proceedings to determine whether to disapprove, the proposed rule change (File No. SR–NYSE–2017–11).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.6

Eduardo A. Aleman, Assistant Secretary.
[FR Doc. 2017–09691 Filed 5–24–17; 8:45 am]
BILLING CODE 8011–01–P

SECURITIES AND EXCHANGE COMMISSION

Self-Regulatory Organizations: The Depository Trust Company; Fixed Income Clearing Corporation; National Securities Clearing Corporation; Notice of No Objection to Advance Notices To Enhance the Credit Risk Rating Matrix and Make Other Changes

May 19, 2017.


I. Description of the Advance Notices

The Advance Notices consist of proposed modifications to the Rules, By-Laws and Organizational Certificate of DTC (“DTC Rules”), the Rulebook of GSD (“GSD Rules”), the Clearing Rules of MBSD (“MBSD Rules”), and the Rules & Procedures of NSCC (“NSCC Rules”) (collectively, the “Rules”).5 The Advance Notices are proposals by the Clearing Agencies to amend the Rules to: (i) Enhance their shared credit risk rating matrix (“Credit Risk Rating Matrix” or “CRRM”), which was developed by the Clearing Agencies to evaluate the credit risks posed by certain Clearing Agency members to the Clearing Agencies (and by implication to all of the Clearing Agency members), as a result of providing services to such members; and (ii) make other amendments to the Rules, both related and unrelated to the CRRM, to provide more transparency and description regarding the Clearing Agencies’ current ongoing membership monitoring process, as described below.

Currently, the CRRM rates the credit risk presented by members of the Clearing Agencies that are U.S. broker-dealers and U.S. banks. The CRRM assigns a credit rating based on certain quantitative factors (“Credit Rating”), which vary based upon whether the member is a broker-dealer or bank.6 The current CRRM also uses a relative scoring approach (i.e., rating


Available at http://www.dtcc.com/en/legal/rules-and-procedures. FICC is comprised of two divisions: the Government Securities Division (“GSD”) and the Mortgage-Backed Securities Division (“MBSD”). Each division serves as a central counterparty, becoming the buyer and seller to each of their respective members’ securities transactions and guaranteeing settlement of those transactions, even if a member defaults. GSD provides, among other things, clearance and settlement for trades in U.S. Government debt issues. MBSD provides, among other things, clearance and settlement for trades in mortgage-backed securities. GSD and MBSD maintain separate sets of rules, margin models, and clearing funds.

For U.S. broker-dealers, the Clearing Agencies consider size (i.e., total excess net capital), capital leverage, liquidity, and profitability. For U.S. banks, the Clearing Agencies consider size, capital, asset quality, earnings, and liquidity.

Ultimately, the ratings generated are based on a 7-point rating system, with “1” being the strongest Credit Rating and “7” being the weakest Credit Rating. Although the current CRRM does not directly consider qualitative factors, the Clearing Agencies’ credit risk staff may manually downgrade a particular member’s Credit Rating based on various qualitative factors.7 Members that receive a Credit Rating of 5, 6, or 7 are placed on the Clearing Agencies’ “Watch List,” as these members present a greater risk of default.8 To improve the coverage and the effectiveness of the current CRRM, the Clearing Agencies are proposing three enhancements, as discussed below. In addition to the enhancements, the Clearing Agencies also propose to make other changes to their Rules to more fully describe the Clearing Agencies’ current ongoing membership monitoring process, both related and unrelated to the CRRM, also discussed below.9

A. Proposed CRRM Enhancements

Currently, the CRRM is comprised of two Credit Rating models—one for U.S. broker-dealers and one for U.S. banks. The first proposed enhancement would expand the CRRM by adding a third model that would enable the CRRM to generate Credit Ratings for members that are foreign banks or foreign trust companies that have audited financial data that is publicly available. The Credit Rating for these particular members would be based on both quantitative and qualitative factors, as indicated in the second enhancement, below. According to the Clearing Agencies, the expected benefit of this expansion and enhancement of the CRRM would be that the Clearing Agencies could better evaluate the default risk of their foreign bank or foreign trust company members.

The second proposed enhancement would supplement the Clearing Agencies’ ability to manually downgrade members by incorporating

quantitative factors currently considered by the Clearing Agencies include: (a) Available news reports and/or regulatory observations relating to the member; (b) member’s liquidity arrangements; and (c) material changes to the member’s organizational structure.

Members on the Watch List are subject to enhanced surveillance by the Clearing Agencies and additional margin charges.

