SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54816; File No. SR-NSCC-2006-09)

November 27, 2006

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Allow Cash, Next Day, and Seller's Option Equity Trades to Be Processed in the Continuous Net Settlement System and to Modify the Clearing Fund Formula to Mitigate the Risk Associated with the Shorter Settlement Cycle of Cash and Next Day Settling Trades

I. Introduction

On July 24, 2006, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-NSCC-2006-09 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").[1] Notice of the proposal was published in the Federal Register on September 29, 2006.[2] The Commission received no comment letters. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

NSCC seeks to modify its procedures for equity trade processing to enable cash,[3] next day,[4] and seller's option[5] equity trades received on a locked-in basis from self-regulatory organizations ("SROs") and Qualified Special Representatives ("QSRs") to be processed in

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

2 Securities Exchange Act Release No. 54482 (September 22, 2006), 71 FR 57588.

3 A "cash trade" is a trade that settles on the same day as the trade.

4 A "next day trade" is a trade that settles on the day after the trade ("T+1").

5 A "seller's option trade" is a trade that gives the seller the right to deliver the securities on a specified date ranging from not less than two but not more than 180 days after the trade.

NSCC's Continuous Net Settlement ("CNS") system.[6] NSCC is also proposing to add a new element to its clearing fund formula to cover trades, such as cash and next day settling CNS trades, that settle in less than three days.[7]

A. Cash, Next Day, and Seller's Option Equity Trades Processed in CNS

Currently, cash, next day, and seller's option equity trades are recorded or compared, as applicable, and are reported by NSCC to its members but are not settled through NSCC's facilities. Instead these trades currently settle on a trade-for-trade basis directly between counterparties.

When NSCC updated and revised CNS in 2004 (referred to as the "CNS Rewrite"), a major aspect included a new platform for the system that accommodates real-time updates, including the capacity to add trades to the settlement process on a real-time basis for late input into CNS until noon of settlement day.[8] At that time, rule changes were made to permit as-of regular way equity trades (i.e., trades settling on a T+3 basis that are either recorded or compared after trade date) to be submitted to NSCC up to the cut-off time designated by NSCC on T+3 for processing in CNS for settlement on their originally designated settlement dates. Given the system's real-time capabilities, members would now also like to have cash, next day, and seller's option equity trades in CNS-eligible CUSIPS made eligible for processing

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6 Cash and next day trades in debt securities are compared but are not settled through NSCC. NSCC is not at this time seeking to make such trades eligible for CNS.

7 NSCC plans to implement the proposed rule change in the first quarter of 2007. NSCC will notify the Commission and issue an Important Notice when it is prepared to implement the proposed rule change.

8 Securities Exchange Act Release No. 50026 (July 15, 2004), 69 FR 43650 [File No. SR-NSCC-2004-01].

in CNS. This would provide members with the benefits of netting, automated trade processing, and NSCC's trade guaranty. Accordingly, NSCC proposes to amend its Procedure II (Trade Comparison and Recording Service) to permit cash, next day, and seller's option equity transactions submitted by SROs and QSRs on behalf of members to be processed for settlement through the facilities of NSCC.

Cash trades submitted after the cut-off time designated by NSCC, which is currently 11:30a.m., would only be recorded and reported by NSCC and would, as is the current situation, have to be settled directly between the parties outside of NSCC.[9] Next day as-of trades if received prior to the applicable cut-off time, would be processed for settlement on their originally designated settlement date.[10] If such trades were received after the applicable cut-off time, the trade would be assigned the next settlement day for settlement. Seller's option equity trades would be accepted for processing so long as the parties' designated settlement date is not more than 180 days beyond the trade date. Finally, trades that are (i) designated "special trades,"[11] (ii) in non-CNS eligible securities, (iii) in securities undergoing corporate actions, or (iv) scheduled to settle between the ex-dividend date and the record date would continue to be processed on a trade-for-trade basis outside NSCC's facilities.

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[9] NSCC announced the 11:30 a.m. cut-off time in its Important Notice A#6220, P&S#5790 (March 23, 2006), which is the same as the current cut-off time for receipt of next day as-of trade input. Any changes to the cut-off times would be announced by NSCC through an Important Notice.

[10] Id.

[11] A "special trade" is defined in NSCC's rules to mean a transaction reported to NSCC involving a security either which the parties thereto agree to settle on a member-to-member basis or which NSCC designates as settling on a member-to-member basis.

Conforming changes as needed are also being made to Procedure IV (Special Representative Service), Procedure V (Balance Order Accounting Operation), and Procedure VII (CNS Accounting Operation).

B. Shortened Process Trade Component in the Clearing Fund Formula

NSCC is also proposing to modify its clearing fund formula (Procedure XV) by including an additional component that is intended to mitigate the risk associated with trades that are processed on a settlement cycle shorter than three days such as cash and next day settling CNS trades. Because NSCC's trade guaranty would attach to these trades prior to the scheduled collection of clearing fund monies, the proposed new additional component is intended to mitigate risk by calculating an average clearing fund requirement for this type of activity (referred to in the proposed rules and this release as "Specified Activity") based upon historical activity.[12]

Specified Activity positions would be isolated and a charge would be applied using not less than two standard deviations. The new component would equal the average of a member's charges for Specified Activity on the three highest days with the Special Activity charges calculated over the most recent 20-day period. Specified Activity includes cash trades, next day settling trades, as-of trades compared or recorded on T+3 (including trades received after the applicable T+2 cut-off time), and other similar transactions.

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12 This component is also being added to Appendix 1.

III. Discussion

Section 19(b) 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 the rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act requires 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 its custody or control or for which it is responsible.[13] The Commission believes that NSCC's rule change is consistent with this Section because it should facilitate the prompt and accurate clearance and settlement of securities by expanding the types of trades eligible for inclusion in settlement through CNS. In addition, the proposed rule change should help assure the safeguarding of securities and funds in NSCC's custody or control or for which it is responsible by enabling NSCC to more accurately determine and collect collateral to cover the potential additional exposures resulting from trades that are processed on a settlement cycle shorter than three days.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NSCC-2006-09) be and hereby is approved.

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[13] 15 U.S.C. 78q-1(b)(3)(F).

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[14]

Nancy M. Morris
Secretary

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[14] 17 CFR 200.30-3(a)(12).