

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62726; File No. SR-NSCC-2010-05)

August 16, 2010

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Enhance the Process for Transfers Through the Automated Customer Account Transfer Service

I. Introduction

On June 4, 2010, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NSCC-2010-05 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ The proposed rule change was published for comment in the Federal Register on July 2, 2010.² No comment letters were received on the proposal. This order approves the proposal.

II. Description

NSCC’s Automated Customer Account Transfer Service (“ACATS”) system enables Members to effect automated transfers of customer accounts among themselves.³ For ACATS transfers processed through NSCC’s Continuous Net Settlement (“CNS”) system,⁴ long and short

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 62385 (June 25, 2009), 75 FR 38579 (July 2, 2010).

³ ACATS complements a Financial Industry Regulatory Authority (“FINRA”) rule requiring FINRA members to use automated clearing agency customer account transfer services and to effect customer account transfers within specified time frames.

⁴ CNS is an ongoing accounting system which nets today’s settling trades with yesterday’s closing positions to produce a net short or long position for a particular security for a particular Member. NSCC is the counter party for all positions. The positions are then passed against the Member’s designated depository positions and available securities are allocated by book-entry. This allocation of securities is accomplished through an evening cycle followed by a day cycle. Positions which remain open after the evening cycle may be changed as a result of trades accepted for settlement that day. CNS allocates deliveries in both the night and day cycles using an algorithm based on priority groups in descending order, age of position within a priority group, and random numbers within age groups.

positions are passed against Members' positions at The Depository Trust Company ("DTC") and available securities are delivered from short Members' accounts at DTC and allocated to long Members' accounts by book-entry movements.

NSCC is making changes to its ACATS system in connection with a concurrent rule change by DTC⁵ and is making these changes for two reasons. First, NSCC believes the changes will enhance protection for customer securities in ACATS transfers so that customer account transfers to new firms will be maximized in the event of a Member failure. Accordingly, NSCC will modify its ACATS processing and its Rules so that deliveries or receives processed through CNS will satisfy a Member's ACATS receive or deliver obligations prior to satisfying other CNS-related obligations of that Member in the same security. NSCC will also track CNS ACATS items to prevent reversals of completed transfers in the event of a Member's failure. Second, NSCC believes the changes will facilitate compliance by its Members with their securities possession and control requirements.⁶ To that end, NSCC will modify its Rules to clarify that in no event does NSCC have a lien on securities that are carried by a Member for the

⁵ File No. SR-DTC-2010-09. Securities Exchange Act Release Nos. 62384 (June 25, 2010), 75 FR 38581 (July 2, 2010) and 62385 (June 25, 2009), 75 FR 38579 (July 2, 2010).

⁶ Commission Rule 15c3-3 provides that a broker-dealer shall promptly obtain and shall thereafter maintain the physical possession or control of all fully paid securities and excess margin securities carried for the account of customers. 17 CFR 240.15c3-3.

account of its customers and that are delivered through the CNS ACATS service.⁷

1. ACATS Transfers Through the CNS System

Through ACATS, an NSCC Member to which a customer's securities account is to be transferred ("Receiving Member") submits a Transfer Initiation Request to initiate the account transfer process. NSCC causes all CNS-eligible items in that customer account to enter NSCC's CNS accounting operation on the day before settlement date unless the Receiving Member notifies NSCC that certain items should be withheld from CNS processing.⁸

Ordinary CNS items enter the system at contract value, but ACATS items enter CNS unvalued. This reflects the nature of the ACATS CNS items as "free" transfers. To incentivize deliveries, ACATS items are marked-to-the-market on the morning of settlement date using their full CNS value as of the prior day's closing price. Consequently, the Delivering Member's CNS projection report shows a short securities position, and its CNS cash reconciliation report shows a cash debit for the "full value" mark. Conversely, the Receiving Member's projection report shows a long securities position, and its cash reconciliation report shows a cash credit equal to the "full value" mark. If the Delivering Member fulfills its ACATS delivery obligation, then its short position is cancelled, and the cash debit for the mark is offset by a cash credit. Likewise, upon receipt of the securities by the Receiving Member, the Receiving Member's long position is

⁷ DTC's Settlement Service Guide currently provides that securities delivered to a receiving DTC Participant's account from CNS are classified as collateral which may otherwise be made available to NSCC in the event that the DTC Participant fails to meet its NSCC settlement obligation. Pursuant to the concurrent DTC rule change, DTC will revise its Service Guide to provide that ACATS deliveries from CNS will be designated by the DTC Participant as minimum amount securities when credited to the Participant's account. This designation will prevent the securities from being designated as collateral for either this purpose or for purposes of DTC's Rules.

⁸ NSCC Rule 50 (Automated Customer Account Transfer Service).

offset, and the cash credit for the mark is offset by the cash debit. The net result is a “free” transfer of securities because no money is paid by either the Delivering Member or Receiving Member.

For transactions processed through CNS, NSCC normally becomes the counter party to the transaction and guarantees settlement.⁹ However, CNS ACATS transfers are not guaranteed. If a party fails to pay any portion of its money settlement obligation on settlement Date,¹⁰ NSCC may reverse uncompleted ACATS items and any associated debits or credits calculated using the marking process described above would be eliminated.

ACATS transfers settled through CNS are fungible with all other CNS activity. The CNS system does not distinguish between ACATS transactions and other transactions, which means that CNS ACATS receives and delivers are netted with guaranteed settling trades in the same securities. However, NSCC will now begin tracking ACATS receive and deliver obligations in CNS, and CNS allocations will be applied to ACATS receive and deliver obligations for a Member in a security before satisfying another obligation in the same security. At the end of each processing day, CNS ACATS fails will continue to be marked to the full-market value and netted with all other CNS obligations under NSCC’s Rules.

