



NATIONAL  
SECURITIES  
CLEARING  
CORPORATION

**RULES & PROCEDURES**

TEXT OF PROPOSED RULE CHANGE

**Underlined and boldface** text indicates new text

**~~Strikethrough and boldface~~** indicates deleted text

## PROCEDURE VII. CNS ACCOUNTING OPERATION

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## E. Controlling Receipts from CNS

After securities are received by the Corporation from Members with short positions, they are allocated to other Members which have long positions. The allocation of these securities is governed by an algorithm which changes daily so as not to benefit any one Member. Members may change their relative rank within this algorithm by submitting Priority Requests. The submission of a Buy-In Notice will also affect the priority of a Member's long position in that particular security.

## 1. Standing Priority Request

A Member may enter a Standing Priority Request which moves its long positions in all securities to a higher rank in the allocation formula every day and remains in effect until canceled or changed by the Member in writing.

A Member may enter a Standing Priority Request for the evening cycle only, the day cycle only, or both the evening and day cycles in respect of its general account or any sub-account.

## 2. Priority Overrides

A Member may override a Standing Priority Request which it has previously submitted, or obtain priority when it has not submitted a Standing Priority Request by submitting a Priority Override. Each Priority Override changes the Member's relative rank in the allocation algorithm for its long position in one security only. The Priority Override remains in effect for one day.

The Member may submit a Priority Override for the specified security for the evening cycle only, the day cycle only, or for both the evening and day cycles.

## 3. Buy-In Notices

A Member which submits a Buy-In Notice in accordance with the provisions of subsection J of this Section is assigned to a higher relative rank in the allocation algorithm for the quantity of securities specified on the Buy-In Notice than those Members which have requested high priority through the use of a Standing Priority Request or Priority Override.

#### 4. Allocation Algorithm

The algorithm which governs the allocation of long positions is based on priority groups in descending order, age of position within a priority group and random numbers within age groups.

Priority groups include the following:

- (a) long positions in a CNS Reorganization Sub-Account established pursuant to paragraph H.4. of this Section VII of these Procedures;
- (b) long positions against which Buy-In Notices are due to expire that day but which were not filled the previous day;
- (c) long positions against which Buy-In Notices are due to expire the following day;
- (d) (i) long positions in a receiving ID Net Subscriber's agency account established at a Qualified Securities Depository, and (ii) long positions against the component securities of index receipts;
- (e) in descending sequence, priority levels as specified by Standing Priority Requests and as modified by Priority Overrides.

When more than one long position in a given security exists within the same priority group, the "oldest" position is allocated first. Age is defined as the number of consecutive days during which the position has been long, irrespective of quantity.

When more than one long position in a given security exists within the same priority group all of which have been long the same number of consecutive days, the allocation rank is determined by a computer generated random number. Random numbers, which change daily, are computed so that each Member's random number is different for each security.

The allocation algorithm for the evening and day delivery cycles is computed separately to allow for Standing Priority Requests and Priority Overrides which have specified different levels of priority for evening and day cycles.

Following the allocation of securities to a Member pursuant to the Allocation Algorithm described above, deliveries in a particular security processed through CNS, other than buy-in allocations made pursuant to priority groups (b) and (c) above, will be deemed by the Corporation to satisfy a Member's ACATS receive obligation prior to other CNS-related receive obligations for that Member in the same security, and this information shall be provided to the Member's Designated Depository to

facilitate processing in accordance with the Designated Depository's procedures.

5. Fully-Paid-For Account

(Procedures for Movements to the Long Free Account ~~other than for the Stock Borrow Program~~)

The Corporation's processing day is divided into two parts. It begins with an evening cycle on the evening preceding the settlement day for which the work is being processed and is followed by a day cycle which ends on the settlement day for which the work is processed. If a Member with a long position and/or a position due for settlement on the next settlement day, in anticipation of receiving securities from the Corporation (other than municipal securities, as that term is defined by the Securities Exchange Act of 1934, as amended), as a result of the allocation process during the evening or day cycle for that settlement day, instructs that securities within its possession or control (other than municipal securities) be delivered on the next day and is subsequently not allocated the securities during the evening or following day cycle, the Member may, in order to meet the "customer segregation" requirements of SEC Rule 15c3-3, instruct the Corporation, during the day cycle for that settlement day by the time specified by the Corporation, to transfer the position(s) which has not been allocated to a special CNS sub-account (the "Long Free Account"). The Corporation will then debit the Member's settlement account for the value of the position in the Long Free Account. The Long Free Account will be guaranteed by the Corporation and will be marked daily.

All funds which the Corporation receives from debiting the Member's settlement account for the value of a position moved into the Long Free Account and all marks credited to the Long Free Account as a result of marking positions to the market daily, will be segregated by the Corporation from all other funds received by the Corporation. Any time that a Member determines that he no longer needs the position(s) in the Long Free Account for 15c3-3 purposes, he may instruct the Corporation to transfer back the position(s) to its Long Valued Account and make the appropriate adjustment to its settlement account.

**NOTE:** The SEC has stated that: "any broker/dealer that takes advantage of proposed rule NSCC-82-25 must recall deficits from bank loan within shorter time intervals than those presently allowed under SEC Rule 15c3-3(d)(1). In the case of bank loan, broker/dealers will be expected to effect a recall within one business day instead of the two business days presently allowed.

