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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66731; File No. SR-NSCC-2012-02)

April 4, 2012

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Enhance its Margining Methodology as Applied to Municipal and Corporate Bonds

I. Introduction

On February 1, 2012, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change SR-NSCC-2012-02 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").[1] The proposed rule change was published for comment in the Federal Register on February 22, 2012.[2] The Commission received no comment letters. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

This rule change will enhance NSCC's margining methodology as it applies to municipal and corporate bonds.

Proposal Overview

A primary objective of NSCC's clearing fund ("Clearing Fund") is to have on deposit from each applicable member assets sufficient to satisfy losses that may otherwise be incurred by NSCC as the result of the default of the member and the resultant close out of that member's unsettled positions under NSCC's trade guaranty. Each member's Clearing Fund required deposit is calculated daily pursuant to a formula set forth in Procedure XV of NSCC's Rules,

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1 15 U.S.C. 78s(b)(1).

2 Securities Exchange Act Release No. 34-66398 (February 15, 2012), 77 FR 10589 (February 22, 2012).

which formula is designed to provide sufficient funds to cover this risk of loss. The Clearing Fund formula accounts for a variety of risk factors through the application of a number of components, each described in Procedure XV.[3]

The volatility component or "VaR" is a core component of this formula and is designed to calculate the amount of money that may be lost on a portfolio over a given period of time and that is assumed would be necessary to liquidate the portfolio within a given level of confidence. Pursuant to Procedure XV, NSCC may exclude from this calculation net unsettled positions in classes of securities such as illiquid municipal or corporate bonds, whose volatility is amenable to generally accepted statistical analysis only in a complex manner. The volatility charge for such positions is determined by multiplying the absolute value of the positions by a predetermined percentage ("haircut"), which shall not be less than 2%.

In connection with its ongoing review of the adequacy and appropriateness of its margining methodologies, NSCC is amending Procedure XV of its Rules so that NSCC will apply this haircut-based margining methodology at a rate of no less than 2% as is currently permitted by Procedure XV to all municipal and corporate bonds processed through NSCC. The

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3 In addition to those described in this filing, Clearing Fund components also include (i) a mark-to-market component that takes into account the difference between the contract price and market price for the net position of each security in a member's portfolio through settlement; (ii) the Market Maker Domination component ("MMDOM") is charged to Market Makers or firms that clear for them; (iii) a "special charge" in view of price fluctuations in or volatility or lack of liquidity of any security; (iv) an additional charge between 5-10% of a member's outstanding fail positions; (v) a "specified activity charge" for transactions scheduled to settle on a shortened settlement cycle (i.e., less than T+3 or T+3 for "as-of" transactions); (vi) an additional charge that NSCC may require of members on surveillance status; and (vii) an "Excess Capital Premium" that takes into account the degree to which a member's collateral requirement compares to the member's excess net capital by applying a charge if a member's Required Deposit minus amounts applied from the charges described in (ii) and (iii) above is above its required capital.

proposed rule change will make clear that to the extent NSCC deems appropriate NSCC may apply this haircut to any of the municipal and corporate bonds that it processes. As NSCC continues its ongoing review of the adequacy of its margining methodology in achieving the desired coverage, the proposed rule change will allow NSCC to apply a margin requirement to these instruments that it deems appropriate.

NSCC reviews its risk management processes against applicable regulatory and industry standards, including, but not limited to: (i) the Recommendations for Central Counterparties ("Recommendations") of the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions ("IOSCO") and (ii) the securities laws and rulemaking promulgated by the Commission. In conformance with Recommendations 3 and 4 of the IOSCO Recommendations and with the Commission rules proposed under the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, specifically proposed Rule 17Ad-22(b)(1) addressing measurement and management of credit exposures, this proposed rule change will assist NSCC in its continuous efforts to ensure the reliability of its margining methodology and will limit NSCC's exposures to losses by allowing NSCC to apply a margin requirement to the corporate and municipal bonds it clears that captures the risk characteristics, which are asset class specific, of these instruments, including historical price volatility, market liquidity, and idiosyncratic risk.

Implementation Timeframe

Members will be advised of the implementation date through issuance of an NSCC Important Notice.

Proposed Rule Changes

In order make clear that to the extent NSCC deems appropriate it may apply a haircut-based margining methodology to all municipal and corporate bonds processed at NSCC, NSCC is amending Sections I(A)(1)(a)(ii) and I(A)(2)(a)(ii) of Procedure XV, as marked on Exhibit 5 to the proposed rule filing, by removing the qualifier "illiquid" before "municipal or corporate bonds." No other changes to the Rules are contemplated by this proposed rule change.

III. Discussion

Section 17A(b)(3)(F) of the Act[4] requires, among other things, that the rules of a clearing agency be designed, to assure the safeguarding of securities and funds which are in the custody or control of such clearing agency or for which it is responsible and in general to protect investors and the public interest.

As a central counterparty, NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions, thereby reducing the risk faced by members and contributing to global financial stability. The effectiveness of a central counterparty's risk controls and the adequacy of its financial resources are critical to achieving these risk-reducing goals. Because the proposed rule change will assist NSCC in its continuous efforts to ensure the reliability of its margining methodology and will limit NSCC's exposures to losses by allowing it to apply a margin requirement to corporate and municipal bonds cleared at NSCC that better addresses the risk characteristics of these instruments, the proposed rule change should help assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible, and in general, protect investors

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4 15 U.S.C. 78q-1(b)(3)(F).

and the public interest and therefore is consistent with the requirements of Section 17A(b)(3)(F) of the Act. The proposed rule change is not inconsistent with the existing rules of NSCC, including any other rules proposed to be amended.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act[5] and the rules and regulations thereunder.

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5 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[6] that the proposed rule change (File No. SR-NSCC-2012-02) be, and hereby is, approved.[7]

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.[8]

Kevin O'Neill
Deputy Secretary

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6 15 U.S.C. 78s(b)(2).

7 In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

8 17 CFR 200.30-3(a)(12).