



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 XV. CLEARING FUND FORMULA AND OTHER MATTERS¹

I.(A) Clearing Fund Formula for Members

Each Member of the Corporation, except as otherwise provided in this Procedure, is required to contribute to the Clearing Fund maintained by the Corporation an amount calculated by the Corporation equal to:

(1) For CNS Transactions

(a)(i) The volatility of such Member's net of unsettled Regular Way, When-Issued and When-Distributed pending positions (i.e., net positions that have not yet passed Settlement Date) and fail positions (i.e., net positions that did not settle on Settlement Date), hereinafter collectively referred to as Net Unsettled Positions. When the Corporation deems it appropriate, the volatility of such positions shall be determined after taking into account offsetting pending transactions that: (x) have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation², and (y) have not been submitted for processing through the ID Net service. Such calculation shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

(ii) The Corporation shall have the discretion to exclude from the above calculations Net Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, such as municipal or corporate bonds. The amount of Clearing Fund required with respect to such Net Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the positions covered by subsection y of this paragraph;

plus

¹ All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

² The Corporation may, in its discretion, decline to consider any such transactions, as well as other similar transactions referred to in respect of this Procedure, if it has reason to believe that the institutional counter party may not or cannot settle the transaction.

(b) The net of each day's difference between (x) the contract price of such Member's Regular Way, When-Issued and When-Distributed net positions for transactions not submitted through the ID Net service that have not yet passed Settlement Date and its fail positions, and (y) the Current Market Price for such positions³ (such difference to be known as the "Regular Mark-to-Market"); provided that: (i) the Corporation shall exclude from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), (ii) the Corporation may, but shall not be required to, exclude from this calculation any shares delivered by the Member in the night cycle to satisfy all or any portion of a short position, and (iii) that if the Member is an ID Net Subscriber and if the value of the Regular Mark-to-Market as computed above is a positive number, then the value of the Regular Mark-to-Market shall be zero;

plus

(c) If such Member is an ID Net Subscriber, the net of each day's difference between (x) the contract price of the net positions attributable to such Member's transactions submitted through the ID Net service, and (y) the Current Market Price for such positions (such difference to be known as the "ID Net Mark-to-Market"), provided that if the value of the ID Net Mark-to-Market as computed above is a positive number, then the value of the ID Net Mark-to-Market shall be zero.

plus

(d) If such Member clears for one or more Market Makers⁴ (i.e., the Member's Correspondent(s)) or is itself a Market Maker in any security dominated by either the Member or its Correspondent(s) (where domination is calculated for each Member and each of its Correspondent(s) according to criteria determined by the Corporation from time to time), and if the sum of the absolute values of the Net Unsettled Positions in such dominated security or securities of any one or more of such Market Makers exceeds the excess net capital of the respective Market Maker or the Member (whether or not it is a Market Maker), (i.e., such Market Maker's or Member's Excess), the Corporation may then require the Member to contribute an additional Clearing Fund Deposit to the Corporation either in an amount equal to each such Market Maker's or Member's Excess or the sum of each of the absolute values of the Net Unsettled Positions or a combination of both. In performing the calculation, the Corporation may take into account

³ For fail positions, the contract price used for this purpose is the prior day's Market Price.

⁴ As used in this Procedure, the term "Market Maker" shall mean a member firm of the National Association of Securities Dealers, Inc. (NASD) that is registered by the NASD as a Market Maker.

offsetting pending (i.e., non-fail) transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. In addition, where a Market Maker's Net Unsettled Positions in dominated issues are cleared by one or more Members, the Corporation may treat those positions, for purposes of calculations pursuant to this paragraph, as if they were all cleared by the Market Maker's clearing Member, as listed in the records of the Corporation in accordance with Section 3(e) of Rule 3⁵;

plus

(e) An additional payment ("special charge") from Members in view of price fluctuations in or volatility or lack of liquidity of any security. The Corporation shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time;

plus

(f) 5% or such greater amount, as determined by the Corporation, not to exceed 10% of such Member's long fail CNS positions plus 5%, or such greater amount, as determined by the Corporation, not to exceed 10% of such Member's short fail CNS positions, plus.

