 46332 (October 4, 2017) (SR-DTC-2017-014, SR-FICC-2017-017, SR-NSCC-2017-013).

<sup>31</sup> See *supra* note 26.

<sup>32</sup> See *supra* note 26.

<sup>33</sup> See *supra* note 10.

<sup>34</sup> See *supra* note 13 (concerning the Capital Policy).

<sup>35</sup> See *supra* note 10.

## (iii) Recovery Tool Characteristics

The Recovery Plan would describe NSCC's evaluation of the tools identified within the Recovery Plan, and its rationale for concluding that such tools are comprehensive, effective, and transparent, and that such tools provide incentives to Members and minimize negative impact on Members and the financial system.

## 3. NSCC Wind-Down Plan

The Wind-down Plan would provide the framework and strategy for the orderly wind-down of NSCC if the use of the recovery tools described in the Recovery Plan does not successfully return NSCC to financial viability. NSCC states that while such event is extremely unlikely given the comprehensive nature of the recovery tools, NSCC is proposing a wind-down strategy that provides for (1) the transfer of NSCC's business, assets, and membership to another legal entity, (2) such transfer being effected in connection with proceedings under Chapter 11 of the U.S. Bankruptcy Code,<sup>36</sup> and (3) after effectuating this transfer, NSCC liquidating any remaining assets in an orderly manner in bankruptcy proceedings. NSCC states that the proposed transfer approach to a wind-down would meet its objectives of (1) assuring that NSCC's critical services will be available to the market as long as there are Members in good standing, and (2) minimizing disruption to the operations of Members and financial markets generally that might be caused by NSCC's failure.

In describing the transfer approach to NSCC's Wind-down Plan, the R&W Plan would identify the factors that NSCC considered in developing this approach, including the fact that NSCC does not own material assets that are unrelated to its clearance and settlement activities. Therefore, NSCC states that a business reorganization or "bail-in" of debt approach would be unlikely to mitigate significant losses. Additionally, NSCC states that the proposed approach was developed in consideration of its critical and unique position in the U.S. markets, which precludes any approach that would cause NSCC's critical services to no longer be available.

First, the Wind-down Plan would describe the potential scenarios that could lead to the wind-down of NSCC, and the likelihood of such scenarios. The Wind-down Plan would identify the time period leading up to a decision to wind-down NSCC as the Runway Period. NSCC states that this period

would follow the implementation of any recovery tools, as it may take a period of time, depending on the severity of the market stress at that time, for these tools to be effective or for NSCC to realize a loss sufficient to cause it to be unable to effectuate settlements and repay its obligations.<sup>37</sup> The Wind-down Plan would identify some of the indicators that NSCC has entered the Runway Period.

The trigger for implementing the Wind-down Plan would be a determination by the Board that recovery efforts have not been, or are unlikely to be, successful in returning NSCC to viability as a going concern. As described in the R&W Plan, NSCC states that this is an appropriate trigger because it is both broad and flexible enough to cover a variety of scenarios, and would align incentives of NSCC and the Members to avoid actions that might undermine NSCC's recovery efforts. Additionally, NSCC states that this approach takes into account the characteristics of NSCC's recovery tools and enables the Board to consider (1) the presence of indicators of a successful or unsuccessful recovery, and (2) potential for knock-on effects of continued iterative application of NSCC's recovery tools.

The Wind-down Plan would describe the general objectives of the transfer strategy, and would address assumptions regarding the transfer of NSCC's critical services, business, assets, and membership, and the assignment of NSCC's links with other FMIs, to another legal entity that is legally, financially, and operationally able to provide NSCC's critical services to entities that wish to continue their membership following the transfer ("Transferee"). The Wind-down Plan would provide that the Transferee would be either (1) a third party legal entity, which may be an existing or newly established legal entity or a bridge entity formed to operate the business on an interim basis to enable the business to be transferred subsequently ("Third Party Transferee"); or (2) an existing, debt-free failover legal entity established ex-ante by DTCC ("Failover Transferee") to be used as an alternative Transferee in the event that no viable or preferable Third Party Transferee timely commits to acquire NSCC's business. NSCC would

<sup>37</sup> The Wind-down Plan would state that, given NSCC's position as a user-governed financial market utility, it is possible that Members might voluntarily elect to provide additional support during the recovery phase leading up to a potential trigger of the Wind-down Plan, but would also be designed to make clear that NSCC cannot predict the willingness of Members to do so.

seek to identify the proposed Transferee, and negotiate and enter into transfer arrangements during the Runway Period and prior to making any filings under Chapter 11 of the U.S. Bankruptcy Code.<sup>38</sup> The Wind-down Plan would anticipate that the transfer to the Transferee be effected in connection with proceedings under Chapter 11 of the U.S. Bankruptcy Code, and pursuant to a bankruptcy court order under Section 363 of the Bankruptcy Code, with the intent that the transfer be free and clear of claims against, and interests in, NSCC, except to the extent expressly provided in the court's order.<sup>39</sup>

NSCC states that in order to effect a timely transfer of its services and minimize the market and operational disruption of such transfer, NSCC would expect to transfer all of its critical services and any non-critical services that are ancillary and beneficial to a critical service, or that otherwise have substantial user demand from the continuing membership. Following the transfer, the Wind-down Plan would anticipate that the Transferee and its continuing membership would determine whether to continue to provide any transferred non-critical service on an ongoing basis, or terminate the non-critical service following some transition period. NSCC's Wind-down Plan would anticipate that the Transferee would enter into a transition services agreement with DTCC so that DTCC would continue to provide the shared services it currently provides to NSCC, including staffing, infrastructure and operational support. The Wind-down Plan would also anticipate the assignment of NSCC's link arrangements, including those with DTC, CDS and OCC, described above, to the Transferee.<sup>40</sup> The Wind-down Plan would provide that Members' open positions existing prior to the effective time of the transfer would be addressed by the provisions of the proposed Wind-down Rule and Corporation Default Rule, as defined and described below, and that the Transferee would not

<sup>38</sup> See 11 U.S.C. 101 *et seq.*

<sup>39</sup> See 11 U.S.C. 363.

