

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-76348; File No. SR-NSCC-2015-007)

November 4, 2015

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Provide Mechanism for Sub-Account Settlement with Respect to the Alternative Investment Product Services

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 October 30, 2015, National Securities Clearing Corporation (“NSCC” or the “Corporation”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of amendments to NSCC’s Rules & Procedures (“Rules”)<sup>3</sup> in connection with creating a mechanism for certain users of the Alternative Investment Product Services (“AIP”) to settle at the sub-account level, and to make certain technical changes and corrections, as more fully described below. The text of the proposed rule change is available on NSCC’s website at <http://www.dtcc.com/legal/sec-rule-filings>, at the principal office of NSCC, and at the Commission’s Public Reference Room.

II. Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule

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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> NSCC’s Rules may be found at: <http://www.dtcc.com/legal/rules-and-procedures>.

change. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Statement of Purpose.

Background. In 2008, the Commission approved NSCC's proposed rule change to establish AIP, a non-guaranteed processing platform for alternative investment products such as hedge funds, funds of hedge funds, commodities pools, managed futures, and real estate investment trusts.<sup>4</sup> AIP facilitates, among other things, processing activities such as subscriptions and redemptions, distributions, position reporting, and account maintenance relating to alternative investment products and settles related payments ("AIP Payments").

Settlement of AIP Payments is done on a prefunded basis. On each date for which settlement will occur ("Settlement Date"), an AIP participant ("AIP Member") that is in a debit position for such day must satisfy its full debit balance before NSCC will settle any contra-side credit positions with respect to such AIP Member. NSCC simply passes AIP Payments from one AIP Member to the contra-side AIP Member without netting and without guaranteeing payment, and settlement of AIP Payments is segregated from all other money settlement at NSCC.

Participation in AIP is governed by Rule 53 of NSCC's Rules. A party seeking to be an AIP Member is required to enter into a separate AIP membership agreement with NSCC, even if it is otherwise a participant of other NSCC services.

AIP Members are divided into two categories — "AIP Manufacturers" and "AIP Distributors". AIP Manufacturers act on behalf of, or under authority of, the sponsor, general

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<sup>4</sup> Securities Exchange Act Release No. 57813 (May 12, 2008), 73 FR 28539 (May 16, 2008) (SR-NSCC-2007-12).

partner, or other party responsible for the creation or manufacturing of an eligible alternative investment product (“Eligible AIP Product”). AIP Manufacturers are generally the fund entities themselves (“Funds”). AIP Distributors act on behalf of, or under authority of, a customer or other investor in an Eligible AIP Product. AIP Distributors are generally the broker/dealers whose clients invest in Eligible AIP Products.

Fund Administrators. Within the alternative investments industry, there are parties on the creation/manufacturing side of transactions known as “fund administrators”. Fund administrators are not the Funds themselves, but rather, agents for the Funds. Where a Fund engages a fund administrator to act on the Fund’s behalf, it is typically the fund administrator that handles all of the transaction processing for that Fund.

Within AIP, a fund administrator is a party engaged under contract to provide administrative services with respect to one or more Eligible AIP Products and is eligible to be an AIP Member as an AIP Manufacturer (“AIP Fund Administrator”). In general, AIP Fund Administrators process AIP transactions with respect to their various Fund clients by creating separate sub-accounts within AIP, each of which is attributable to a specific Fund client. In this structure, the Fund client generally would not be an AIP Member.

Under the current AIP Rules, AIP Fund Administrators are responsible for all activities related to their sub-accounts. These activities include, for example, submitting, reviewing, and confirming order instructions, reviewing and confirming settlement statements, and making AIP Payments. With respect to making AIP Payments, the Rules provide that on Settlement Date all sub-account obligations roll up to the AIP Fund Administrator’s primary AIP account. These obligations are then presented to the AIP Fund Administrator’s settlement bank for gross debit settlement and gross credit settlement.

Because AIP Fund Administrators are responsible for settlement of AIP Payments, an AIP

Fund Administrator in a debit position on Settlement Date must assure that each applicable Fund client has timely delivered payment to such AIP Fund Administrator's settlement bank. To the extent that a single Fund client fails to deliver its payment on Settlement Date (and the AIP Fund Administrator is not otherwise able to cover such Fund's shortfall), NSCC is required to reverse all of the AIP Fund Administrator's contra-side credit positions for the day, including the contra-side credit positions attributable to Funds that actually did pay.

In recent months, NSCC has learned from several fund administrators interested in becoming AIP Members that the responsibility to make AIP Payments at NSCC is a responsibility that fund administrators generally do not undertake outside of AIP. In the current processing environment outside of AIP, fund administrators perform all transaction processing functions for their Funds, but they generally do not control money settlement.

As explained by certain fund administrators to NSCC, the current AIP Payment structure as applied to AIP Fund Administrators has slowed adoption of AIP by the fund administrator community.

Proposed Rule Change. To address this matter, NSCC is proposing to permit AIP Fund Administrators, at their discretion, to create sub-accounts that settle separately from their primary AIP accounts, as well as from their other AIP sub-accounts, ("AIP Settling Sub-Accounts").