(g) an amount for certain activity (referred to as "Specified Activity") based on the average of the Member's three highest aggregate calculated charges for daily Specified Activity measured over the most recent 20 settlement days. For purposes of this calculation, "Specified Activity" means transactions (other than Index Receipt creates and redeems and their underlying component securities, or cash component, if applicable) processed by the Corporation on a shortened processing cycle (i.e., otherwise than on a three-day processing and settlement cycle), including T+3 as-of trades,⁶ cash trades, next day settling trades, and similar transactions. This charge shall be calculated by: (i) netting Specified Activity by cusip to a single long or short position, and (ii) applying a charge to each such position, using not less than two standard deviations as determined by historic pricing. The standard deviations will be the same as those derived for the daily volatility calculations; provided however, that as is the case with the volatility charge, for those securities whose volatility is either less amenable to statistical analysis, or so amenable only in a complex manner, the Corporation shall instead apply the same percentage charge to those securities as applied pursuant to clause I.(A)(1)(a) above.

⁵ The Corporation may require or permit such Member to deliver some or all shares necessary to complete a short obligation in lieu of part or all of its requirement under this section or subsection I.(A)(2)(c).

⁶ That is, as-of trades compared or recorded on T+3 prior to the applicable comparison/recording cut-off time, including trades received after the applicable T+2 cut-off time. With respect to next day settling trades, this includes next day as-of trades.

(2) For Balance Order Transactions

(a)(i)The volatility of such Member's net of unsettled Regular Way, When-Issued and When-Distributed positions that have not yet passed Settlement Date, hereinafter collectively referred to as Net Balance Order Unsettled Positions. When the Corporation deems it appropriate, the volatility of such positions shall be determined after taking into account offsetting pending transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. Such calculation shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

(ii)The Corporation shall have the discretion to exclude from the above calculations Net Balance Order Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, such as municipal or corporate bonds. The amount of Clearing Fund required with respect to such Net Balance Order Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the positions covered by subsection y of this paragraph;

plus

(b) The net of each day's difference between the contract price of such Member's Net Balance Order Unsettled Positions, and the Current Market Price for such positions, provided that the Corporation shall exclude from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number);

plus

(c) If such Member clears for one or more Market Makers (i.e., the Member's Correspondent(s)) or is itself a Market Maker in any security dominated by either the Member or its Correspondent(s) (where domination is calculated for each

Member and each of its Correspondent(s) according to criteria determined by the Corporation from time to time), and if the sum of the absolute values of the Net Balance Order Unsettled Positions in such dominated security or securities of any one or more of such Market Makers exceeds the excess net capital of the respective Market Maker or the Member (whether or not it is a Market Maker), (i.e., such Market Maker's or Member's Excess), the Corporation may then require the Member to contribute an additional Clearing Fund Deposit to the Corporation either in an amount equal to each such Market Maker's or Member's Excess or the sum of each of the absolute values of the Net Balance Order Unsettled Positions or a combination of both. In performing the calculation, the Corporation may take into account offsetting pending (i.e., non-fail) transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. In addition, where a Market Maker's Net Balance Order Unsettled Positions in dominated issues are cleared by one or more Members, the Corporation may treat those positions, for purposes of calculations pursuant to this paragraph, as if they were all cleared by the Market Maker's clearing Member, as listed in the records of the Corporation in accordance with Section 3(e) of Rule 3;

plus

(d) An additional payment ("special charge") from Members in view of price fluctuations in or volatility or lack of liquidity of any security. The Corporation shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time, plus

(e) an amount for certain activity (referred to as "Specified Activity") based on the average of the Member's three highest aggregate calculated charges for daily Specified Activity measured over the most recent 20 settlement days. For purposes of this calculation, "Specified Activity" means transactions (other than Index Receipt creates and redeems and their underlying component securities, or cash component, if applicable) processed by the Corporation on a shortened processing cycle (i.e., otherwise than on a three-day processing and settlement cycle), including T+3 as-of trades,⁷ cash trades, next day settling trades, and similar transactions. This charge shall be calculated by: (i) netting Specified Activity by cusip to a single long or short position, and (ii) applying a charge to each such position, using not less than two standard deviations as determined by historic pricing. The standard deviations will be the same as those derived for the daily volatility calculations; provided however, that as is the case with the volatility charge, for those securities whose volatility is either less amenable to statistical analysis, or so amenable only in a complex manner, the Corporation shall instead apply the same percentage charge to those securities as applied pursuant to clause I.(A)(1)(a) above.

⁷ That is, as-of trades compared or recorded on T+3 prior to the applicable comparison/recording cut-off time, including trades received after the applicable T+2 cut-off time. With respect to next day settling trades, this includes next day as-of trades.

(3) For Other Transactions

The greater of (i) 2-1/2% of such Member's average daily settlement debits and credits other than CNS, Mutual Fund Services and Envelope Settlement Service debits and credits and (ii) 5% of such Member's average daily settlement debits other than CNS, Mutual Fund Services and Envelope Settlement Service debits, for other transactions (Other Transactions) as determined by the Corporation from time to time, adjusted for broker/dealer Members by a factor that shall be calculated as follows:

$$\frac{\text{Average Daily Settlement Debits As Determined by the Corporation}}{\text{Excess Net Capital}}$$

The factor calculation shall be adjusted in order to provide a minimum of one with a maximum of three.