<sup>40</sup> The proposed transfer arrangements outlined in the Wind-down Plan do not contemplate the transfer of any credit or funding agreements, which are generally not assignable by NSCC. However, to the extent the Transferee adopts rules substantially identical to those NSCC has in effect prior to the transfer, NSCC states that the Transferee would have the benefit of any rules-based liquidity funding. The Wind-down Plan contemplates that no Clearing Fund would be transferred to the Transferee, as it is not held in a bankruptcy remote manner and it is the primary prefunded liquidity resource to be accessed in the recovery phase.

<sup>36</sup> 11 U.S.C. 101 *et seq.*



acquire any pending or open transactions with the transfer of the business. The Wind-down Plan would anticipate that the Transferee would accept transactions for processing with a trade date from and after the effective time of the transfer.

The Wind-down Plan would provide that, following the effectiveness of the transfer to the Transferee, the wind-down of NSCC would involve addressing any residual claims against NSCC through the bankruptcy process and liquidating the legal entity. The Wind-down Plan does not contemplate NSCC continuing to provide services in any capacity following the transfer time, and any services not transferred would be terminated.

The Wind-down Plan would also identify the key dependencies for the effectiveness of the transfer, which include regulatory approvals that would permit the Transferee to be legally qualified to provide the transferred services from and after the transfer, and approval by the applicable bankruptcy court of, among other things, the proposed sale, assignments, and transfers to the Transferee.

The Wind-down Plan would address governance matters related to the execution of the transfer of NSCC's business and its wind-down. The Wind-down Plan would address the duties of the Board to execute the wind-down of NSCC in conformity with (1) the Rules, (2) the Board's fiduciary duties, which mandate that it exercise reasonable business judgment in performing these duties, and (3) NSCC's regulatory obligations under the Act as a registered clearing agency. The Wind-down Plan would also identify certain factors the Board may consider in making these decisions, which would include, for example, whether NSCC could safely stabilize the business and protect its value without seeking bankruptcy protection, and NSCC's ability to continue to meet its regulatory requirements.

The Wind-down Plan would describe (1) actions NSCC or DTCC may take to prepare for wind-down in the period before NSCC experiences any financial distress, (2) actions NSCC would take both during the recovery phase and the Runway Period to prepare for the execution of the Wind-down Plan, and (3) actions NSCC would take upon commencement of bankruptcy proceedings to effectuate the Wind-down Plan.

Finally, the Wind-down Plan would include an analysis of the estimated time and costs to effectuate the R&W Plan, and would provide that this estimate be reviewed and approved by

the Board annually. In order to estimate the length of time it might take to achieve a recovery or orderly wind-down of NSCC's critical operations, as contemplated by the R&W Plan, the Wind-down Plan would include an analysis of the possible sequencing and length of time it might take to complete an orderly wind-down and transfer of critical operations, as described in earlier sections of the R&W Plan. The Wind-down Plan would also include in this analysis consideration of other factors, including the time it might take to complete any further attempts at recovery under the Recovery Plan. The Wind-down Plan would then multiply this estimated length of time by NSCC's average monthly operating expenses, including adjustments to account for changes to NSCC's profit and expense profile during these circumstances, over the previous twelve months to determine the amount of LNA that it should hold to achieve a recovery or orderly wind-down of NSCC's critical operations. The estimated wind-down costs would constitute the Recovery/Wind-down Capital Requirement under the Capital Policy.<sup>41</sup> Under that policy, the General Business Risk Capital Requirement is calculated as the greatest of three estimated amounts, one of which is this Recovery/Wind-down Capital Requirement.<sup>42</sup>

NSCC states that the R&W Plan is designed as a roadmap, and the types of actions that may be taken both leading up to and in connection with implementation of the Wind-down Plan would be primarily addressed in other supporting documentation referred to therein.

The Wind-down Plan would address proposed Rule 41 (Corporation Default) and proposed Rule 42 (Wind-down of the Corporation), which would be adopted to facilitate the implementation of the Wind-down Plan, as discussed below.

### B. Proposed Rules

In connection with the adoption of the R&W Plan, NSCC proposes to adopt the Proposed Rules, each of which is described below. NSCC states that the Proposed Rules are designed to facilitate the execution of the R&W Plan and are designed to provide Members and Limited Members with transparency as to critical aspects of the R&W Plan, particularly as they relate to the rights and responsibilities of both NSCC and Members. NSCC also states that the Proposed Rules are designed to provide

a legal basis to these aspects of the R&W Plan.

#### 1. Rule 41 (Corporation Default)

The proposed Rule 41 ("Corporation Default Rule") would provide a mechanism for the termination, valuation and netting of unsettled, guaranteed Continuous Net Settlement ("CNS") system<sup>43</sup> transactions in the event NSCC is unable to perform its obligations or otherwise suffers a defined event of default, such as entering insolvency proceedings. NSCC states that the proposed Corporation Default Rule is designed to provide Members with transparency and certainty regarding what would happen if NSCC were to fail (defined in the proposed Rule as a Corporation Default).

