

Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CboeBZX-2020-079 and should be submitted on or before December 7, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

**J. Matthew DeLesDernier,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90383; File No. SR-BX-2020-033]

### Self-Regulatory Organizations; Nasdaq BX, Inc.; Notice of Filing of Proposed Rule Change To Utilize the FIX Protocol To Submit Orders to BX's Price Improvement Auction Mechanism

November 9, 2020.

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> notice is hereby given that on October 27, 2020, Nasdaq BX, Inc. ("BX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Options 3, Section 7(d)(1)(A) relating to "Financial Information eXchange" or "FIX" in connection with offering BX Participants the ability to utilize FIX to submit orders to its Price Improvement Auction ("PRISM") mechanism.

The text of the proposed rule change is available on the Exchange's website at <https://listingcenter.nasdaq.com/rulebook/bx/rules>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The Exchange proposes to offer BX Participants a manner in which to send messages through FIX, to other BX Participants, for the specific purpose of requesting another BX Participant submit an "Initiating Order"<sup>3</sup> along with the sender's PRISM Order<sup>4</sup> into the Price Improvement Auction ("PRISM") mechanism for execution pursuant to Options 3, Section 13. Specifically, the Exchange proposes to amend BX Options 3, Section 7(d)(1)(A) relating to "Financial Information eXchange" or "FIX" in connection with this offering. This functionality would provide an additional workflow to BX Participants seeking to enter paired orders into PRISM. This proposal does not amend the PRISM rule within Options 3, Section 13 in connection with offering Participants the ability to submit a Request for PRISM through FIX.

FIX is an interface that allows Participants and their Sponsored Customers to connect, send, and receive messages related to orders and auction orders and responses to and from the Exchange. Features include the following: (1) Execution messages; (2) order messages; and (3) risk protection

triggers and cancel notifications.<sup>5</sup> Today, all BX Participants utilize FIX to submit orders to BX.

This proposal would expand the capabilities of the FIX protocol to allow a BX Participant (sender) to utilize FIX to send a message to other BX Participants (responders) with an order the sender represents as agent ("PRISM Order") on behalf of a Public Customer, broker dealer or other entity requesting the responders provide a contra-side Initiating Order (a "response") and begin a PRISM auction (collectively a "Request for PRISM").<sup>6</sup> Today, Participants communicate their desire to have their orders paired in other ways,<sup>7</sup> which may be less efficient. This proposal would permit BX Participants to streamline their workflow and utilize FIX as a tool to message a Request for PRISM to all BX Participants that opted to receive these notifications, as described below. If a BX Participant desires to respond to the request, the BX Participant would add an Initiating Order to the sender's PRISM Order and submit the paired order directly into PRISM, through FIX, for processing in accordance with Options 3, Section 13. BX Participants may elect to "opt in" to receive Requests for PRISM. BX Participants that do not elect to "opt in" will not receive such requests. Once a BX Participant elects to receive Requests for PRISM, they would receive all requests from any BX Participant submitting a Request for PRISM. The BX Participant cannot elect to only receive requests from certain Participants and the sender may not elect to send the request to a select group of BX Participants.

Specifically, the Request for PRISM created by the BX Participant would be systematized so that a BX Participant may add an Initiating Order to the previously submitted sender PRISM Order and directly submit the PRISM Order through FIX. The Exchange will set a certain time period up to one second<sup>8</sup> within which the PRISM Order must be submitted or it would otherwise cancel or book pursuant to the sending

<sup>5</sup> See Options 3, Section 7(d)(1)(A).

<sup>6</sup> The Request for PRISM, if accepted and submitted into PRISM, would become the "PRISM Order" pursuant to Options 3, Section 13.

<sup>7</sup> This proposal represents an alternative to the other methods of submitting an order which may include: telephone, electronically using an external order management system, or utilizing instant message.

<sup>8</sup> The Exchange will initially set the time period to 100 milliseconds to respond to the Request for PRISM or otherwise not respond before the Request for PRISM would become unavailable. The Exchange will post the time period on its System settings page.

<sup>21</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> An Initiating Order is an order executed against principal interest or against any other order it represents as agent. See Options 3, Section 13.

<sup>4</sup> A PRISM Order is an order submitted by a BX Participant that it represents as agent on behalf of a Public Customer, broker dealer, or any other entity, electronically, for execution. See Options 3, Section 13.

Participant's instructions, as described in more detail below.