(4) For Mutual Fund Transactions

(a) \$5,000 if such Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member;

or

(b) \$10,000 if such Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member;

or

(c) \$20,000 if such Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.

I.(B) Additional Clearing Fund Formula

(1) Additional Deposits for Members on Surveillance

Any Member who is placed on surveillance status shall be required to make such additional Clearing Fund deposits as determined by the Corporation on the same day as requested by the Corporation within such timeframe as required by the Corporation from time to time.

The Corporation shall require Members who are rated 5, 6, or 7 on the credit risk matrix to contribute to the Clearing Fund an amount determined by multiplying the absolute value of any long Net Unsettled Positions in classes of "family-issued securities" (defined as securities that were issued by either that Member or by an affiliate of that Member) by a percentage designated by the Corporation; such percentage, to be no less than 40% and up to 100%, would be determined,

from time to time, in the sole discretion of the Corporation, within the parameters described as follows, based on the Member's rating on the credit risk matrix and on the type of family-issued securities submitted to the Corporation.

Fixed income securities that are family-issued securities would be charged a haircut rate of no less than 80% for firms that are rated 6 or 7 on the credit risk matrix, and no less than 40% for firms that are rated 5 on the credit risk matrix; and equity securities that are family-issued securities would initially be charged a haircut rate of 100% for firms that are rated 6 or 7 on the credit risk matrix, and no less than 50% for firms that are rated 5 on the credit risk matrix.

The Corporation shall exclude long Net Unsettled Positions in such family-issued securities of Members who are rated 5, 6, or 7 on the credit risk matrix from the calculations describe in Subsections I.(A)(1)(a)(i) and (ii) and I.(A)(2)(a)(i) and (ii).

(2) Excess Capital Premium

If a Member's contribution to the Clearing Fund, as computed pursuant to Section I.(A) of this Procedure (but excluding any charges as set forth in Subsections I.(A)(1)(c), I.(A)(1)(d), I.(A)(2)(c), and I.(A)(2)(d) of this Procedure), plus any amount collected pursuant to 1.(B)(1) above or Rule 15 (such aggregate amount referred to as the "Calculated Amount"), when divided by its excess net capital or capital (as applicable), as defined in the membership standards set forth in Addendum B, is greater than 1.0 (the "Excess Capital Ratio"), then the Corporation may require such Member to deposit, within such timeframe as the Corporation may require, an additional amount (the "Excess Capital Premium") to the Clearing Fund equal to the product of: (a) the amount by which the Calculated Amount exceeds its excess net capital or capital (as applicable), as defined in the membership standards set forth in Addendum B, multiplied by (b) its Excess Capital Ratio.

Notwithstanding the foregoing, the Corporation may: (i) collect an amount less than the Excess Capital Premium (including no premium), and (ii) return all or a portion of the Excess Capital Premium if it believes that the imposition or maintenance of the Excess Capital Premium is not necessary or appropriate.⁸

I.(C) Clearing Fund Formula for Mutual Fund/Insurance Services Members who use the Mutual Fund Services.⁹

⁸ The Corporation has identified the following guidelines or circumstances, which are intended to be illustrative, but not limited, where the premium will not be imposed: (a) where the premium results from charges applied with respect to municipal securities trades settling in CNS, where the member has offsetting compared trades settling on a trade-for-trade basis through DTC; and (b) management will look to see whether the premium results from an unusual or non-recurring circumstance where management believes it would not be appropriate to assess the premium. Examples of such circumstances are a member's late submission of trade data for comparison or trade recording that would otherwise reduce the margined position if timely submitted, or an unexpected haircut or capital charge that does not fundamentally change its risk profile.

⁹ This section applies to entities whose use of the Corporation's services are restricted to the Mutual

Each Mutual Fund/Insurance Services Member is required to contribute to the Clearing Fund maintained by the Corporation an amount, in cash, approximately equal to:

(a) \$5,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member;

or

(b) \$10,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member;

or

(c) \$20,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.

I.(D) Clearing Fund Formula for Fund Members, Insurance Carrier/Retirement Services Members and Certain Mutual Fund/Insurance Services Members

The Clearing Fund Formula for each Fund Member, Insurance Carrier/Retirement Services Member and those Mutual Fund/Insurance Services Members who use the Corporation's Insurance and Retirement Processing Services shall be established at such time as the Corporation determines appropriate.

