

Principle 19: Tiered participation arrangements

An FMI should identify, monitor, and manage the material risks to the FMI arising from tiered participation arrangements.

Key Consideration 1: An FMI should ensure that its rules, procedures, and agreements allow it to gather basic information about indirect participation in order to identify, monitor, and manage any material risks to the FMI arising from such tiered participation arrangements.

Key Consideration 2: An FMI should identify material dependencies between direct and indirect participants that might affect the FMI.

Key Consideration 3: An FMI should identify indirect participants responsible for a significant proportion of transactions processed by the FMI and indirect participants whose transaction volumes or values are large relative to the capacity of the direct participants through which they access the FMI in order to manage the risks arising from these transactions.

Key Consideration 4: An FMI should regularly review risks arising from tiered participation arrangements and should take mitigating action when appropriate.

CCAS 17Ad-22(e)(19)

Each covered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable:

Identify, monitor, and manage the material risks to the covered clearing agency arising from arrangements in which firms that are indirect participants in the covered clearing agency rely on the services provided by direct participants to access the covered clearing agency's payment, clearing, or settlement facilities.

Indirect participants are firms that rely on the services provided by Members in order to have their activity cleared and settled through NSCC's facilities.

Identification and monitoring of indirect participant risk

The risks that indirect participants pose to NSCC are identified and monitored as part of the application process for NSCC Members, and as part of NSCC's ongoing Member due diligence process. Applicants for Membership must indicate whether they intend to self-clear only, or also clear activity on behalf of correspondent firms. Among the aims of these review processes is for NSCC to better understand the material dependencies between Members and the indirect participants that rely on Members to access NSCC's clearance and settlement services, as well as significant Member-indirect participant relationships and the various risk controls and mitigants that Members employ to manage their risks with respect to such relationships.

During the membership application process, NSCC requests and reviews, pursuant to its authority under Rule 2A (Initial Membership Requirements) and Rule 15 (Assurances of Financial Responsibility and Operational Capability), information from applicants regarding the types of businesses they conduct, including the anticipated activity to be introduced to NSCC by such applicants on behalf of indirect participants.

Thereafter, as part of its ongoing Member due diligence process, NSCC collects information periodically, pursuant to its authority under Rule 2B (Ongoing Membership Requirements and Monitoring) and Rule 15 (Assurances of Financial Responsibility and Operational Capability), from Members in order to understand their overall business condition, risk management practices, which may cover operational, credit, legal and other risks, and financial standing, including information related to the indirect participants that rely on them.

In particular, NSCC requires that Members submit information regarding the risk that significant indirect participants represent to NSCC and the Members, the criteria and procedures used by the Members for on-boarding their indirect participants, as well as the risk management policies and procedures they employ for ongoing monitoring and risk management of indirect participant activities.

Management of indirect participant risk

NSCC employs the Rules-based tools described below applicable to its Members in order to manage the risks that indirect participants may pose to NSCC.

Credit Risk Rating. NSCC's review of the information received on indirect participants through its Member application and periodic Member due diligence processes described above may factor into the qualitative factors that affect NSCC's credit risk rating of a Member. As described in further detail in response to Principles 4 (Credit risk) and 18 (Access and participation requirements), the resulting credit risk rating of a Member helps determine the level of financial review that will be performed on that Member and may impact the Member's Clearing Fund requirement. If NSCC believes the CRRM model-generated rating is not sufficiently conservative, or deems such action necessary to protect itself and its Members, NSCC may opt to use mitigation actions such as the override framework to lower the Member's credit risk rating, and/or place the Member on the Watch List. This would apply if a Member fails to provide sufficient disclosure, as requested during the due diligence process, to allow NSCC to assess the risk exposure posed by the Member's activity, including the indirect member's activity.

In addition, NSCC Sponsored Members are subject to adverse news monitoring by NSCC. Specifically, NSCC uses a monitoring tool daily to identify instances of adverse news regarding such sponsored members. If any such news is deemed "severe", according to an internal procedure, it is escalated and reviewed by a cross-function team to determine if any action may be necessary, which could include, for example, outreach to the member, requiring additional reporting from the member, or other appropriate risk management measures as permitted by NSCC's Rules.

Monitoring and Margin Collection. As described in further detail in response to Principle 6 (Margin), NSCC collects Required Fund Deposit from its Members on a daily basis in accordance with the methodology set forth in Procedure XV of NSCC's Rules. Such Required Fund Deposit is calculated based on, among other risk factors, the trading activity submitted to NSCC on Members' own behalf and on behalf of any executing brokers that clear through them. NSCC may also require additional intraday margin should NSCC deem it necessary or appropriate based on intraday market moves and intraday trading activity (whether the activity is that of the Member, or the executing brokers who clear through the Member).

In addition, for Category 2 Agent Clearing Members and Sponsoring Members, an excess capital ratio ("ECR") report is generated to monitor the overall ECR across all their NSCC accounts. If the ECR is greater than 1.0, Agent Clearing Members and Sponsoring Members are generally not permitted to submit additional Sponsored Member Transactions and/or Agent Clearing Member Transactions.

Adequate Assurances. NSCC also has the authority under Rule 15 (Assurances of Financial Responsibility and Operational Capability) to seek adequate assurances from a Member if NSCC determines that such adequate assurances are warranted based on its review of such Member's indirect participant relationships.