The proposed rule would define the events that would constitute a Corporation Default, which would generally include (1) the failure of NSCC to make any undisputed payment or delivery to a Member if such failure is not remedied within seven days after notice of such failure is given to NSCC; (2) NSCC is dissolved; (3) NSCC institutes a proceeding seeking a judgment of insolvency or bankruptcy, or a proceeding is instituted against it seeking a judgment of bankruptcy or insolvency and such judgment is entered; or (4) NSCC seeks or becomes subject to the appointment of a receiver, trustee or similar official pursuant to the federal securities laws or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>44</sup> for it or for all or substantially all of its assets.

Upon a Corporation Default, the proposed Corporation Default Rule would provide that all unsettled, guaranteed CNS transactions would be terminated and, no later than 45 days from the date on which the event that constitutes a Corporation Default occurred ("Default Date"), the Board would determine a single net amount owed by or to each Member with respect to such transactions pursuant to the valuation procedures set forth in the Proposed Rule. NSCC states that essentially, for each affected position in a CNS Security, the CNS Market Value would be determined by using the Current Market Price for that security as determined in the CNS System as of the close of business on the next Business Day following the Default Date.

NSCC would determine a Net Contract Value for each Member's net unsettled long or short position in a CNS Security by netting the Member's

<sup>41</sup> See *supra* note 13.

<sup>42</sup> See *supra* note 13.

<sup>43</sup> See Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation), *supra* note 10.

<sup>44</sup> 12 U.S.C. 5381 *et seq.*



(i) contract price for such net position that, as of the Default Date, has not yet passed the Settlement Date, and (ii) the Current Market Price in the CNS System on the Default Date for its fail positions. To determine each Member's CNS Close-out Value, (i) the Net Contract Value for each CUSIP would be subtracted from the CNS Market Value for such CUSIP, and (ii) the resulting difference for all CUSIPs in which the Member had a net long or short position would be summed, and would be netted and offset against any other amounts that may be due to or owing from the Member under the Rules. The proposed Corporation Default Rule would provide for notification to each Member of its CNS Close-out Value, and would also address interpretation of the Rules in relation to certain terms that are defined in the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA").<sup>45</sup>

NSCC states that this valuation approach, which is comparable to the approach adopted by other central counterparties, is appropriate for NSCC given the market in which NSCC operates and the volumes of transactions it processes in CNS because it would provide for a common, clear and transparent valuation methodology and price per CUSIP applicable to all affected Members.

## 2. Rule 42 (Wind-Down of the Corporation)

NSCC states that the proposed Rule 42 ("Wind-down Rule") is designed to facilitate the execution of the Wind-down Plan. The Wind-down Rule would include a proposed set of defined terms that would be applicable only to the provisions of this Proposed Rule. NSCC states that the Wind-down Rule is designed to make clear that a wind-down of NSCC's business would occur (1) after a decision is made by the Board, and (2) in connection with the transfer of NSCC's services to a Transferee, as described therein. NSCC states that, generally, the proposed Wind-down Rule is designed to create clear mechanisms for the transfer of Eligible Members, Eligible Limited Members, and Settling Banks (as these terms would be defined in the Wind-down Rule), and NSCC's business, in order to provide for continued access to critical services and to minimize disruption to the markets in the event the Wind-down Plan is initiated.

### (i) Wind-Down Trigger

First, NSCC states that the Proposed Rule is designed to make clear that the

Board is responsible for initiating the Wind-down Plan, and would identify the criteria the Board would consider when making this determination. As provided for in the Wind-down Plan and in the proposed Wind-down Rule, the Board would initiate the Wind-down Plan if, in the exercise of its business judgment and subject to its fiduciary duties, it has determined that the execution of the Recovery Plan has not or is not likely to restore NSCC to viability as a going concern, and the implementation of the Wind-down Plan, including the transfer of NSCC's business, is in the best interests of NSCC, Members and Limited Members, its shareholders and creditors, and the U.S. financial markets.

### (ii) Identification of Critical Services; Designation of Dates and Times for Specific Actions

The Proposed Rule would provide that, upon making a determination to initiate the Wind-down Plan, the Board would identify the critical and non-critical services that would be transferred to the Transferee at the Transfer Time (as defined below and in the Proposed Rule), as well as any non-critical services that would not be transferred to the Transferee. The proposed Wind-down Rule would establish that any services transferred to the Transferee will only be provided by the Transferee as of the Transfer Time, and that any non-critical services that are not transferred to the Transferee would be terminated at the Transfer Time. The Proposed Rule would also provide that the Board would establish (1) an effective time for the transfer of NSCC's business to a Transferee ("Transfer Time"), (2) the last day that transactions may be submitted to NSCC for processing ("Last Transaction Acceptance Date"), and (3) the last day that transactions submitted to NSCC will be settled ("Last Settlement Date").

### (iii) Treatment of Pending Transactions

The Wind-down Rule would authorize the Board to provide for the settlement of pending transactions prior to the Transfer Time, so long as the Corporation Default Rule has not been triggered. The Board would also have the ability to allow Members to only submit trades that would effectively offset pending positions or provide that transactions will be processed in accordance with special or exception processing procedures. NSCC states that the Proposed Rule is designed to enable these actions in order to facilitate settlement of pending transactions and reduce claims against NSCC that would have to be satisfied after the transfer has

been effected. If none of these actions are deemed practicable (or if the Corporation Default Rule has been triggered), then the provisions of the proposed Corporation Default Rule would apply to the treatment of open, pending transactions.

NSCC states that the Proposed Rule is designed to make clear, however, that NSCC would not accept any transactions for processing after the Last Transaction Acceptance Date or which are designated to settle after the Last Settlement Date. Any transactions to be processed and/or settled after the Transfer Time would be required to be submitted to the Transferee, and would not be NSCC's responsibility.

