

Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSEAMER-2017-11 and should be submitted on or before October 4, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Eduardo A. Aleman,
Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-81550; File No. SR-NSCC-2017-010]

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change To Expand the Application of the Family-Issued Securities Charge

September 7, 2017.

On July 10, 2017, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-NSCC-2017-010 ("Proposed Rule Change") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² The Proposed Rule Change was published for comment in

the **Federal Register** on July 31, 2017.³ The Commission did not receive any comments 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 is a proposal by NSCC to further address specific wrong-way risk⁴ that is present when NSCC acts as central counterparty to a transaction with an NSCC member ("Member") where the underlying securities are securities issued by such Member or an affiliate of such Member ("family-issued securities").⁵ Currently, NSCC applies a targeted margin charge to address the specific wrong-way risk of family-issued securities transactions ("FIS Charge") where the Member is on NSCC's Watch List.⁶ NSCC believes that Members on the Watch List present a higher credit risk (*i.e.*, a greater risk of defaulting on their settlement obligations), compared to Members not on the Watch List.⁷ As such, the family-issued securities of Members on the Watch List currently receive a FIS Charge because of the increased credit risk presented by such Members.⁸ As described in detail below, NSCC

³ Securities Exchange Act Release No. 81203 (July 25, 2017), 82 FR 35563 (July 31, 2017) (SR-NSCC-2017-010) ("Notice"). NSCC also filed a related advance notice with the Commission pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 and Rule 19b-4(n)(1) under the Act. 15 U.S.C. 5465(e)(1) and 17 CFR 240.19b-4(n)(1). The advance notice was published in the **Federal Register** on August 2, 2017. Securities Exchange Act Release No. 81286 (August 2, 2017), 82 FR 37141 (August 8, 2017) (SR-NSCC-2017-804). The Commission did not receive any comments on that proposal.

⁴ Specific wrong-way risk is the risk that an exposure to a counterparty is highly likely to increase when the creditworthiness of that counterparty is deteriorating. See *Principles for financial market infrastructures*, issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions 47 n.65 (April 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

⁵ Notice, 82 at 35563-64. As part of this proposal, NSCC proposes to define in its rules that, for a given Member, a family-issued security is a security that was issued by such Member or an affiliate of such Member. Notice, 82 at 35563.

⁶ Notice, 82 at 35563. As part of its ongoing monitoring of its membership, NSCC utilizes an internal credit risk rating matrix to rate its risk exposures to its Members based on a scale from 1 (the strongest) to 7 (the weakest). Members that fall within the weakest three rating categories (*i.e.*, 5, 6, and 7) are placed on NSCC's "Watch List" and, as provided under NSCC's Rules and Procedures ("Rules"), may be subject to enhanced surveillance or additional margin charges. See Section 4 of Rule 2B and Section I(B)(1) of Procedure XV of NSCC's Rules, available at http://dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf.

⁷ Notice, 82 at 35564.

⁸ *Id.*

proposes in the Proposed Rule Change to expand the application of the FIS Charge to all Members, regardless of a Member's Watch List status, but still maintain a higher FIS Charge for Members that present a greater credit risk to NSCC, such as Members on the Watch List.⁹

Currently, in calculating a Watch List Member's overall margin charge (*i.e.*, a Watch List Member's required deposit to NSCC's clearing fund), NSCC excludes the Member's net, unsettled long position in family-issued securities from the volatility component of the margin calculation ("VaR Charge").¹⁰ Instead, for such unsettled long positions, NSCC calculates the required margin (*i.e.*, the FIS Charge) by multiplying the position value by a set percentage, which is determined based on a Member's rating on NSCC's internal credit risk rating matrix.¹¹ NSCC applies this separate margin calculation to deal with specific wrong-way risk that arises from these positions because NSCC has to liquidate the unsettled family-issued security long positions in the Member's portfolio to manage the default.¹² Given that the Member's default would likely adversely affect NSCC's ability to liquidate such positions at full value (because the value of the family-issued securities will decline in response to the Member's default), NSCC applies the FIS Charge to try to address the risk of a shortfall.¹³ According to NSCC, the FIS Charge constitutes a more conservative approach to collecting margin on family-issued security positions than what may be achieved by applying the VaR Charge, which does not recognize the relationship between the Member and the family-issued securities.¹⁴

Although the risk of default by Members that are not on the Watch List is lower than Members on the Watch

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* More specifically, fixed-income securities that are family-issued securities are charged a rate of no less than 80 percent for firms that are rated 6 or 7 on the credit risk rating matrix, and no less than 40 percent for firms that are rated 5 on the credit risk rating matrix. Equity securities that are family-issued securities are charged a rate of 100 percent for firms that are rated 6 or 7 on the credit risk rating matrix, and no less than 50 percent for firms that are rated 5 on the credit risk rating matrix. See Section I(B)(1) of Procedure XV of NSCC's Rules, available at http://dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf.