II. Minimum Clearing Fund and Additional Deposit Requirements

(A) Each Member of the Corporation shall be required to contribute a minimum of \$10,000 (the "minimum contribution"). The first 40% (but no less than \$10,000) of a Member's Required Deposit must be in cash and the remaining amount, may be evidenced by open account indebtedness secured by the pledge of Eligible Clearing Fund Securities, which shall be valued, for collateral purposes, as set forth in subsection III below. A Mutual Fund/Insurance Services Member's entire deposit is required to be in cash.

1. Special Provisions Related to Eligible Clearing Fund Securities:

(a) Any deposits of Eligible Clearing Fund Agency Securities¹⁰ or Eligible Clearing Fund Mortgage-Backed Securities¹¹,

Fund Services and/or the Insurance and Retirement Processing Services. Entities which use or are permitted to use Services other than or in addition to the Mutual Fund Services and Insurance and Retirement Processing Services are covered by section I.(A).

¹⁰ A Member that is an Agency may not pledge Eligible Clearing Fund Agency Securities of which it is the issuer.

respectively, in excess of 25 percent of the Member's Required Deposit will be subject to an additional haircut equal to twice the percentage as specified in the proposed haircut schedule detailed in subsection III below, and

- (b) No more than 20 percent of a Member's Required Deposit secured by pledged Eligible Agency Securities may be of a single issuer.
- (B) All Clearing Fund requirements and other deposit requirements shall be made by Members and Mutual Fund/Insurance Services Members, within one hour of demand unless otherwise determined by the Corporation; provided, however, that to the extent the Member and Mutual Fund/Insurance Services Member is meeting such obligation with a (1) deposit of cash, such deposit shall be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire, and (2) delivery of eligible securities, such delivery shall be received within the deadlines established by a Qualified Securities Depository. At the discretion of the Corporation, cash deposits may be included as part of the Member's or Mutual Fund/Insurance Services Member's, daily settlement obligation.
 - (C) Additional Clearing Fund deposits shall not be requested unless they exceed such threshold as determined by the Corporation from time to time.
 - (D) Where the amount of a Member's and Mutual Fund/Insurance Services Member's deficiency is in excess of \$1,000 but less than \$5,000, the Corporation may require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000, the Corporation may require payment in multiples of \$5,000.
- III. Collateral Value of Eligible Clearing Fund Securities
- (A) Eligible Clearing Fund Securities pledged to secure Clearing Fund deposits shall, for collateral valuation purposes, be haircut as follows, or as otherwise determined by the Corporation from time to time:

¹¹ With regard to a Member that pledges Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, such securities will be subject to a premium haircut, as set forth in subsection III below.

<u>Security Type</u>	<u>Remaining Maturity</u>	<u>Haircut</u>
1. Treasury		
Bills, Notes, Bonds, TIPS	Zero to 1 year	2.0%
	1 year to 2 years	2.0%
	2 years to 5 years	3.0%
	5 years to 10 years	4.0%
	10 years to 15 years	6.0%
	15 years or greater	6.0%
Zero Coupon	Zero to 1 year	5.0%
	1 year to 2 years	5.0%
	2 years to 5 years	5.0%
	5 years to 10 years	12.0%
	10 years to 15 years	12.0%
	15 years or greater	12.0%
2. Agency*		
Notes, Bonds	Zero to 1 year	7.0%
	1 year to 2 years	7.0%
	2 years to 5 years	7.0%
	5 years to 10 years	7.0%
	10 years to 15 years	10.0%
	15 years or greater	10.0%
Zero Coupon	Zero to 1 year	7.0%
	1 year to 2 years	7.0%
	2 years to 5 years	7.0%
	5 years to 10 years	18.0%
	10 years to 15 years	18.0%
	15 years or greater	18.0%

* Any deposits of Eligible Clearing Fund Agency Securities or Eligible Clearing Fund Mortgage-Backed Securities in excess of 25 percent of a Member's Required Clearing Fund deposit will be subject to a haircut that is twice the amount of the percentage noted in the haircut schedule. Eligibility requirements will be announced by the Corporation from time to time.

3. Mortgage-Backed Security

Pass-Throughs*	Ginnie Mae	7.0%
	Fannie Mae/Freddie Mac	7.0%
Self-issued**		14% (or 21% if Concentration limit is exceeded)

** A Member may deposit Eligible Clearing Fund Mortgage-Backed Securities of which it is the issuer, however such securities will be subject to a premium haircut. This haircut shall be 14% as an initial matter. If a Member also exceeds the 25% concentration limit, the haircut shall be 21%.