The Request for PRISM would include the price, size, symbol, side and instruction for handling of the order, in the event there are no responses. A response must match the PRISM Order and may not improve the price, or the response will be rejected. A response may be configured to improve the PRISM Order stop price<sup>9</sup> pursuant to Options 3, Section 13(ii)(A)(1)(c). The configuration would apply if this response initiated a PRISM auction.

BX Participants are not obligated to respond to the request. If a BX Participant elects not to respond they would ignore the request. If no BX Participant responds, pursuant to the sender's instruction, the PRISM Order would be placed on the Order Book as a Limit Order or cancelled. In any event, no order would be submitted into the PRISM mechanism in the instance that no BX Participant responded to the request.

By way of example, BX Firm A elects to send a Request for PRISM. BX Firm A would enter a Request for PRISM with a PRISM Order, for example an order to sell 100 contracts in AAPL at \$1.00 with an instruction to enter the order on the Order Book if no one responds with an Initiating Order into PRISM. This Request for PRISM is entered into FIX. The Request for PRISM would be sent to all BX Participants who opted in to receive this request, also a timer not to exceed one second would commence. Assume in this example that 3 firms responded (Firm B, C, and D, in that order of response) with each firm willing to buy 100 contracts<sup>10</sup> in AAPL at \$1.00 and they respond within 50 milliseconds. The System would process Firm B's Initiating Order along with the PRISM Order by entering the paired order, through FIX, into PRISM for execution pursuant to Options 3, Section 13. The System would send the other 2 responders (C and D) a reject message.

Assume the same example, that Firm B had responded that it was willing to buy 100 contracts in AAPL at \$1.00, and Firm B also configured the response with a No Worse Than price. Because in this example Firm B's Initiating Order, along with the PRISM Order was sent into PRISM for execution pursuant to Options 3, Section 13, the No Worse Than price would be considered in the allocation and the Initiating Order will

<sup>9</sup> BX Options 3, Section 13(ii)(A)(1) permits Participants to submit a No Worse Than price.

<sup>10</sup> As noted above, a response must match the PRISM Order and may not improve the price, or the response will be rejected.

auto-match unrelated orders and PANs that provide the PRISM Order price improvement up to the No Worse Than price.

Assume the same example, except in this scenario no Participant responds during the timer, the Initiating Order would post to the Order Book as a Limit Order and be handled in accordance with Options 3, Section 10 (Order Book Allocation) pursuant to the Participant's instructions. The System would disseminate a PRISM notification to all Participants if a responder submitted an Initiating Order into the PRISM mechanism. The System would retain an audit trail of the Request for PRISM and the responses, if any, received.

As noted above, a Request for PRISM would be sent to all BX Participants that elected to opt in to receive these requests. Unlike the workflow today, wherein a Participant may call one or multiple members to enter into a PRISM Order, all BX Participants that opted in would receive any Request for PRISM. The System will submit the first Initiating Order response received, during the timer, into a PRISM. Once the recipient of a Request for PRISM has responded to the Request for PRISM by adding the Initiating Order, the PRISM may not be cancelled. The sender may not cancel a Request for PRISM once that Request for PRISM has been sent. The identity of the sender and recipients would not be known to any party. Further, the Exchange would not disclose a list of Participants that opted in to receive Requests for PRISM.

The Exchange believes this new FIX feature will enhance the workflow of BX Participants desiring to enter orders into PRISM for execution and price improvement. The Exchange believes that this new functionality will offer market participants another method to directly engage with other BX Participants to locate an Initiating Order for submission of a paired order into the PRISM mechanism.

The Exchange proposes to amend Options 3, Section 7(d)(1)(A) to add the following sentence to the description of the FIX protocol, "In addition, a BX Participant may elect to utilize FIX to send a message and PRISM Order, as defined within Options 3, Section 13, to all BX Participants that opt in to receive Requests for PRISM requesting that it submit the sender's PRISM Order with responder's Initiating Order, as defined within Options 3, Section 13, into the Price Improvement Auction ('PRISM') mechanism, pursuant to Options 3, Section 13 ('Request for PRISM')."

(a) BX Participants must "opt in" to receive Requests for PRISM. A Participant who opts in to receive

Requests for PRISM will receive all requests from a Participant submitting a Request for PRISM.