¹² Notice, 82 at 35564. In a default scenario, NSCC would receive the family-issued securities from a Member's guaranteed long transactions and would have to liquidate the holding to unwind NSCC's position. *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

List, NSCC believes that it is appropriate to apply the FIS Charge to all Members because all Members' long positions in family-issued securities present specific wrong-way risk. However, the proposal would still maintain the relation between the FIS Charge and the Member's risk of default (*i.e.*, the Member's credit risk), while at the same time addressing the difference in risk posed by equity and fixed-income securities. As such, NSCC proposes in the Proposed Rule Change to apply the FIS Charge to fixed-income securities that are family-issued securities of non-Watch List Members at a rate of no less than 40 percent, and to equities that are family-issued securities of non-Watch List Members at a rate of no less than 50 percent.¹⁵

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.¹⁶ After carefully considering the Proposed Rule Change, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NSCC. In particular, the Commission believes the proposal is consistent with Section 17A(b)(3)(F) of the Act,¹⁷ as well as Rules 17Ad-22(e)(4)(i) and 17Ad-22(e)(6)(i) and (e)(6)(v) thereunder.¹⁸

A. Consistency With 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 be designed to promote the prompt and accurate clearance and settlement of securities transactions, and to assure the safeguarding of securities and funds which are in the

¹⁵ *Id.* According to NSCC, it calibrated the FIS Charge rates based on historical corporate-issue recovery-rate data. The rate applicable to equities is higher than the rate applicable to fixed-income securities because NSCC determined that equities present a greater risk than fixed-income securities of having a value at or near zero when a Member defaults. The Commission understands that NSCC calculated the 40 and 50 percent rates based on a weighted value of the probability of a Member defaulting and the potential loss that NSCC may realize when liquidating family-issued securities after a Member default. Securities Exchange Act Release No. 75768 (August 27, 2015), 80 FR 53219, 53220 (September 2, 2015) (SR-NSCC-2015-003).

¹⁶ 15 U.S.C. 78s(b)(2)(C).

¹⁷ 15 U.S.C. 78q-1(b)(3)(F).

¹⁸ 17 CFR 240.17Ad-22(e)(4)(vi); (e)(6)(i); and (e)(6)(v).

custody or control of the clearing agency or for which it is responsible.¹⁹ The Commission believes that the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(F) of the Act for the reasons set forth below.

The Commission believes that the proposal is designed to promote the prompt and accurate clearance and settlement of securities transactions. As described above, the proposal would provide for the collection by NSCC of margin amounts that contemplate and help address the specific wrong-way risk presented by all Members. In doing so, the proposal would help ensure that NSCC maintains sufficient margin in the event that a Member holding family-issued securities defaults and such positions significantly decrease in value. Without this increased margin, NSCC is at a greater risk of not having enough margin to offset potential losses from the reduced value of family-issued securities in a default scenario. Such losses could threaten NSCC's ability to continue operations of its critical clearance and settlement services. Because the proposal would generally increase the level of financial resources available to NSCC, better enabling NSCC to continue operating in default scenarios, the proposal would help NSCC to continue providing prompt and accurate clearance and settlement of securities transactions in the event of a Member default.

The Commission believes also that the proposal is designed to assure the safeguarding of securities and funds which are in the custody or control of NSCC or for which it is responsible. As described above, the FIS Charge is calculated and collected to help mitigate NSCC's loss exposure to specific wrong-way risk that NSCC may face when liquidating family-issued security positions that are depreciating in value in response to a Member's default. By expanding the FIS Charge to family-issued security transactions presented to NSCC by all Members, the proposal would assist NSCC in collecting margin and maintaining a clearing fund amount that more accurately reflects NSCC's overall risk exposure to its Members. Therefore, the proposal is designed to help assure the safeguarding of securities and funds which are in the custody or control of NSCC by mitigating the risk that NSCC would suffer a loss from a Member default, and reducing Members' exposure to clearing fund losses from the specific wrong-way risk that NSCC faces from Member transactions in family-issued securities. Therefore, for the reasons stated above,

¹⁹ 15 U.S.C. 78q-1(b)(3)(F).

the Commission believes that the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.²⁰

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

The Commission believes that the Proposed Rule Change is consistent with Rule 17Ad-22(e)(4)(i) under the Act, which requires, in part, that NSCC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.²¹

As described above, NSCC is exposed to specific wrong-way risk where it acts as central counterparty for its Members for transactions in family-issued securities. The expanded application of the FIS Charge to all Members would help further mitigate NSCC's loss exposure to this risk. The charge is calculated and imposed based on the value and type of family-issued securities in each Member's portfolio and in consideration of the Members' credit rating, as calculated by NSCC's internal credit risk matrix. Although the FIS Charge may not fully reflect the recovery rate on a family-issue security when a Member defaults, the Commission understands that expanding the FIS Charge to non-Watch List Members, as proposed, would enable NSCC to collect more margin on such positions than would a VaR Charge, more accurately reflecting the risks those positions present. Thus, the expanded FIS Charge is designed to help NSCC collect sufficient financial resources to help cover the specific risk exposure, with a high degree of confidence, which is presented by all Members seeking to clear and settle transactions in family-issued securities. Therefore, the Commission believes that the proposal to expand the FIS Charge to all Members is consistent with Rule 17Ad-22(e)(4)(i) under the Act.²²

C. Consistency With Rule 17Ad-22(e)(6)(i) and (e)(6)(v)

The Commission believes that the Proposed Rule Change is consistent with Rule 17Ad-22(e)(6)(i) and (e)(6)(v) under the Act, which require, in part, that NSCC establish, implement,

²⁰ *Id.*

²¹ 17 CFR 240.17Ad-22(e)(4)(i).