### (iv) Notice Provisions

The proposed Wind-down Rule would provide that, upon a decision to implement the Wind-down Plan, NSCC would provide Members and Limited Members and its regulators with a notice that includes material information relating to the Wind-down Plan and the anticipated transfer of NSCC's membership and business, including, for example, (1) a brief statement of the reasons for the decision to implement the Wind-down Plan; (2) identification of the Transferee and information regarding the transaction by which the transfer of NSCC's business would be effected; (3) the Transfer Time, Last Transaction Acceptance Date, and Last Settlement Date; and (4) identification of Eligible Members and Eligible Limited Members, and the critical and non-critical services that would be transferred to the Transferee at the Transfer Time, as well as those Non-Eligible Members and Non-Eligible Limited Members (as defined in the Proposed Rule), and any non-critical services that would not be included in the transfer. NSCC would also make available the rules and procedures and membership agreements of the Transferee.

### (v) Transfer of Membership

The proposed Wind-down Rule would address the expected transfer of NSCC's membership to the Transferee, which NSCC would seek to effectuate by entering into an arrangement with a Failover Transferee, or by using commercially reasonable efforts to enter into such an arrangement with a Third Party Transferee. Therefore, the Wind-down Rule would provide Members, Limited Members and Settling Banks with notice that, in connection with the implementation of the Wind-down Plan and with no further action required by any party, (1) their membership with NSCC would transfer to the Transferee,

<sup>45</sup> 12 U.S.C. 1811 *et seq.*

(2) they would become party to a membership agreement with such Transferee, and (3) they would have all of the rights and be subject to all of the obligations applicable to their membership status under the rules of the Transferee. These provisions would not apply to any Member or Limited Member that is either in default of an obligation to NSCC or has provided notice of its election to withdraw from membership. Further, NSCC states that the proposed Wind-down Rule is designed to make clear that it would not prohibit (1) Members and Limited Members that are not transferred by operation of the Wind-down Rule from applying for membership with the Transferee, or (2) Members, Limited Members, and Settling Banks that would be transferred to the Transferee from withdrawing from membership with the Transferee.<sup>46</sup>

#### (vi) Comparability Period

NSCC states that the proposed automatic mechanism for the transfer of NSCC's membership is intended to provide NSCC's membership with continuous access to critical services in the event of NSCC's wind-down, and to facilitate the continued prompt and accurate clearance and settlement of securities transactions. The proposed Wind-down Rule would provide that NSCC would enter into arrangements with a Failover Transferee, or would use commercially reasonable efforts to enter into arrangements with a Third Party Transferee, providing that, in either case, with respect to the critical services and any non-critical services that are transferred from NSCC to the Transferee, for at least a period of time to be agreed upon ("Comparability Period"), the business transferred from NSCC to the Transferee would be operated in a manner that is comparable to the manner in which the business was previously operated by NSCC. Specifically, the proposed Wind-down Rule would provide that (1) the rules of the Transferee and terms of membership agreements would be comparable in substance and effect to the analogous Rules and membership agreements of NSCC; (2) the rights and obligations of any Members, Limited Members and Settling Banks that are transferred to the Transferee would be comparable in substance and effect to their rights and obligations as to NSCC; and (3) the

Transferee would operate the transferred business and provide any services that are transferred in a comparable manner to which such services were provided by NSCC. NSCC states that the purpose of these provisions and the intended effect of the proposed Wind-down Rule is to facilitate a smooth transition of NSCC's business to a Transferee and to provide that, for at least the Comparability Period, the Transferee (1) would operate the transferred business in a manner that is comparable in substance and effect to the manner in which the business was operated by NSCC, and (2) would not require sudden and disruptive changes in the systems, operations and business practices of the new members of the Transferee.

#### (vii) Subordination of Claims Provisions and Miscellaneous Matters

The proposed Wind-down Rule would include a provision addressing the subordination of unsecured claims against NSCC of Members and Limited Members who fail to participate in NSCC's recovery efforts (*i.e.*, firms delinquent in their obligations to NSCC or elect to retire from NSCC in order to minimize their obligations with respect to the allocation of losses, pursuant to the Rules). NSCC states that this provision is designed to incentivize Members to participate in NSCC's recovery efforts.<sup>47</sup>

The proposed Wind-down Rule would address other ex-ante matters including provisions providing that Members, Limited Members and Settling Banks (1) will assist and cooperate with NSCC to effectuate the transfer of NSCC's business to a Transferee, (2) consent to the provisions of the rule, and (3) grant NSCC power of attorney to execute and deliver on their behalf documents and instruments that may be requested by the Transferee. Finally, the Proposed Rule would include a limitation of liability for any actions taken or omitted to be taken by NSCC pursuant to the Proposed Rule.

NSCC states that the purpose of the limitation of liability is to facilitate and protect NSCC's ability to act expeditiously in response to extraordinary events. Such limitation of liability would be available only

following triggering of the Wind-down Plan. In addition, and as a separate matter, NSCC states that the limitation of liability provides Members with transparency for the unlikely situation when those extraordinary events could occur, as well as supporting the legal framework within which NSCC would take such actions. NSCC states that these provisions, collectively, are designed to enable NSCC to take such acts as the Board determines necessary to effectuate an orderly transfer and wind-down of its business should recovery efforts prove unsuccessful.

#### 3. Rule 60 (Market Disruption and Force Majeure)

The proposed Rule 60 ("Force Majeure Rule") would address NSCC's authority to take certain actions upon the occurrence, and during the pendency, of a Market Disruption Event, as defined therein. NSCC states that the Proposed Rule is designed to clarify NSCC's ability to take actions to address extraordinary events outside of the control of NSCC and of its membership, and to mitigate the effect of such events by facilitating the continuity of services (or, if deemed necessary, the temporary suspension of services). To that end, under the proposed Force Majeure Rule, NSCC would be entitled, during the pendency of a Market Disruption Event, to (1) suspend the provision of any or all services, and (2) take, or refrain from taking, or require Members and Limited Members to take, or refrain from taking, any actions it considers appropriate to address, alleviate, or mitigate the event and facilitate the continuation of NSCC's services as may be practicable.