In the event of a Member failure, NSCC will use this automated tracking capability to differentiate between completed and uncompleted CNS ACATS transactions. NSCC will

⁹ Pursuant to Addendum K of its Rules, NSCC generally guarantees the completion of Continuous Net Settlement (“CNS”) and Balance Order trades that reach the later of midnight of T+1 or midnight of the day they are reported to Members. Shortened process trades, such as same-day and next-day settling trades, are guaranteed upon comparison or trade recording processing.

¹⁰ This includes failure by a Member to pay a mark-to-market charge.

therefore be able to reverse uncompleted ACATS transfers of a failing Member while allowing assets associated with completed ACATS transfers to remain with the Receiving Member.

NSCC believes this will help maximize CNS-related transfers of customer accounts to new firms.

An ACATS transfer of a failing Member will be deemed uncompleted if the failing Member is a Delivering Member and it has failed to deliver to CNS all or a portion of the securities associated with the ACATS transfer. If the failing Member is a Receiving Member and it has failed to receive all or a portion of the securities associated with the ACATS transfer from CNS, then the transfer will likewise be deemed uncompleted. In either case, if the Delivering Member makes a partial delivery of securities to CNS then the transfer will be deemed completed for the amount of securities received from CNS by the Receiving Member to the extent that amount does not exceed the amount delivered to CNS by the Delivering Member. The transfer will be deemed uncompleted as to any remaining securities beyond that amount, and only the uncompleted portion of the transfer will be subject to reversal. Transfers will also be deemed uncompleted when the failing Member is the Delivering Member and it has a flat or overall long CNS position or when the failing member is the Receiving Member and it has a flat or overall short CNS position.

In the event a Delivering Member and Receiving Member fail on the same settlement day and have an ACATS transfer obligation between them, any transfer deemed uncompleted for the Delivering Member will also be deemed uncompleted for the Receiving Member. NSCC will notify the affected Members of the details associated with the assets subject to the reversal, and the affected Members will have to reestablish customer positions accordingly.

2. Possession and Control Requirements

To facilitate the compliance of Members with their securities possession and control

requirements of securities subject to ACATS transfers processed through CNS, NSCC will modify its Rules to clarify that it does not maintain a lien over ACATS assets delivered to a Receiving Member through CNS.

3. Amendments to Rules and Procedures

To provide for the modifications to ACATS described in this order, NSCC will amend its rules as described in the summaries below.

a. Rule 18 (Procedures for When [the Corporation] Declines or Ceases to Act)

Section 7 of Rule 18 provides that NSCC maintains a lien on all property placed in its possession by a Member as security for any and all liabilities of that Member to NSCC. An exception to this rule is where such a lien would be prohibited under Commission Rules 8c-1 and 15c2-1. NSCC will modify the section to clarify that it does not maintain a lien on ACATS assets that have been delivered to a Receiving Member through CNS.

b. Rule 50 (ACATS)

NSCC will amend Rule 50 to clarify that NSCC may reverse uncompleted ACATS obligations when either the Delivering or Receiving Member has failed to meet its settlement obligation to NSCC. In addition, this Rule will be revised to note that in the event of such a reversal of uncompleted CNS ACATS obligations, NSCC will make files available to each Member to show each open security position due to settle that day that is subject to the reversal as well as such other information as NSCC may deem advisable. NSCC will also make a technical correction to clarify that ACATS transactions enter the CNS Accounting Operation on the day before Settlement Date (SD-1) rather than the day after Trade Date (T+1).

c. Procedure VII (CNS Accounting Operation)

NSCC will modify Procedure VII to provide for the tracking of customer transfers by

stating that deliveries of a particular security through CNS will be used to satisfy a Member's ACATS receive and deliver obligations before being used to satisfy another obligation, such as a trade-related obligation of that Member. In addition, the modified language will indicate that this designation will be provided to the Member's Designated Depository to facilitate its processing of the item.

4. Implementation

NSCC intends to implement these changes during the third quarter of 2010 and will advise Members of the implementation date through issuance of NSCC Important Notices. NSCC has agreed to provide Commission staff with updates on at least a quarterly basis on the progress related to industry discussions for processing enhancements for non-CNS ACAT transfers.¹¹

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act¹² and the rules and regulations thereunder applicable to NSCC. In particular, the Commission believes that the changes NSCC is making to its ACATS system to implement a tracking mechanism to distinguish ACATS activity from other items processed through CNS and to clarify that NSCC does not maintain a lien on ACATS assets delivered to a Receiving

¹¹ In connection with its review of ACATS, NSCC has agreed to provide Commission staff with updates, not less frequently than once per quarter, of its ongoing cooperative efforts with industry participants to determine the feasibility of procedures whereby it will treat ACATS full account transfers uniformly and it will execute, delete or reverse the transfers consistently for all the assets in an account whether those assets are CNS-eligible or not.

¹² 15 U.S.C. 78q-1.

Member through CNS are consistent with NSCC's obligations under Section 17A(b)(3)(F),¹³ which requires, among other things, that the rules of a clearing agency are designed to protect investors and the public interest.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act¹⁴ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (File No. SR-NSCC-2010-05) be, and hereby is, approved.¹⁶

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

Florence E. Harmon
Deputy Secretary

¹³ 15 U.S.C. 78q-1(b)(3)(F).

¹⁴ 15 U.S.C. 78q-1.

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁷ 17 CFR 200.30-3(a)(12).