Although each of the Clearing Agencies uses the CRRM uniformly, the description of the respective Clearing Agencies’ Rules regarding the CRRM are different. To address this issue, the Clearing Agencies propose to adopt similar Rules at each Clearing Agency.
new qualitative factors into the two existing CRRM models, as well as in the new foreign bank and trust company model. Instead of relying primarily on quantitative data, as do the current CRRM models, the proposed enhancement would modify the CRRM models to blend qualitative factors with quantitative factors to produce a Credit Rating for each applicable member in relation to the member’s credit risk. For U.S. banks, foreign banks, and foreign trust companies, the enhanced CRRM would use 70/30 weights between quantitative and qualitative factors to generate Credit Ratings. For U.S. broker-dealers, the weights between quantitative and qualitative factors would be 60/40. According to the Clearing Agencies, these weights were chosen by the Clearing Agencies based on the industry best practice, as well as research and sensitivity analysis conducted by the Clearing Agencies. The Clearing Agencies would review and adjust both the weights and the quantitative and qualitative factors as needed, based on recalibration of the CRRM. According to the Clearing Agencies, this proposed enhancement is expected to reduce the need and the frequency for them to manually override a member’s Credit Rating.

The third enhancement would replace the current CRRM’s relative scoring approach (which considers other members’ Credit Ratings) with a statistical approach that would estimate the absolute probability of default of each member by ranking members based on their individual probability of default. According to the Clearing Agencies, under the current relative scoring approach, a member’s Credit Rating can be affected by changes in its peer group, even if the member’s financial condition is unchanged. They believe this issue would be addressed by the proposed statistical approach because it would eliminate any potential distortion of the rating from

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10 Quantitative and qualitative factors used for each of the three models differ. The quantitative factors for foreign banks and foreign trust companies would include size, capital, leverage, liquidity, profitability, and growth. Qualitative factors would include market position and sustainability, information reporting and compliance, management quality, capital management, and business/product diversity. The added qualitative factors for U.S. broker-dealers would include market position and sustainability, management quality, capital management, liquidity management, geographic diversification, business/product diversity, and access to alternative sources of funding. The added qualitative factors for U.S. banks would include the current business environment, regulatory compliance and litigation risk, management quality, liquidity management, and parental demands/needs.

11 Notices at 82 FR 17923, 17908, 17903.

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12 Add-on charges are margin requirements that are in addition to the Clearing Agencies’ primary value-at-risk margin requirement, such as an intraday charge to account for market volatility and a charge for having a concentrated position in a security. See, e.g., NSCC Procedure XV, section 1(B), available at http://www.dticc.com/en/legal/rules-and-procedures.


The Commission has adopted risk management standards under section 805(a)(2) of the Clearing Supervision Act and section 17A of the Exchange Act ("Rule 17Ad–22"). 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. 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 and against Rule 17Ad–22.

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

As discussed below, the Commission believes that the changes proposed in the Advance Notices are consistent with section 805(b) of the Clearing Supervision Act because they: (i) Are designed to reduce systemic risk; (ii) are designed to support the stability of the financial system; (iii) are designed to promote robust risk management; and (iv) are consistent with promoting safety and soundness.

When considering the CRRM enhancements in their entirety, the Commission believes that the proposal could help reduce the systemic risk presented by the Clearing Agencies, which in turn could help support the stability of the broader financial system. The Commission agrees that the proposed enhancements could enable the Clearing Agencies to (i) more effectively evaluate the credit risk presented by a distinct class of members by expanding the CRRM to foreign banks and foreign trust companies; (ii) more effectively incorporate qualitative data into the Credit Rating; and (iii) more accurately measure the absolute probability of default by rated members. Taken together, these enhancements could in turn improve the Clearing Agencies' ability to determine and evaluate the credit risk presented by the various types of Clearing Agency members and ensure that, as applied to all rated members, the CRRM could be a more developed and nuanced tool for evaluating the credit risk any member presents to the Clearing Agencies.

The Commission further believes that, by enhancing the Clearing Agencies’ ability to make distinctions across their various types of members through the CRRM, the proposed enhancements could also improve the Clearing Agencies’ ability to use their risk-management tools in a more targeted way to reduce the risk and impact of a counterparty default, which in turn also could help mitigate the risks and effects on the broader financial system that could be associated with the default of a member. Accordingly, the Commission believes that the CRRM proposal could help reduce systemic risks and support the stability of the financial system, consistent with section 805(b) of the Clearing Supervision Act.

The Commission also believes that the CRRM proposal is designed to promote robust risk management and is consistent with promoting safety and soundness. The Commission agrees that the proposed enhancements to the CRRM could improve the Clearing Agencies’ ability to identify and measure the credit risk presented by their various members, which in turn could allow the Clearing Agencies to more effectively target their risk management tools to manage the credit, market, and liquidity risk arising from those members with the highest risk of default. Accordingly, the Commission believes that the CRRM proposal is designed to help promote robust risk management, and is consistent with promoting safety and soundness, consistent with section 805(b) of the Clearing Supervision Act.

B. Consistency With Rules 17Ad–22(e)(1), (e)(3), and (e)(18)

The Commission believes that the changes proposed in the Advance Notices are consistent with Rules 17Ad–22(e)(1), (e)(3), and (e)(18) under the Exchange Act.