An AIP Fund Administrator choosing to create an AIP Settling Sub-Account would designate to NSCC the applicable Fund client with responsibility for settlement of AIP Payments with respect to such AIP Settling Sub-Account. Such designated Fund would not be an AIP Member ("AIP Non-Member Fund"). Each such AIP Non-Member Fund would enter into a standard agreement pursuant to which an NSCC-approved AIP Settling Bank would perform settlement services directly for the AIP Non-Member Fund ("Appointment of AIP Settling Bank and AIP Settling Bank Agreement").

Under the proposal, AIP Fund Administrators would remain responsible for all activities with respect to their AIP Settling Sub-Accounts, except that AIP Fund Administrators would not be responsible for settling AIP Payments. For example, AIP Fund Administrators would remain responsible for order processing applicable to their AIP Settling Sub-Accounts, including submitting, reviewing, and confirming order instructions. In addition, AIP Fund Administrators would be responsible for informing their AIP Non-Member Funds of their respective daily AIP Payment obligations. All reporting, liability, and indemnification obligations to NSCC under NSCC's Rules would remain with the AIP Fund Administrator.

As is the case today, settlement of all AIP Payments would be done on a prefunded basis. NSCC would not net or guarantee any AIP Payments with respect to AIP Settling Sub-Accounts, and all settlement of AIP Payments (including those of AIP Non-Member Funds) would continue to be segregated from all other money settlement at NSCC.

Prior to NSCC approving any AIP Settling Sub-Account, NSCC would require the applicable AIP Fund Administrator to enter into documentation and/or agreements, or otherwise procure documentation and/or agreements, in such form as required by NSCC from time to time, which would contain:

- the AIP Fund Administrator's acknowledgement and agreement that it will be responsible for all matters, activities, liabilities, and obligations applicable to AIP Members under the Rules with respect to such AIP Settling Sub-Account, except for settlement of AIP Payments;
- the AIP Fund Administrator's agreement to indemnify NSCC for any loss, liability, or expense sustained by NSCC in connection with, arising from, or related to such AIP Settling Sub-Account, including with respect to the Foreign Account Tax

Compliance Act (“FATCA”)<sup>5</sup>;

- the AIP Fund Administrator's agreement that it will be responsible for (A) all charges incurred and payments due under Rule 26 (Bills Rendered) for the processing of AIP Settling Sub-Account transactions through AIP and (B) any other charges that may be incurred with respect to such AIP Settling Sub-Account under Rule 24 (Charges for Services Rendered);
- the AIP Fund Administrator’s designation of the AIP Non-Member Fund with responsibility for making AIP Payments with respect to such AIP Settling Sub-Account;
- the AIP Non-Member Fund's consent and approval with respect to such designation;
- the AIP Fund Administrator’s agreement of its obligation to notify NSCC of changes in condition to the AIP Non-Member Fund that would otherwise require notice to NSCC under Rule 2B (Ongoing Membership Requirements and Monitoring) or Rule 20 (Insolvency);
- the AIP Fund Administrator’s agreement of its obligation to notify the applicable AIP Non-Member Fund of such AIP Non-Member Fund’s daily AIP Payment balance; and
- the AIP Non-Member Fund’s appointment of an AIP Settling Bank, and such AIP Settling Bank's agreement to act as AIP Settling Bank for such AIP Non-Member Fund.

In addition, the applicable AIP Fund Administrator would need to obtain from the applicable AIP Non-Member Fund tax documentation in such form as required by NSCC from time to time, and

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<sup>5</sup> 26 U.S.C. 1471 et seq.

with respect to any AIP Non-Member Fund that is treated as a non-U.S. entity for U.S. federal income tax purposes, the AIP Fund Administrator would need to provide NSCC with an executed FATCA certification from such AIP Non-Member Fund in the form approved by NSCC.

On a going-forward basis with respect to FATCA, AIP Fund Administrators would need to obtain from their AIP Non-Member Funds periodic tax documentation, including FATCA certifications to the extent applicable, and provide such documentation to NSCC. Failure to provide such tax documentation, including FATCA certifications, in the manner and timeframes set forth by NSCC from time to time would result in revocation of NSCC's approval, in NSCC's sole and absolute discretion, of such AIP Settling Sub-Account.

Under the proposal, AIP Fund Administrators would be required to indemnify NSCC for any loss, liability, or expense sustained by NSCC in connection with, arising from, or related to FATCA in respect of their AIP Settling Sub-Accounts. The proposed FATCA-related provisions in this proposed rule change are substantially similar to the current provisions in the Rules governing how NSCC monitors and treats its non-U.S. members with respect to FATCA.

In connection with this proposal, NSCC would amend the following Rules:

- Rule 1. Definitions
  - The following new defined terms would be created: “AIP Fund Administrator”, “AIP Non-Member Fund”, and “AIP Settling Sub-Account”, each of which would be defined or further described in Rule 53 (Alternative Investment Product Services and Members).
  - The defined term “AIP Settling Bank” would be amended to: provide that AIP Settling Banks undertake to perform settlement services for AIP Members, as well as for AIP Non-Member Funds; and correct an incorrect Rule citation within the defined term.