(b) The Exchange will set a certain time period up to one second within which a recipient of a Request for PRISM may utilize FIX to submit the sender's PRISM Order, along with an Initiating Order (a "response") into the System for execution into PRISM pursuant to Options 3, Section 13. The System will permit the first responder to start a PRISM Auction and will send a reject message to subsequent responders. A response must match the PRISM Order and may not improve the price, or the response will be rejected. A response may be configured to improve the PRISM Order stop price pursuant to Options 3, Section 13(ii)(A)(1)(c); the configuration would apply if this response initiated a PRISM auction. If no BX Participant responds to the Request for PRISM, the PRISM Order would be placed on the Order Book as a Limit Order or cancelled, consistent with the sending Participant's instruction.

(c) A Request for PRISM will be sent simultaneously to all BX Participants who opted in to receive Requests for PRISM.

(d) Once the recipient of a Request for PRISM has responded to the Request for PRISM by adding the Initiating Order, the PRISM may not be cancelled.

(e) The sender may not cancel a Request for PRISM once that Request for PRISM has been sent.

(f) The identity of the sender and recipients will not be known to any party. The Exchange will not disclose a list of Participants that opted in to receive Requests for PRISM.

(g) It would be deemed conduct inconsistent with just and equitable principles of trade and a violation of Options 9, Section 1, and other Exchange Rules, to utilize non-public information in connection with a Request for PRISM to a Participant's economic advantage.

BX will employ surveillances to prevent misuse of non-public information specifically related to a Request for PRISM. Today, Options 3, Section 13(iv)<sup>11</sup> and (v)<sup>12</sup> describes

<sup>11</sup> BX Options 3, Section 13(iv) provides, "A pattern or practice of submitting multiple orders in response to a PAN at a particular price point that exceed, in the aggregate, the size of the PRISM Order, will be deemed conduct inconsistent with just and equitable principles of trade and a violation of General 9, Section 1."

<sup>12</sup> BX Options 3, Section 13(v) provides, "A pattern or practice of submitting unrelated orders or quotes that cross the stop price, causing a PRISM Auction to conclude before the end of the PRISM Auction period will be deemed conduct inconsistent with just and equitable principles of

certain activity prohibited by BX related to PRISM.

#### Implementation

The Exchange intends to begin implementation of the proposed rule change by June 30, 2021. The Exchange will issue an Options Trader Alert to Participants with the date of implementation.

#### 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>13</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>14</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by proposing another method for BX Participants to submit PRISM Orders, while effectively reducing certain workflow. In particular, the proposal provides greater flexibility for Participants submitting orders into PRISM, specifically providing an avenue for BX Participants desiring to send orders to the PRISM mechanism to locate an Initiating Order to pair their PRISM Order with and participate in a PRISM Auction. The Exchange also believes the proposal will provide an opportunity for Participants to achieve better handling of orders by providing Participants with an ability to solicit interest from any BX Participant who opts in to receive a Request for PRISM. A BX Participant sending a Request for PRISM via FIX would have the opportunity to have their order responded to by a broader array of market participants in a more direct fashion. Adopting this proposal and providing the ability for BX Participants to anonymously solicit interest from other BX Participants desiring to enter a Initiating Order into PRISM will promote just and equitable principles of trade and foster cooperation and coordination with persons engaged in facilitating transactions in securities. Any BX Participant may respond to a PRISM Auction and therefore all BX

Participants benefit from the ability to interact with additional order flow that this functionality would generate as a result of matching PRISM Orders to Initiating Orders, thereby removing impediments to and perfecting the mechanism of a free and open market and a national market system.

Today, Participants communicate their desire to have their orders paired in other ways,<sup>15</sup> which may be less efficient. For example, today parties on trading floors negotiate paired orders prior to entry into a trading crowd.<sup>16</sup> This proposal would permit BX Participants to streamline their workflow and utilize FIX as a tool to message a Request for PRISM to all BX Participants opting to receive these requests. This proposal would not amend the manner in which PRISM operates. There are no amendments proposed to BX Options 3, Section 13 herein. This feature, which expands the FIX protocol offering to allow any BX Participant to send a Request for PRISM to all BX Participants opting to receive these requests, would offer BX Participants a manner in which to effectively communicate an interest to initiate a PRISM Auction. The functionality, which systematizes the Request for PRISM for streamlined entry to PRISM through FIX, provides an avenue for BX Participants who have no order flow arrangements to locate interest. If no one responds to the Request for PRISM, then the sending Participant may elect to have the System post the PRISM Order to the Order Book as a Limit Order or cancel the PRISM Order. If a Participant responds to a Request for PRISM then the paired order will be entered into PRISM by the System and any BX Participant may respond. All BX Participants benefit from the ability to interact with order flow on BX.