The proposed Force Majeure Rule would identify the events or circumstances that would be considered a Market Disruption Event. The proposed Force Majeure Rule would define the governance procedures for how NSCC would determine whether, and how, to implement the provisions of the rule.

A determination that a Market Disruption Event has occurred would generally be made by the Board, but the Proposed Rule would provide for limited, interim delegation of authority to a specified officer or management committee if the Board would not be able to take timely action. In the event such delegated authority is exercised, the proposed Force Majeure Rule would require that the Board be convened as promptly as practicable, no later than five Business Days after such determination has been made, to ratify, modify, or rescind the action. The proposed Force Majeure Rule would also provide for prompt notification to

<sup>46</sup> The Members and Limited Members whose membership is transferred to the Transferee pursuant to the proposed Wind-down Rule would submit transactions to be processed and settled subject to the rules and procedures of the Transferee, including any applicable margin charges or other financial obligations.

<sup>47</sup> Nothing in the proposed Wind-down Rule would seek to prevent a Member, Limited Member or Settling Bank that retired its membership at NSCC from applying for membership with the Transferee. Once its NSCC membership is terminated, however, such firm would not be able to benefit from the membership assignment that would be effected by this proposed Wind-down Rule, and it would have to apply for membership directly with the Transferee, subject to its membership application and review process.

the Commission, and advance consultation with Commission staff, when practicable, including notification when an event is no longer continuing and the relevant actions are terminated. The Proposed Rule would require Members and Limited Members to notify NSCC immediately upon becoming aware of a Market Disruption Event, and, likewise, would require NSCC to notify Members and Limited Members if it has triggered the Proposed Rule and of actions taken or intended to be taken thereunder.

Finally, the Proposed Rule would address other related matters, including a limitation of liability for any failure or delay in performance, in whole or in part, arising out of the Market Disruption Event. NSCC states that the purpose of the limitation of liability would be similar to the purpose of the analogous provision in the proposed Wind-down Rule, which is to facilitate and protect NSCC's ability to act expeditiously in response to extraordinary events.

#### 4. Proposed Change to the Rule Numbers

In order to align the order of the Proposed Rules with the order of comparable rules in the rulebooks of the other Clearing Agencies, NSCC proposes to re-number the current Rule 42 (Wind-down of a Member, Fund Member or Insurance Carrier/Retirement Services Member) to Rule 40, which is currently reserved for future use.

## II. Discussion and Commission Findings

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive: To mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.<sup>48</sup>

Section 805(a)(2) of the Clearing Supervision Act<sup>49</sup> authorizes the Commission to prescribe 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. Section 805(b) of the Clearing Supervision Act<sup>50</sup> provides the following objectives and principles for

the Commission's risk management standards prescribed under Section 805(a):

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

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act<sup>51</sup> and Section 17A of the Act<sup>52</sup> ("Rule 17Ad-22").<sup>53</sup> Rule 17Ad-22 requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.<sup>54</sup> Therefore, it is appropriate for the Commission to review proposed changes in advance notices against the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act<sup>55</sup> and against Rule 17Ad-22.<sup>56</sup>

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

The Commission believes that the proposed changes in the Advance Notice are designed to help NSCC promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. As described above, the R&W Plan, generally, would help NSCC promote robust risk management and reduce systemic risks by providing NSCC with a roadmap for actions it may employ to monitor and manage its risks, and, as needed, to stabilize its financial condition in the event those risks materialize. Specifically, the Recovery Plan would provide a roadmap that would identify a number of triggers for the potential application of a number of available recovery tools. Identifying triggers for the potential application of recovery tools would help promote robust risk management and reduce systemic risks by better enabling NSCC to more promptly determine when and how it may need to manage a significant stress event, and, as needed, stabilize its financial condition.

Similarly, the Force Majeure Rule is designed to provide a roadmap to

address extraordinary events that may occur outside of NSCC's control. Specifically, the Force Majeure Rule would define a Market Disruption Event and provide governance around determining when such an event has occurred. The Force Majeure Rule also would describe NSCC's authority to take actions during the pendency of a Market Disruption Event that it deems appropriate to address such an event and facilitate the continuation of NSCC's services, if practicable. By defining a Market Disruption Event and providing such governance and authority, the Commission believes that the Force Majeure Rule also would help promote robust risk management and reduce systemic risks by improving NSCC's ability to identify and manage a force majeure event, and, as needed, to stabilize its financial condition so that NSCC can continue to operate and act as a source of stability for the financial markets it serves.

The Commission believes that the Recovery Plan and the Force Majeure Rule reflect an approach designed to allow for a more considered and comprehensive evaluation by NSCC of a stressed market situation and the ways in which NSCC could apply available recovery tools in a manner intended to minimize the potential negative effects of the stress situation for NSCC, its Members, and the broader financial system. Therefore, the Commission believes that the Recovery Plan and the Force Majeure Rule would help promote robust risk management at NSCC and, thus, reduce systemic risks by establishing a means for NSCC to best determine the most appropriate way to address such stress situations in an effective manner.

The Commission believes that the R&W Plan, generally, would help NSCC promote safety and soundness and support the stability of the broader financial system by providing a roadmap to wind-down that is designed to ensure the availability of NSCC's critical services to the marketplace, while reducing disruption to the operations of Members and financial markets that might be caused by NSCC's failure. Specifically, as described above, the Wind-down Plan, as facilitated by the Wind-down Rule and the Corporation Default Rule, would provide for the wind-down of NSCC's business and transfer of membership and critical services if the recovery tools do not successfully return NSCC to financial viability. Accordingly, critical services, such as services that lack alternative providers or products, services that the failure of which could impact the availability of market

<sup>51</sup> 12 U.S.C. 5464(a)(2).