- Rule 2. Members and Limited Members

The description of “AIP Settling Bank Only Member” as a type of NSCC Limited Member would be amended to provide that AIP Settling Bank Only Members undertake to perform settlement services with respect to AIP on behalf of AIP Members, as well as AIP Non-Member Funds.

- Rule 53. Alternative Investment Product Services and Members

The Rule would be amended to: permit AIP Fund Administrators to create AIP Settling Sub-Accounts and address the agreements and documents that NSCC would require prior to approving any such AIP Settling Sub-Account; describe the tax and FATCA-related requirements in connection with creating and maintaining such AIP Settling Sub-Accounts; describe the settlement process with respect to AIP Settling Sub-Accounts; state that NSCC will not notify any AIP Non-Member Fund of any debit or credit balance and identify that it is the AIP Fund Administrator’s obligation to notify each such AIP Non-Member Fund of its applicable debit or credit balance; state that NSCC will not guarantee AIP Payments to any AIP Non-Member Fund; specify that NSCC will not be liable for the acts, delays, omissions, bankruptcy, or insolvency of any AIP Non-Member Fund unless the Corporation was grossly negligent, engaged in willful misconduct, or in violation of federal securities laws for which there is a private right of action; and address applicable technical changes in connection with the foregoing.

- Rule 55. Settling Banks and AIP Settling Banks

The Rule would be amended to provide that AIP Settling Banks may undertake to: perform settlement services on behalf of AIP Non-Member Funds; describe the settlement process with respect to AIP Settling Sub-Accounts; and make certain



technical corrections.

- Rule 58. Limitation on Liability

The Rule would be amended to specify that NSCC will not be liable for the acts, delays, omissions, bankruptcy, or insolvency of any AIP Non-Member Fund unless the Corporation was grossly negligent, engaged in willful misconduct, or in violation of federal securities laws for which there is a private right of action; and make clear that NSCC will not be responsible for the completeness or accuracy of any AIP data received from or transmitted to an AIP Member (including an AIP Fund Administrator with respect to any AIP Settling Sub-Account thereof), nor for any errors, omissions, or delays which may occur in the transmission of such AIP data to or from an AIP Member (including an AIP Fund Administrator with respect to any AIP Settling Sub-Account thereof).

- Addendum D (Statement of Policy; Envelope Settlement Service, Mutual Fund Services, Insurance and Retirement Processing Services and other Services Offered by the Corporation)

The Rule would be amended to make clear that settlement with respect to AIP Settling Sub-Accounts is not guaranteed and that NSCC will reverse any credit previously given to any AIP Member (including any AIP Settling Sub-Account) that is the contra-side to an AIP Member (including a contra-side AIP Settling Sub-Account) whose payment was not received by NSCC.

2. Statutory Basis.

NSCC believes that the proposed rule change is consistent with the requirements of the Act,

in particular Section 17A(b)(3)(F) of the Act.<sup>6</sup> Section 17A(b)(3)(F) of the Act, among other items, requires that NSCC's Rules be designed (i) to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions and (ii) to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. In recent months, NSCC has learned from fund administrators interested in becoming AIP Members that fund administrators generally do not control money settlement for their Fund clients. Within AIP, settlement of AIP Payments is the responsibility of AIP Members, including AIP Fund Administrators. This disconnect has impeded the adoption of AIP by the fund administrator community. The proposed rule change would allow AIP Payments to settle at the sub-account level, which would redirect responsibility for settlement of AIP Payments to the AIP Fund Administrator's designated Fund clients. Under the proposal, if an AIP Non-Member Fund fails to make its AIP Payment on Settlement Date, only the credit positions on the contra-side of the applicable AIP Settling Sub-Account would be reversed. The current AIP Rules require NSCC to reverse all of an AIP Fund Administrator's contra-side credit positions to the extent the AIP Fund Administrator fails to meet any portion of its daily AIP Payment balance. In allowing settlement at the sub-account level, NSCC would be fostering cooperation and coordination with fund administrators and Funds engaged in the clearance and settlement of alternative investment securities transactions and would be removing an impediment to the prompt and accurate clearance and settlement of alternative investment securities transactions. Therefore, NSCC believes that the proposed rule change is consistent with the Act, in particular, Section 17A(b)(3)(F)<sup>7</sup> of the Act.

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<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>7</sup> Id.

(B) Clearing Agency's Statement on Burden on Competition

NSCC does not believe that the proposed rule change would have any impact, or impose any burden, on competition because the ability to settle at the sub-account level is optional and available to all AIP Fund Administrators.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments relating to the proposed rule change have not yet been solicited or received. NSCC will notify the Commission of any written comments when received by NSCC.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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-NSCC-

2015-007 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-NSCC-2015-007. 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, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on NSCC's website at <http://www.dtcc.com/legal/sec-rule-filings>. 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-NSCC-2015-007 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>8</sup>

Brent J. Fields  
Secretary

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<sup>8</sup> 17 CFR 200.30-3(a)(12).