Permitting Participants to opt in to receive a Request for PRISM is consistent with the Act and promotes free and open markets because anyone can opt in and participate. Also, if a BX Participant does not want to opt in, it prevents Participants from receiving unwanted solicitations. Once a Participant elects to receive Requests for

PRISM, they would receive a request from any BX Participant.<sup>17</sup> The Exchange believes that it is consistent with the Act to not allow Participants to selectively exclude interest from certain Participants, if they chose to utilize this workflow. Additionally, the Exchange believes that no BX Participant should be required to accept solicitations of interest from other Participants if they elect not to receive such notifications.

The identity of the sender and the recipients would not be known to any party. The Exchange believes that it is consistent with the Act to not disclose the identities of any party as the Exchange believes that anonymity will prevent potential manipulation that may result if the Request for PRISM is not responded to and eventually rests on the Order Book as a Limit Order. Further, parties may feel free to solicit interest without disclosing information as the identity of the sender will remain unknown. Finally, selectively responding to certain senders would be avoided by not disclosing identifying information about the parties. The Exchange would permit BX Participants to opt in and subsequently opt out as they desire. The Exchange would not disclose the parties that have opted in to further create an anonymous communication among BX Participants.

The PRISM auction will be governed by Options 3, Section 13. Any paired order entered into PRISM must comply with the required price to commence the auction and NBBO requirements to prevent trade-through as provided for within Options 3, Section 13. The auction eligibility requirements apply to all paired orders entered into PRISM even those that were submitted as a result of a Request for PRISM.

BX will employ surveillances to prevent misuse of non-public information specifically related to a Request for PRISM similar to the manner in which it employs surveillances today to ensure that information available in auctions is not misused. The Exchange would have information regarding the Request for PRISM and would be able to monitor entries into both the Order Book and PRISM Auction. Today, Options 3, Section 13(iv)<sup>18</sup> and (v)<sup>19</sup> describes certain activity prohibited by BX related

trade and a violation of General 9, Section 1. It will also be deemed conduct inconsistent with just and equitable principles of trade and a violation of General 9, Section 1 to engage in a pattern of conduct where the Initiating Participant breaks up a PRISM Order into separate orders for the purpose of gaining a higher allocation percentage than the Initiating Participant would have otherwise received in accordance with the allocation procedures contained in subparagraph (ii)(E) and (ii)(F) above."

<sup>13</sup> 15 U.S.C. 78f(b)

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> This proposal represents an alternative to the other methods of submitting an order which may include: telephone, electronically using an external order management system, or utilizing instant message.

<sup>16</sup> See PHLX Options 8, Section 30(c) which provides that a Phlx member or member organization representing an order in options ("originating order") may solicit another member, member organization or nonmember broker-dealer outside the trading crowd ("solicited party") to participate in the transaction on a proprietary basis, provided the paired order is exposed.

<sup>17</sup> While Participants will have a certain time period, up to one second, to act if they elect to participate in the Request for PRISM, the Participant also may elect not to respond. If no recipient Participants respond this would cause the cancellation of the initial Request for PRISM and no order would be submitted into the PRISM mechanism.

<sup>18</sup> See note 11 above.

<sup>19</sup> See note 12 above.

to PRISM in addition to Options 3, Section 22. Participants receiving such Requests for PRISM may not utilize the information to a Participant's economic advantage as provided for in proposed Options 3, Section 7(d)(1)(A)(1)(f). The Exchange notes the requests are subject to the restrictions noted within Options 3, Section 22, Limitations on Order Entry, as well as restriction noted with Options 3, Section 13. The communications that would occur, through FIX, would be available to the Exchange and these communications would be maintained. The Exchange would have information regarding the Request for PRISM and would be able to monitor entries into both the Order Book and PRISM Auction.

Broker-dealers are required to obtain best execution of customer orders,<sup>20</sup> including taking into account price improvement opportunities. All broker-dealers have a duty to obtain best execution when representing orders on an agency basis.

The Exchange believes that this proposal removes impediments to and perfects the mechanism of a free and open market and a national market system by promoting a more efficient workflow to seek to pair BX Participants who desire to initiate a PRISM Auction with Initiating Orders. This functionality permits Participants to further pair buyers and sellers for the purpose of executing transactions on its facility. Further, this proposal promotes competition by allowing Participants to seek the best execution through the Request for PRISM which offers a means for BX Participants to effectively solicit all BX Participants to locate interest for participation in a PRISM Order. Finally, the Exchange believes this proposal protect investors and the public interest by creating an auditable method of surveilling Requests for PRISM.