<sup>52</sup> 15 U.S.C. 78q-1.

<sup>53</sup> See 17 CFR 240.17Ad-22.

<sup>54</sup> *Id.*

<sup>55</sup> 12 U.S.C. 5464(b).

<sup>56</sup> See 17 CFR 240.17Ad-22.

<sup>48</sup> See 12 U.S.C. 5461(b).

<sup>49</sup> 12 U.S.C. 5464(a)(2).

<sup>50</sup> 12 U.S.C. 5464(b).

liquidity, and services that are interconnected with other participants and processes within the U.S. financial system would be able to continue in an orderly manner while NSCC is seeking to wind-down its services. By designing the Wind-down Plan and these Proposed Rules to enable the continuity of NSCC's critical services and membership in an orderly manner while NSCC is seeking to wind-down its services, the Commission believes these proposed changes would help NSCC promote safety and soundness and support stability in the broader financial system in the event the Wind-down Plan is implemented.

As described above, NSCC proposes to re-number current Rule 42 (Wind-down of a Member, Fund Member or Insurance Carrier/Retirement Services Member) to Rule 40, which is currently reserved for future use, to align the order of the Proposed Rules with the order of comparable rules in the rulebooks of the other Clearing Agencies. This proposed change would help create ease of reference to and heightened transparency of such rules, particularly for Members and for other clearing agencies and other market infrastructure that have links to, or reliance upon, the critical services offered by NSCC. Enhanced access to and transparency of these rules would therefore assist such parties in understanding, planning for, and reacting in an orderly manner to, the implementation by NSCC of the R&W Plan. Therefore, the Commission believes that NSCC's proposed change to the numbering of its Rules would help support the stability of the broader financial system.

By better enabling NSCC to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system, as described above, the Commission believes that the proposed changes in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act.<sup>57</sup>

#### *B. Consistency With Rules 17Ad-22(e)(2)(i), (iii), and (v) Under the Act*

Rule 17Ad-22(e)(2)(i) under the Act requires a covered clearing agency<sup>58</sup> to

establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent.<sup>59</sup> Rule 17Ad-22(e)(2)(iii) under the Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that support the public interest requirements in Section 17A of the Act<sup>60</sup> applicable to clearing agencies, and the objectives of owners and participants.<sup>61</sup> Rule 17Ad-22(e)(2)(v) under the Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that specify clear and direct lines of responsibility.<sup>62</sup>

As described above, the R&W Plan is designed to identify clear lines of responsibility concerning the R&W Plan including (1) the ongoing development of the R&W Plan; (2) ongoing maintenance of the R&W Plan; (3) reviews and approval of the R&W Plan; and (4) the functioning and implementation of the R&W Plan. As described above, the R&R Team, which reports to the Management Committee, is responsible for maintaining the R&W Plan and for the development and ongoing maintenance of the overall recovery and wind-down planning process. Meanwhile, the Board, or such committees as may be delegated authority by the Board from time to time pursuant to its charter, would review and approve the R&W Plan biennially, and also would review and approve any changes that are proposed to the R&W Plan outside of the biennial review. Moreover, the R&W Plan would state the stages of escalation required to manage recovery under the Recovery Plan or to invoke NSCC's wind-down under the Wind-down Plan, which would range from relevant business line managers up to the Board. The R&W Plan would identify the parties responsible for certain activities under both the Recovery Plan and the Wind-down Plan, and would describe their respective roles. The R&W Plan also would specify the process NSCC would take to receive input from various parties at NSCC, including management committees and the Board.

In considering the above, the Commission believes that the R&W Plan would help contribute to establishing, implementing, maintaining, and enforcing written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent because it would specify lines of control. The Commission also believes that the R&W Plan would help contribute to establishing, implementing, maintaining, and enforcing written policies and procedures reasonably designed to provide for governance arrangements that support the public interest requirements in Section 17A of the Act<sup>63</sup> applicable to clearing agencies, and the objectives of owners and participants because the R&W Plan specifies the process NSCC would take to receive input from various NSCC stakeholders. In addition, the Commission believes that the R&W Plan would help contribute to establishing, implementing, maintaining, and enforcing written policies and procedures reasonably designed to provide for governance arrangements that specify clear and direct lines of responsibility because it specifies who is responsible for the ongoing development, maintenance, reviews, approval, functioning, and implementation of the R&W Plan.

Therefore, the Commission believes that the R&W Plan is consistent with Rules 17Ad-22(e)(2)(i), (iii), and (v) under the Act.<sup>64</sup>

#### *C. Consistency With Rule 17Ad-22(e)(3)(ii) Under the Act*

Rule 17Ad-22(e)(3)(ii) under the Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency, which includes plans for the recovery and orderly wind-down of the covered clearing agency necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.<sup>65</sup>

As described above, the R&W Plan's Recovery Plan provides a plan for NSCC's recovery necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses by defining the risk management activities, stress conditions and

<sup>57</sup> 12 U.S.C. 5464(b).

<sup>58</sup> A "covered clearing agency" means, among other things, a clearing agency registered with the Commission under Section 17A of the Exchange Act (15 U.S.C. 78q-1 *et seq.*) that is designated systemically important by the Financial Stability Oversight Counsel ("FSOC") pursuant to the Clearing Supervision Act (12 U.S.C. 5461 *et seq.*). See 17 CFR 240.17Ad-22(a)(5)-(6). On July 18, 2012, FSOC designated NSCC as systemically important. U.S. Department of the Treasury, "FSOC Makes First Designations in Effort to Protect Against

Future Financial Crises," available at <https://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx>. Therefore, NSCC is a covered clearing agency.