The Commission believes that the changes proposed in the Advance Notices are consistent with Rule 17Ad–22(e)(1) under the Exchange Act, which requires, in part, that the Clearing Agencies “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [m]aintain a sound risk management framework for comprehensively managing . . . risks that arise in or are born by [the Clearing Agencies], which includes . . . systems designed to identify, measure, monitor and manage the range of risks that arise in or are borne by [the Clearing Agencies].” As discussed above, the CRRM is a risk measurement tool used by the Clearing Agencies to help assess the credit risk presented by their various members. The proposed enhancements to the CRRM could help the Clearing Agencies better identify and measure such risks, which in turn could help facilitate the Clearing Agencies’ management of credit, market, and liquidity risk that arises from being a central counterparty (in the case of NSCC and FICC) and central securities depository (in the case of DTC). Accordingly, the Commission believes that the proposed enhancements are designed to help effectively manage the Clearing Agencies’ risk exposures, including their credit exposure to participants, arising from their payment, clearing, and settlement processes, consistent with Rule 17Ad–22(e)(3)(i).

Finally, the Commission believes that the proposal is consistent with Rule 17Ad–22(e)(18) under the Exchange Act, which requires, in part, that the Clearing Agencies “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]stablish objective, risk-based, and publicly disclosed criteria for participation, which . . . require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis.” As described above, the proposal would provide more description regarding the Clearing Agencies’ authority to review additional reporting from members regarding their financial or operational condition and

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18 Id.
22 17 CFR 240.17Ad–22(e)(1); (e)(2); and (e)(3).
23 17 CFR 240.17Ad–22(e)(1).
the financial information of any Indirect Member. Because such authority could enable the Clearing Agencies to better determine whether the member has sufficient financial resources and monitor compliance with the Clearing Agencies’ financial requirements on an ongoing basis, the Commission believes this requirement is consistent with Rule 17Ad–22(e)(18).

III. Conclusion

It is therefore noticed, pursuant to section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission does not object to these advance notice proposals (SR–DTC–2017–801, SR–FICC–2017–804, and SR–NSCC–2017–801) and that the Clearing Agencies are authorized to implement the proposals as of the date of this notice or the date of an order by the Commission approving a proposed rule change that reflects rule changes that are consistent with the relevant advance notice proposal (SR–FICC–2017–006, SR–DTC–2017–002, SR–NSCC–2017–002), whichever is later.

By the Commission.

Eduardo A. Aleman,
Assistant Secretary.

[FR Doc. 2017–10689 Filed 5–24–17; 8:45 am]
BILLING CODE 8011–01–P

SEcurities and ExchaNge COMmission


Self-Regulatory Organizations; The Depository Trust Company; Fixed Income Clearing Corporation; National Securities Clearing Corporation; Order Approving Proposed Rule Changes To Enhance the Credit Risk Rating Matrix and Make Other Changes

May 19, 2017


The Proposed Rule Changes were published for comment in the Federal Register on April 11, 2017.3 The Commission received no comments to the Proposed Rule Changes. This order approves the Proposed Rule Changes.

I. Description of the Proposed Rule Changes

The Proposed Rule Changes consist of proposed modifications to the Rules, By-Laws and Organizational Certificate of DTC (“DTC Rules”), the Rulebook of GSD (“GSD Rules”), the Clearing Rules of MBSD (“MBSD Rules”), and the Rules & Procedures of NSCC (“NSCC Rules”) (collectively, the “Rules”). The Proposed Rule Changes are proposals by the Clearing Agencies to amend the Rules to: (i) Enhance their shared credit risk rating matrix (“Credit Risk Rating Matrix” or “CRRM”), which was developed by the Clearing Agencies to evaluate the credit risks posed by certain Clearing Agency members to the Clearing Agencies (and by implication to all of the Clearing Agency members), as a result of providing services to such members; and (ii) make other amendments to the Rules, both related and unrelated to the CRRM, to provide more transparency and description regarding the Clearing Agencies’ current ongoing membership monitoring process, as described below.

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Ultimately, the ratings generated are based on a 7-point rating system, with “1” being the strongest Credit Rating and “7” being the weakest Credit Rating. Although the current CRRM does not directly consider qualitative factors, the Clearing Agencies’ credit risk staff may manually downgrade a particular member’s Credit Rating based on various qualitative factors. Members that receive a Credit Rating of 5, 6, or 7 are placed on the Clearing Agencies’ “Watch List,” as these members present a greater risk of default.

To improve the coverage and the effectiveness of the current CRRM, the Clearing Agencies are proposing three enhancements, as discussed below. In addition to the enhancements, the Clearing Agencies also propose to make other changes to their Rules to more fully describe the Clearing Agencies’ current ongoing membership monitoring process, both related and unrelated to the CRRM, also discussed below.

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24177 Federal Register / Vol. 82, No. 100 / Thursday, May 25, 2017 / Notices