Price improvement auctions are widely recognized by market participants as invaluable, both as a tool to access liquidity, and a mechanism to help meet their best execution obligations. The proposed rule change will further the ability of BX Participants to submit orders into PRISM. Finally, the proposal serves as a competitive response to price improvement auctions on other options exchanges by providing for another manner in which BX Participants may solicit interest for the purpose of entering a paired order into PRISM in a more widespread fashion. The Exchange

believes the Request for PRISM will attract more liquidity in PRISM.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Exchange's proposal offers all BX Participants the ability to send a Request for PRISM, through FIX, to any BX Participant who opts in to receive such requests.

The proposed rule creates a new modality for Participants to send orders to BX Participants for representation. Today, all BX Participants utilize FIX to submit orders to BX and all Participants who utilize FIX may submit orders into PRISM. Any Participant may respond to the PRISM Auction.

The Exchange notes that it is providing BX Participants an ability to anonymously solicit interest for the purpose of entering a paired order into PRISM. Today, BX Participants locate interest by other methods. This functionality would allow all BX Participants another method to enter a paired order into PRISM by anonymously permitting a solicitation of interest to seek an Initiating Order to pair with their PRISM Order. The Exchange believes that this functionality will allow a greater number of BX Participants to utilize PRISM. Any BX Participant may contact other market participants to continue to solicit interest, as is the case today. The Exchange believes that this proposal will benefit all BX Participants by offering an increased opportunity to trade on the Exchange.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

No written comments were either solicited or received.

#### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will: (a) By order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

#### **IV. Solicitation of Comments**

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

##### *Electronic Comments*

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BX-2020-033 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-BX-2020-033. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BX-2020-033 and should be submitted on or before December 7, 2020.

<sup>20</sup> The duty of best execution requires broker-dealers to periodically assess the quality of competing markets to assure that order flow is directed to the markets providing the most beneficial terms for their customer orders.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

**J. Matthew DeLesDernier,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90367; File No. SR-NSCC-2020-802]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of No Objection to Advance Notice To Enhance National Securities Clearing Corporation's Haircut-Based Volatility Charge Applicable to Illiquid Securities and UITs and Make Certain Other Changes to Procedure XV

November 6, 2020.

#### I. Introduction

On March 16, 2020, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-NSCC-2020-802 ("Advance Notice") pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 ("Clearing Supervision Act")<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> under the Securities Exchange Act of 1934 ("Exchange Act")<sup>3</sup> to enhance the calculation of certain components of the Clearing Fund formula.<sup>4</sup> The Advance

Notice was published for comment in the **Federal Register** on April 15, 2020.<sup>5</sup> The Commission received comments on the proposal.<sup>6</sup> On May 15, 2020, the Commission requested further information for consideration of the Advance Notices, pursuant to Section 806(e)(1)(D) of the Clearing Supervision Act ("RFI"),<sup>7</sup> which tolled the Commission's period of review of the Advance Notices until 60 days from the date the information required by the Commission was received by the Commission.<sup>8</sup> On September 9, 2020, the Commission received responses to the RFI from NSCC.<sup>9</sup> This publication serves as notice of no objection to the Advance Notice.

#### II. The Advance Notice

##### A. Background

NSCC provides clearing, settlement, risk management, central counterparty services, and a guarantee of completion for virtually all broker-to-broker trades involving equity securities, corporate and municipal debt securities, and unit investment trust transactions in the U.S. markets. A key tool that NSCC uses to manage its credit exposure to its Members is collecting an appropriate Required Fund Deposit (*i.e.*, margin) from each Member.<sup>10</sup> A Member's Required Fund Deposit is designed to mitigate potential losses to NSCC associated with liquidation of the Member's portfolio in the event of a

Rule Change. Securities Exchange Act Release No. 89949 (September 22, 2020), 85 FR 60854 (September 28, 2020) (SR-NSCC-2020-003).

<sup>5</sup> Securities Exchange Act Release No. 88615 (April 9, 2020), 85 FR 21037 (April 15, 2020) (SR-NSCC-2020-802) ("Notice of Filing").