<sup>59</sup> 17 CFR 240.17Ad-22(e)(2)(i).

<sup>60</sup> 15 U.S.C. 78q-1.

<sup>61</sup> 17 CFR 240.17Ad-22(e)(2)(iii).

<sup>62</sup> 17 CFR 240.17Ad-22(e)(2)(v).

<sup>63</sup> 15 U.S.C. 78q-1.

<sup>64</sup> 17 CFR 240.17Ad-22(e)(2)(i), (iii), and (v).

<sup>65</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

indicators, and tools that NSCC may use to address stress scenarios that could eventually prevent NSCC from being able to provide its critical services as a going concern. More specifically, through the framework of the Crisis Continuum, which identifies tools that can be employed to mitigate losses and mitigate or minimize liquidity needs as the market environment becomes increasingly stressed, the Recovery Plan would identify measures that NSCC may take to manage risks of credit losses and liquidity shortfalls, and other losses that could arise from a Member default. The Recovery Plan also would address NSCC's management of general business risks and other non-default risks that could lead to losses by identifying potential non-default losses and the resources available to NSCC to address such losses, including recovery triggers and tools to mitigate such losses. Therefore, the Commission believes that the R&W Plan's Recovery Plan helps NSCC establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by NSCC, which includes a recovery plan necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.

As described above, the R&W Plan's Wind-down Plan provides a plan for orderly wind-down of NSCC, which would be triggered by a determination by the Board that recovery efforts have not been, or are unlikely to be, successful in returning NSCC to viability as a going concern. Once triggered, the Wind-down Plan sets forth mechanisms for the transfer of NSCC's membership and business, and it is designed to maintain continued access to NSCC's critical services and to minimize market impact of the transfer while NSCC is seeking to ultimately wind-down its services. Specifically, the Wind-down Plan would provide for the transfer of NSCC's business, assets, and membership to another legal entity with such transfer being effected in connection with proceedings under Chapter 11 of the U.S. Bankruptcy Code.<sup>66</sup> After effectuating this transfer, NSCC would liquidate any remaining assets in an orderly manner in bankruptcy proceedings.

Although the Commission is not opining on the Wind-down Plan's consistency with the U.S. Bankruptcy

Code, in reviewing the proposed changes, the Commission believes that NSCC's intent to use bankruptcy proceedings to achieve an orderly liquidation of assets after any transfer of NSCC's business appears reasonable, in light of the provisions of the Bankruptcy Code that address the liquidation and distribution of a debtor's property among creditors and interest holders.<sup>67</sup> Under many circumstances, Section 363 of the Bankruptcy Code provides for the sale of property "free and clear of any interest in such property of an entity other than the estate[.]"<sup>68</sup> The Commission believes that NSCC's analysis regarding the applicability of these provisions, while not free from doubt, presents a reasonable approach to liquidation in light of the circumstances and the available alternatives.<sup>69</sup> Therefore, the Commission believes that the R&W Plan's Wind-down Plan helps NSCC establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by NSCC, which includes a wind-down plan necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.

Therefore, the Commission believes that the R&W Plan is consistent with Rule 17Ad-22(e)(3)(ii) under the Act.<sup>70</sup>

#### *D. Consistency With Rules 17Ad-22(e)(15)(i)-(ii) Under the Act*

Rule 17Ad-22(e)(15)(i) under the Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize, including by determining the amount of liquid net assets funded by equity based upon its general business risk profile and the length of time required to achieve a recovery or

orderly wind-down, as appropriate, of its critical operations and services if such action is taken.<sup>71</sup> Rule 17Ad-22(e)(15)(ii) under the Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize, including by holding liquid net assets funded by equity equal to the greater of either (x) six months of the covered clearing agency's current operating expenses, or (y) the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency, as contemplated by the plans established under Rule 17Ad-22(e)(3)(ii) under the Act,<sup>72</sup> discussed above.<sup>73</sup>

As discussed above, NSCC's Capital Policy is designed to address how NSCC holds LNA in compliance with these requirements,<sup>74</sup> while the Wind-down Plan would include an analysis to estimate the amount of time and cost to achieve a recovery or orderly wind-down of NSCC's critical operations and services, and would provide that the Board review and approve this analysis and estimation annually. The Wind-down Plan also would provide that the estimate would be the Recovery/Wind-down Capital Requirement under the Capital Policy. Under that policy, the General Business Risk Capital Requirement, which is the amount of LNA that NSCC plans to hold to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialize, is calculated as the greatest of three estimated amounts, one of which is this Recovery/Wind-down Capital Requirement. Therefore, the Commission believes that the R&W Plan is consistent with Rules 17Ad-22(e)(15)(i) and (ii) under the Act.<sup>75</sup>

### **III. Conclusion**

*It is therefore noticed*, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,<sup>76</sup> that the Commission *does not object* to advance notice SR-

<sup>67</sup> See, e.g., 11 U.S.C. 363, 726, and 1129(a)(7).

<sup>68</sup> See 11 U.S.C. 363(f).

<sup>69</sup> The Wind-down Plan would identify certain factors the Board may consider in evaluating alternatives, which would include, for example, whether NSCC could safely stabilize the business and protect its value without seeking bankruptcy protection, and NSCC's ability to continue to meet its regulatory requirements.

<sup>70</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>71</sup> 17 CFR 240.17Ad-22(e)(15)(i).

<sup>72</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>73</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

<sup>74</sup> *Supra* note 13.

<sup>75</sup> 17 CFR 240.17Ad-22(e)(15)(i) and (ii).

