

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68267; File No. SR-Phlx-2012-133)

November 20, 2012

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change, as Modified by Amendment No. 1, to Amend Rule 3218

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 November 15, 2012, NASDAQ OMX PHLX LLC (“Phlx” or the “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 Phlx. On November 15, 2012, Phlx filed Amendment No. 1 to the proposed rule change.<sup>3</sup> Phlx filed the proposal pursuant to Section 19(b)(3)(A)<sup>4</sup> and Rule 19b-4(f)(6)<sup>5</sup> thereunder so that the proposal was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

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

<sup>3</sup> In Amendment No. 1, Phlx deleted “October \_\_, 2012” and inserted “November 1, 2012” on page 9 of 19 of the original filing, concerning when Phlx provided the Commission with written notice of the proposed rule change.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(6).

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

Phlx is filing this proposed rule change to amend Rule 3218. The text of the proposed rule change is below. Proposed new language is italicized; proposed deletions are in brackets.

**3218. Clearance and Settlement**

(a) All transactions through the facilities of PSX shall be cleared and settled through a registered clearing agency using a continuous net settlement system. This requirement may be satisfied by direct participation, use of direct clearing services, [or] by entry into a correspondent clearing arrangement with another member *organization* that clears trades through such a[n] *clearing agency* [.] *, or by use of the services of CDS Clearing and Depository Services, Inc. in its capacity as a member of such a clearing agency.*

(b) No change.

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

Phlx proposes to modify Rule 3218 to clarify that the use of a long-standing arrangement between National Securities Clearing Corporation (“NSCC”) and CDS Clearing and Depository Services, Inc. (“CDS”)<sup>6</sup> for clearing transactions in US

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<sup>6</sup> CDS was formerly known as The Canadian Depository for Securities Limited.

securities provides an acceptable method for clearing transactions executed on Phlx's NASDAQ OMX PSX trading system ("PSX"). Among other things, CDS operates Canada's national clearance and settlement operations for cash equities trading, performing a role analogous to NSCC in the US. CDS is regulated by the Ontario and Quebec securities commissions and the Bank of Canada, with working and reporting relationships with the Canadian Securities Administrators (CSA), other Canadian provincial securities commissions, and the Canadian Office of the Superintendent of Financial Institutions. CDS is also a full service member of NSCC and a participant in the Depository Trust Company ("DTC").

Currently, a Canadian broker-dealer seeking to buy or sell US securities may do so through a US registered broker-dealer with which it establishes a relationship for that purpose. In such a relationship, the US broker-dealer manages the clearance and settlement of the resulting trades, either through direct membership at NSCC or indirectly through a clearing broker with which it has established a relationship. Under the proposed change, a Canadian broker-dealer that is a member of CDS may make use of CDS, and its direct membership in NSCC, to clear and settle the resulting trades. Specifically, the clearing report for the trade will "lock in" CDS, with reference to the CDS membership of the Canadian broker-dealer, as a party to the trade.<sup>7</sup> NSCC then looks to CDS for satisfaction of clearance and settlement obligations of the Canadian broker-dealer. NSCC requires CDS to commit collateral to the NSCC clearing fund like

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<sup>7</sup> As an NSCC member, CDS is responsible for the settling and clearing of its participants' trades conducted with US broker-dealers. For purposes of "locking-in" parties, certain CDS participants have discrete NSCC participant codes that identify the Canadian broker-dealer and its participation in the NSCC/CDS clearing arrangement. On midnight of T+1, NSCC takes on the buyer's credit risk and the seller's delivery risk.

any other NSCC member, the amount of which is based on a risk-based margining methodology. In a similar manner, CDS requires its participants to commit collateral to CDS. The sole risk incurred by Phlx and then by NSCC in the arrangement is the highly remote risk that CDS itself might default on its obligations to clear and settle on behalf of the Canadian broker-dealer. This risk is conceptually indistinguishable from the risk of a clearing broker default; moreover, because the value of Canadian trades cleared through the mechanism is likely to be small in comparison to the values cleared through many large US clearing brokers, the magnitude of this risk is correspondingly smaller.

The relationship between NSCC and CDS was established more than two decades ago, and various aspects of the relationship have been recognized through several prior filings<sup>8</sup> and no-action letters,<sup>9</sup> as well as a recent similar filing by The NASDAQ Stock Market LLC.<sup>10</sup> A recent description of the parameters of the relationship may be found in NSCC's Assessment of Compliance with the CPSS/IOSCO Recommendations for

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<sup>8</sup> See Securities Exchange Act Release No. 36918 (March 4, 1996), 61 FR 9739 (March 11, 1996) (SR-NASD-95-49) (approving access to Automated Confirmation Transaction Service for CDS members); Securities Exchange Act Release No. 40523 (October 6, 1998), 63 FR 54739 (October 13, 1998) (approving establishment of a CDS omnibus account at DTC to facilitate cross-border clearing).