<sup>6</sup> Comments are available at <https://www.sec.gov/comments/sr-nsc-2020-003/srnsc2020003-7108527-215929.pdf>. All but one of the comments were submitted with respect to the Proposed Rule Change. *Supra* note 4. Because the proposals contained in the Advance Notice and the Proposed Rule Change are the same, all public comments received on the proposal were considered regardless of whether the comments were submitted with respect to the Advance Notice or the Proposed Rule Change.

<sup>7</sup> 12 U.S.C. 5465(e)(1)(D).

<sup>8</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/nsc-2020/34-88615-request-for-info.pdf>.

<sup>9</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 "Response to the Commission's Request for Additional Information," available at <https://www.sec.gov/rules/sro.shtml>.

<sup>10</sup> Terms not defined herein are defined in NSCC's Rules and Procedures ("Rules"), available at [http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf). See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules.

Member default.<sup>11</sup> The aggregate of all NSCC Members' Required Fund Deposits (together with certain other deposits required under the Rules) constitutes NSCC's Clearing Fund, which NSCC would access should a Member default and that Member's Required Fund Deposit, upon liquidation, be insufficient to satisfy NSCC's losses.<sup>12</sup>

Each Member's Required Fund Deposit consists of a number of applicable components, each of which is calculated to address specific risks faced by NSCC, as identified within NSCC's Rules.<sup>13</sup> Generally, the largest component of Members' Required Fund Deposits is the volatility component. The volatility component is designed to reflect the amount of money that could be lost on a portfolio over a given period within a 99% confidence level. This component represents the amount assumed necessary to absorb losses while liquidating the portfolio.

NSCC's methodology for calculating the volatility component of a Member's Required Fund Deposit depends on the type of security and whether the security has sufficient pricing or trading history for NSCC to perform statistical analysis. Generally, for most securities (*e.g.*, equity securities), NSCC calculates the volatility component using, among other things, a parametric Value at Risk ("VaR") model, which results in a "VaR Charge."<sup>14</sup> However, the VaR model generally relies on predictability, and this model may be less reliable for measuring market risk of securities that exhibit illiquid characteristics. More specifically, the VaR model relies on assumptions that are based on historical observations of security prices. Securities that exhibit illiquid characteristics, which generally have low trading volumes or are not traded frequently may not present sufficient instances of price observations to allow

<sup>11</sup> Under NSCC's Rules, a default would generally be referred to as a "cease to act" and could encompass a number of circumstances, such as a member's failure to make a Required Fund Deposit in a timely fashion. See Rule 46 (Restrictions on Access to Services), *supra* note 10.

<sup>12</sup> See Rule 46 (Restrictions on Access to Services), *supra* note 10.

<sup>13</sup> See Procedure XV, *supra* note 10.

<sup>14</sup> Specifically, NSCC calculates the VaR Charge as the greatest of (1) the larger of two separate calculations that utilize the VaR model, (2) a gap risk measure calculation based on the largest non-index position in a portfolio that exceeds a concentration threshold, which addresses concentration risk that can be present in a member's portfolio, and (3) a portfolio margin floor calculation based on the market values of the long and short positions in the portfolio, which addresses risks that might not be adequately addressed with the other volatility component calculations. See Sections I.(A)(1)(a)(i) and I.(A)(2)(a)(i) of Procedure XV, *supra* note 10.

<sup>21</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> 15 U.S.C. 78a *et seq.*

<sup>4</sup> NSCC also filed related proposed rule change with the Commission pursuant to Section 19(b)(1) of the Act and Rule 19b-4 thereunder, seeking approval of proposed changes to their rules necessary to implement the Advance Notices ("Proposed Rule Change"). 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The Proposed Rule Change was published in the **Federal Register** on March 21, 2020. Securities Exchange Act Release No. 88474 (March 25, 2020), 85 FR 17910 (March 31, 2020) (SR-NSCC-2020-003). On May 15, 2020, the Commission designated a longer period within which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change. Securities Exchange Act Release No. 88885 (May 15, 2020), 85 FR 31007 (May 21, 2020) (SR-NSCC-2020-003). On June 24, 2020, the Commission issued an order instituting proceedings to determine whether to approve or disapprove the Proposed Rule Changes. Securities Exchange Act Release No. 89145 (June 24, 2020), 85 FR 39244 (June 30, 2020) (SR-NSCC-2020-003). On September 22, 2020, the Commission designated a longer period for Commission action on the proceedings to determine whether to approve or disapprove the Proposed