²² *Id.*

maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market; and uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.²³

As described above, NSCC faces specific wrong-way risk where it acts as central counterparty to Member transactions in family-issued securities. To help address this risk, NSCC applies the FIS Charge in calculating the Member's required margin. Specifically, the FIS Charge is a component of the margin that NSCC calculates and collects using a risk-based margin methodology that is designed to help maintain the coverage of NSCC's credit exposures to its Members at a confidence level of at least 99 percent. The FIS Charge is tailored to consider both the value and type of family-issued securities held by the Member, as well as the credit risk presented by the Member, as calculated by NSCC.

However, currently, the FIS Charge is assessed only against Members on the Watch List because of the additional credit risk presented by such Members. Nevertheless, all Members, not just Members on the Watch List, present specific wrong-way risk. As such, NSCC proposes to expand the FIS Charge to all Members, while maintaining the relation between the FIS Charge and the Member's credit risk. Specifically, NSCC proposes to apply the FIS Charge to fixed-income securities that are family-issued securities of non-Watch List Members at a rate of no less than 40 percent, and to equities that are family-issued securities of non-Watch List Members at a rate of no less than 50 percent. Although NSCC proposes to apply a lesser percentage rate to non-Watch List Members than some Watch List Members, the proposed rate is designed to more accurately reflect the risks posed than what is reflected in a VaR Charge.

Because the expanded FIS Charge also would be a tailored component of the margin that NSCC collects from non-Watch List Members to help cover NSCC credit exposure to such Members, as the charge would be based on different product risk factors with respect to equity and fixed-income securities, as described above, the Commission believes that the proposed

changes in the Proposed Rule Change are consistent with Rule 17Ad-22(e)(6)(i) and (e)(6)(v) under the Act.²⁴

III. Conclusion

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act, in particular the requirements of Section 17A of the Act²⁵ and the rules and regulations promulgated thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that proposed rule change SR-NSCC-2017-010 be and hereby is APPROVED as of the date of this order or the date of a notice by the Commission authorizing NSCC to implement its related advance notice proposal (SR-NSCC-2017-804), whichever is later.²⁶

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁷

Eduardo A. Aleman,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

Submission for OMB Review; Comment Request

Upon Written Request, Copies Available From: Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549-2736.

Extension:

Rule 38a-1, OMB Control No. 3235-0586, SEC File No. 270-522.

Notice is hereby given that, pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission (the "Commission") has submitted to the Office of Management and Budget a request for extension of the previously approved collection of information discussed below.

Rule (17 CFR 270.38a-1) under the Investment Company Act of 1940 (15 U.S.C. 80a) ("Investment Company Act") is intended to protect investors by fostering better fund compliance with securities laws. The rule requires every registered investment company and business development company ("fund") to: (i) Adopt and implement

written policies and procedures reasonably designed to prevent violations of the federal securities laws by the fund, including procedures for oversight of compliance by each investment adviser, principal underwriter, administrator, and transfer agent of the fund; (ii) obtain the fund board of directors' approval of those policies and procedures; (iii) annually review the adequacy of those policies and procedures and the policies and procedures of each investment adviser, principal underwriter, administrator, and transfer agent of the fund, and the effectiveness of their implementation; (iv) designate a chief compliance officer to administer the fund's policies and procedures and prepare an annual report to the board that addresses certain specified items relating to the policies and procedures; and (v) maintain for five years the compliance policies and procedures and the chief compliance officer's annual report to the board.

The rule contains certain information collection requirements that are designed to ensure that funds establish and maintain comprehensive, written internal compliance programs. The information collections also assist the Commission's examination staff in assessing the adequacy of funds' compliance programs.

While Rule 38a-1 requires each fund to maintain written policies and procedures, most funds are located within a fund complex. The experience of the Commission's examination and oversight staff suggests that each fund in a complex is able to draw extensively from the fund complex's "master" compliance program to assemble appropriate compliance policies and procedures. Many fund complexes already have written policies and procedures documenting their compliance programs. Further, a fund needing to develop or revise policies and procedures on one or more topics in order to achieve a comprehensive compliance program can draw on a number of outlines and model programs available from a variety of industry representatives, commentators, and organizations.

There are approximately 4,133 funds subject to Rule 38a-1. Among these funds, 97 were newly registered in the past year. These 97 funds, therefore, were required to adopt and document the policies and procedures that make up their compliance programs. Commission staff estimates that the average annual hour burden for a fund to adopt and document these policies and procedures is 105 hours. Thus, we estimate that the aggregate annual

²⁴ *Id.*

²⁵ 15 U.S.C. 78q-1.

²⁶ 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).

²⁷ 17 CFR 200.30-3(a)(12).

²³ 17 CFR 240.17Ad-22(e)(6)(i) and (e)(6)(v).