<sup>9</sup> See Letter from Dan W. Schneider, Deputy Associate Director, Commission, to Karen L. Saperstein, Assistant General Counsel, NSCC (November 26, 1984) (available at 1984 WL 47355) (taking no-action position with respect to use of CDS and NSCC with respect to clearing of trades executed on behalf of Canadian broker-dealers on the Boston Stock Exchange); Letter from Dan W. Schneider, Deputy Associate Director, Commission, to Karen L. Saperstein, Assistant General Counsel, NSCC (October 24, 1984) (available at 1984 WL 47356) (taking no-action position with respect to CDS becoming a member of NSCC).

<sup>10</sup> Securities Exchange Act Release No. 66310 (February 2, 2012), 77 FR 6610 (February 8, 2012) (SR-NASDAQ-2012-015).

Central Counterparties.<sup>11</sup> The most prominent use of the relationship arises under FINRA Rule 7220A, which allows over-the-counter trades executed on behalf of CDS members to be reported through the FINRA/NASDAQ Trade Reporting Facility and cleared through the CDS/NSCC relationship.

In order to clearly establish that use of the CDS/NSCC relationship is a permissible method of clearing transactions executed on PSX, Phlx is proposing to amend Rule 3218. Currently, the rule provides that trades must be cleared through a registered clearing agency using a continuous net settlement (“CNS”) system, and that this requirement may be satisfied by direct participation, use of direct clearing services, or by entry into a correspondent clearing arrangement with another member organization that clears trades through such an agency.<sup>12</sup> NSCC is currently the only registered clearing agency using a CNS system for trades executed on PSX. While it is possible that the term “direct clearing services” could be construed to cover CDS’s participation in NSCC on behalf of its members – because CDS is a direct member of NSCC for the purpose of providing clearing services to its members – the term has not previously been construed by Phlx in that manner. Accordingly, Phlx believes that the clarity of the rule would be enhanced by directly recognizing the CDS/NSCC relationship in the rule text. Phlx proposes amending the rule to provide that the rule may be satisfied through “use of the services of CDS Clearing and Depository Services, Inc. in its capacity as a member of

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<sup>11</sup> “Assessment of Compliance with the CPSS/IOSCO Recommendations for Central Counterparties,” NSCC (November 14, 2011) (available at [http://www.dtcc.com/legal/compliance/NSCC\\_Self\\_Assessment.pdf](http://www.dtcc.com/legal/compliance/NSCC_Self_Assessment.pdf) ).

<sup>12</sup> Phlx is also clarifying Rule 3218 by replacing the term “member” with the term “member organization,” which refers more precisely to a registered broker-dealer authorized to trade on PSX.

such a clearing agency.” Whenever a clearing arrangement making use of CDS’s membership in NSCC is established, NSCC will require the Phlx member organization, the Canadian broker on whose behalf it is acting, CDS, and Phlx to sign a short agreement, to be addressed to NSCC, in which the parties acknowledge their use of the CDS/NSCC arrangement.

## 2. Statutory Basis

Phlx believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>13</sup> in general, and with Section 6(b)(5) of the Act,<sup>14</sup> in particular, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. Specifically, by allowing Canadian broker-dealers whose trades are executed on PSX to make use of the long-standing arrangement between NSCC and CDS for clearing transactions, Phlx believes that the proposed rule change will directly foster cooperation and coordination with the two primary North American cash equities clearinghouses and their respective members, thereby promoting a free and open market. Because the arrangement between NSCC and CDS – which has been in place, in varying forms, for over two decades – includes mechanisms to provide for the collateralization of the obligations arising thereunder, Phlx believes that the

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

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

proposed change is fully consistent with the protection of investors and the public interest.

(B) Self-Regulatory Organization's Statement on Burden on Competition

Phlx does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. The proposed change will ensure that Canadian broker-dealers whose trades are executed on PSX are able to make use of an additional available option for clearing such transactions, thereby promoting competition with respect to the availability of clearing services.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments were neither solicited nor received.

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

The foregoing rule change has become effective upon filing pursuant to Section 19(b)(3)(A) of the Act<sup>15</sup> and Rule 19b-4(f)(6) thereunder<sup>16</sup> because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public

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<sup>15</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>16</sup> 17 CFR 240.19b-4(f)(6).

interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2012-133 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2012-133. This file number should be included on the subject line if e-mail 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, N.E., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of Phlx and on Phlx's website:

<http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLX/pdf/phlx-filings/2012/SR-Phlx-2012-133.pdf>.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2012-133 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>17</sup>

Kevin M. O'Neill  
Deputy Secretary

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