**ADDENDUM C****(ADDENDUM LETTER RESERVED FOR FUTURE USE)****NSCC AUTOMATED STOCK BORROW PROCEDURES**

~~In the course of daily operations, the Corporation's CNS System often has a need for securities that exceeds the shares made available via Member deliveries to clearing. This need can arise from several sources, including the satisfaction of Member priority requests for allocation and buy-ins submitted by Members.~~

~~In order to improve the efficiency of the clearing system in dealing with these situations, the Corporation's Board has authorized the implementation of automated stock borrow procedures (the Stock Borrow Program) to satisfy needs for stock that are not filled via normal deliveries from Members.~~

~~Members wishing to participate in the program will notify the Corporation each day by such times as the Corporation specifies of the securities they have on deposit at DTC that are available to be borrowed by the Corporation. For this purpose, a Member may not lend securities issued by that Member or by any of that Member's affiliates through the program. In addition, corporate and municipal bonds are not eligible for lending through the program. Note: The daytime stock borrow program is a separate process from the nighttime stock borrow process, and securities available to be borrowed that are sent for nighttime processing will not be applied in the daytime process. Members can choose to participate (i) only in the night stock borrow program, (ii) only in the daytime stock borrow program, or (iii) in both the night and daytime stock borrow programs.~~

~~After the Corporation's nighttime processing of regular deliveries, any needs remaining unsatisfied will be borrowed from Members who have delivered instructions specifying available securities for the nighttime stock borrow process.<sup>1</sup> Similarly, any share needs remaining unsatisfied at a time designated during the day cycle will also be borrowed from Members who have delivered during the day cycle will also be borrowed from Members who have delivered instructions specifying available securities for the daytime stock borrow process. Any shares borrowed will be entered into a special CNS sub-account and the Member will be advanced the full market value of the shares borrowed until they are returned. Borrowed stock will be returned through normal long allocation against the special sub-account as shares become available.~~

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<sup>1</sup> ~~Securities subject to a voluntary reorganization will not be borrowed by the Corporation after nighttime processing on E+2 through the end of the protected period.~~

~~More specifically, the processing steps will be as follows:~~

- ~~1. Each day, Members wishing to participate in the program will inform the Corporation of the number of shares of each security in their general unpledged account at DTC that are available to be borrowed, and the cycle(s) for which the borrowing availability applies. This information, in the form prescribed by the Corporation, must be submitted to the Corporation by the times specified by the Corporation. Data to be submitted to indicate availability will be Member number, CUSIP number, available shares and applicable borrowing cycle. Availability information submitted earlier in the day with respect to the relevant night or day processing cycle can be modified up until such times as determined by the Corporation by completing and returning such information as determined by the Corporation.~~
- ~~2. After regular evening allocation processing, the Corporation will attempt to borrow any needs for stock that still remain unsatisfied. Borrowing will be done versus the Members that have indicated an availability in each security. The full amount indicated as available by a Member will be utilized prior to borrowing anything from the next selected Member in sequence. The Corporation will use an allocation algorithm to determine the order in which it will borrow securities made available by Members to meet the Corporation's system needs. In addition:  
  
Step I: On each day, each Member will be assigned a random allocation number, for each security made available to the Corporation for potential borrowing. In the event that more than one Member has made the same security available, the allocation rank is determined by a computer generated random number. Random numbers, which change daily, are computed so that each Member's random number is different for each security.  
  
Step II: Each potential borrow will then be sequenced using the random allocation number with the lowest number being the first priority for borrowing.~~
- ~~3. Similarly, at the time during the day cycle designated by the Corporation, the Corporation will attempt to borrow any needs for stock that remain unsatisfied at that time. Borrowing will be done versus those Members that have indicated an availability during that day in each security. Any Member that has remaining availability in a security after the evening allocation processing borrowing must submit new availability instructions to participate in daytime stock~~

- ~~borrowing. The utilization of such availability will follow the same allocation procedures as used for nighttime stock borrows.~~
- ~~4. When stock is borrowed, the Corporation will create miscellaneous activity updates to the Member's CNS account to record the borrow. When the borrowing is done in the day cycle, the Corporation will make available information in such form as it determines regarding the borrowing activity. The number of shares borrowed will be journalled short against the Member's "D" CNS sub-account and long versus the Member's "C" CNS sub-account. A CNS short cover from the Member's "D" CNS sub-account will automatically occur against the shares on deposit in its DTC account, thus advancing the Member the market value of the stock. The long position in the Member's "C" CNS sub-account will reflect the shares borrowed by the Corporation, and will be marked to the market daily.~~
  - ~~5. Shares borrowed will be paid back, and the Member charged back at current market prices, through normal allocation to the Member's "C" CNS sub-account. Borrows will be returned when regular short deliveries for a day exceed all priority needs.~~
  - ~~6. In addition to the regular return of borrowed stock, the Stock Borrow Program provides a priority close-out procedure where a Member requires the return of securities borrowed by the Corporation in order to meet the "customer securities segregation" requirements of SEC Rule 15c3-3. In such instances, Members, through use of the CNS priority instructions, can instruct the Corporation to put them on high allocation priority. Alternatively, the Member may initiate buy-in procedures by submitting a Notice of Buy-In.~~
  - ~~7. In lieu of utilizing the recall provisions of SEC Rule 15c3-3, the following procedure is available: If the lending Member, when notified of what has been borrowed, finds that his "seg account" is now deficient due to a recalculation of the Member's requirement and the borrowing, the Member would notify the Corporation. The Corporation would convert the lending Member's right to receive back from the Corporation securities borrowed, versus payment, represented by a long valued position, into a right to receive back from the Corporation without payment, the securities borrowed, represented by a separate long free account. The Corporation would also charge the Member's settlement account for the value of those securities in this separate long free account, thus reversing the credit which otherwise would have been extended.~~
  - ~~8. The only fees to Members for this program will be normal short cover (when a borrow is made) and long allocation (when a borrow is~~

~~returned) charges and, if instructions are received other than in  
machine readable input, fees for processing paper input.~~