<sup>76</sup> 12 U.S.C. 5465(e)(1)(I).

<sup>66</sup> 11 U.S.C. 101 *et seq.*

NSCC–2017–805, as modified by Amendment No. 1, and that NSCC is authorized to implement the proposal as of the date of this notice or the date of an order by the Commission approving proposed rule change SR–NSCC–2017–017, as modified by Amendment No. 1, whichever is later.

By the Commission.

**Eduardo A. Aleman,**

*Assistant Secretary.*

[FR Doc. 2018–18869 Filed 8–29–18; 8:45 am]

BILLING CODE 8011–01–P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–83937; File No. SR–NSCC–2018–004]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change To Terminate the Commission Billing Service and the Commission Billing Limited Membership

August 24, 2018.

On July 13, 2018, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR–NSCC–2018–004, 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 July 24, 2018.<sup>3</sup> The Commission did not receive any comment letters on the proposed rule change. For the reasons discussed below, the Commission approves the proposed rule change.

#### I. Description of the Proposed Rule Change

The proposed rule change would amend the Rules and Procedures of NSCC (“Rules”) to terminate the Commission Billing service. Currently, the Commission Billing service facilitates the payment of commissions between NSCC’s members (“Members”) and floor brokerage firms<sup>4</sup> that charge commissions (“Commission Billing

Members”).<sup>6</sup> Commission Billing Members hold a limited membership at NSCC that allows such firms to participate in NSCC solely for the collection of commissions.<sup>7</sup> NSCC tabulates all commission payment records received on a monthly basis, and either sends amounts to The Depository Trust Company (“DTC”) for payment (for Members that are also Participants of DTC) or processes payments through the Automated Clearing House.<sup>8</sup>

NSCC proposes to terminate the Commission Billing service and the associated membership category.<sup>9</sup> NSCC states that over the years the volumes of trades handled by floor brokerage firms have decreased, leading to a significant decrease in the use of this service.<sup>10</sup> NSCC states that the reduced volumes of transactions have caused this service to be provided at a financial loss to NSCC.<sup>11</sup> Additionally, NSCC states that due to the use of legacy systems that lack automation and support features, the service continues to rely on manual processes and requires personnel involvement, which can lead to errors.<sup>12</sup> NSCC would implement the proposed changes no later than November 30, 2018.<sup>13</sup>

#### II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act 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 rules and regulations thereunder applicable to such organization.<sup>14</sup> The Commission believes the proposal is consistent with Act, specifically Section 17A(b)(3)(F) of the Act and Rules 17Ad–22(e)(21)(iv) under the Act.<sup>15</sup>

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

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency, such as NSCC, be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>16</sup>

As described above, the proposed rule change would terminate the

Commission Billing service and the associated membership category. The proposed change is designed to eliminate an underutilized service that takes up NSCC resources (through its reliance on manual operations and by operating at a financial loss) and is no longer relied on by Members or the industry. As NSCC would no longer need to divert resources to the service, the proposed rule change would afford NSCC the opportunity to redeploy those resources in a manner that could better support NSCC’s other, more utilized clearance and settlement services. Accordingly, the Commission finds that the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.<sup>17</sup>

##### B. Rule 17Ad–22(e)(21)(iv) Under the Act

Rule 17Ad–22(e)(21)(iv) under the Act requires a covered clearing agency<sup>18</sup> to establish, implement, maintain, and enforce written policies and procedures reasonably designed to be efficient and effective in meeting the requirements of its participants and the markets it serves.<sup>19</sup> As described above, use of the Commission Billing service has significantly decreased, as the industry has change and the service no longer provides the same value that it had historically. As a result, NSCC currently operates the service at a financial loss. As such, NSCC has determined that it would be more efficient and effective in meeting the requirements of its Members and the market NSCC serves to eliminate the service. In doing so, NSCC would be able to redirect the resources being consumed by the Commission Billing service to other, more needed services. Therefore, the Commission finds that the proposed rule change is designed to help ensure that NSCC is efficient and effective in meeting the requirements of its participants,

<sup>17</sup> *Id.*

<sup>18</sup> A “covered clearing agency” means, among other things, a clearing agency registered with the Commission under Section 17A of the Exchange Act (15 U.S.C. 78q–1 *et seq.*) that is designated systemically important by the Financial Stability Oversight Counsel (“FSOC”) pursuant to the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5461 *et seq.*). See 17 CFR 240.17Ad–22(a)(5)–(6). On July 18, 2012, FSOC designated NSCC as systemically important. U.S. Department of the Treasury, “FSOC Makes First Designations in Effort to Protect Against Future Financial Crises,” available at <https://www.treasury.gov/press-center/press-releases/Pages/tg1645.asp>. Therefore, NSCC is a covered clearing agency.

<sup>19</sup> 17 CFR 240.17Ad–22(e)(21)(iv).

<sup>6</sup> Notice, 83 FR at 35041.

<sup>7</sup> *Id.*

<sup>8</sup> Notice, 83 FR at 35041–42.

<sup>9</sup> Notice, 83 FR at 35042.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>15</sup> 15 U.S.C. 78q–1(b)(3)(F); 17 CFR 240.17Ad–22(e)(21)(iv).

<sup>16</sup> 15 U.S.C. 78q–1(b)(3)(F).

<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. 83666 (July 18, 2018), 83 FR 35041 (July 24, 2018) (SR–NSCC–2018–004) (“Notice”).

<sup>4</sup> Available at <http://www.dtcc.com/legal/rules-and-procedures>.

<sup>5</sup> Floor brokerage firms are members of the New York Stock Exchange (“NYSE”) and NYSE American. Floor brokerage firms execute trades on behalf of their clients for a commission.