

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-93953; File No. SR-NSCC-2021-013)

January 11, 2022

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Provide for a Passive Acknowledgment Process, Codify Certain Settlement Processes, and Make Technical and Conforming Changes to the NSCC Rules & Procedures

I. INTRODUCTION

On November 18, 2021, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² proposed rule change SR-NSCC-2021-013. The proposed rule change was published for comment in the Federal Register on December 8, 2021.³ The Commission did not receive any comment letters on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. DESCRIPTION OF THE PROPOSED RULE CHANGE

NSCC proposes to modify its Rules and Procedures (“Rules”)⁴ in order to (i) provide for a passive acknowledgment process whereby any settling bank that does not timely acknowledge its intention to pay to or collect its settlement balance from NSCC), or refuse to settle for one or more members for which it is the designated settling

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 93709 (December 2, 2021), 86 Fed. Reg. 69687 (December 8, 2021) (SR-NSCC-2021-013) (“Notice”).

⁴ Capitalized terms not defined herein are defined in the Rules, available at <http://www.dtcc.com/legal/rules-and-procedures>.

bank and has not otherwise been in contact with NSCC, would be deemed to have acknowledged its settlement balances, (ii) amend the definition of AIP Settling Bank and remove AIP Settling Bank Only Member as a membership category, (iii) codify certain settlement processes, and (iv) make certain technical and conforming changes.

A. Current Settlement Process

NSCC membership consists of Members that have access to NSCC’s guaranteed central counterparty services and Limited Members that have access to NSCC’s non-guaranteed services, such as Mutual Fund Services and Alternative Investment Product Services (“AIP”).⁵ Limited Members that only have access to AIP are referred to as AIP Members.⁶ AIP Non-Member Funds are entities that are not AIP Members but that NSCC has approved to settle AIP Payments.⁷

NSCC provides two separate standardized, automated money settlement processes: (i) end of day settlement for Members and Limited Members other than AIP Members (“EOD Settlement”), and (ii) daily settlement for AIP Members and AIP Non-

⁵ See Section 2 of Rule 2, supra note 4.

⁶ Id.

⁷ See Rule 53, supra note 4. See also definition of “AIP Non-Member Fund” in Rule 1, id.

Member Funds (“AIP Settlement”).⁸ Each member⁹ designates a settling bank¹⁰ to settle its payment obligations with NSCC.¹¹ Money settlement is effected via the Federal Reserve Banks’ National Settlement Service (“NSS”).¹²

The Depository Trust Company (“DTC”) acts as NSCC’s Settlement Agent¹³ for both EOD Settlement and AIP Settlement. On a daily basis, NSCC calculates settlement

⁸ See Section 1 of Rule 12 and Section 7 of Rule 53, supra note 4. All AIP money settlement is effected on a gross basis, where on the applicable settlement date, AIP debits are collected first, and then all contra-side credits, where the corresponding debits have been collected, are paid. See Section 9 of Rule 55, supra note 4.

⁹ The use of “members” here refers to any participant that is required to appoint a Settling Bank or AIP Settling Bank, which includes Members, Limited Members including AIP Members, and AIP Non-Member Funds. See Section 1 of Rule 12 and Section 7(h) of Rule 53, supra note 4.

¹⁰ The use of “settling banks” here refers collectively to Settling Banks and AIP Settling Banks. Settling Banks settle on behalf of Members and Limited Members with respect to EOD Settlement and AIP Settling Banks settle on behalf of AIP Members and AIP Non-Member Funds with respect to AIP Settlement. See Section 1 of Rule 12 and Section 7(g) of Rule 53, supra note 4.

¹¹ See Section 1 of Rule 12 and Section 7(h) of Rule 53, supra note 4.

¹² See Section D.2 of Procedure VIII of NSCC’s Rules, supra note 4. For a general description of the NSS, see National Settlement Service, available at <https://www.frbservices.org/financial-services/national-settlement-service/index.html>.

¹³ “Settlement Agent” means the bank or trust company that NSCC may, from time to time, designate to act as its agent for purposes of receiving money settlement debit amounts from Settling Banks and participants and paying money settlement credit amounts to Settling Banks and participants. See Rule 1, supra note 4.

payment amounts for EOD Settlement¹⁴ and for AIP Settlement and reports to its members and their respective settling banks, a settlement balance.¹⁵

Once the settling banks receive the settlement balances, the settling banks must submit¹⁶ either (1) acknowledgment that they will settle their balances with NSCC, or (2) refusal to settle such amount on behalf of one or more of their respective members.¹⁷ The

¹⁴ For EOD Settlement, NSCC's settlement process is centralized with DTC's end-of-day money settlement ("DTC Settlement") through a netting procedure called a cross-endorsement, in which each participant's net debit at one organization is netted against its net credit at the other organization. See DTC's Settlement Service Guide, available at <https://www.dtcc.com/~//media/Files/Downloads/legal/service-guides/Settlement.pdf>.

¹⁵ For EOD Settlement, NSCC provides Settling Banks a net-net debit or net-net credit number, where "net-net" refers to the end-of-day net-net settlement balance for each Settling Bank that settles on behalf of more than one Member is the net of the net debit and net credit balances of all Members for which that Settling Bank settles, after cross-endorsement with DTC, including the Settling Bank's own settlement obligations as a Member if it settles for itself. See Section 2 of Rule 55, *supra* note 4; DTC's Settlement Service Guide, *id.* For AIP Settlement, NSCC provides each AIP Settling Bank an aggregate gross debit number and an aggregate gross credit number with respect to each AIP Member or AIP Non-Member Fund on whose behalf it settles. See Section 9 of Rule 55, *supra* note 4.

¹⁶ NSCC represents that, pursuant to its settlement procedures, AIP Settling Banks must affirmatively acknowledge or refuse to settle in the same manner as Settling Banks. See Notice, *supra* note 3, at 69688.

¹⁷ A Settling Bank that is a Member and settles solely for its own accounts may opt out of the requirement to acknowledge its settlement balances, which NSCC states is an operational convenience because the Settling Bank may not refuse to settle for itself. See Section D.1 of Procedure VIII, *supra* note 4; Notice, *supra* note 3, at 69690 (representing that because Members are required to also be DTC participants, the Settling Bank Member would be subject to DTC's rules, which prohibit a Settling Bank from refusing to settle for itself). The passive acknowledgment process would not apply to such NSCC Settling Banks that have chosen to opt out of the requirement to acknowledge its settlement balances. See Notice, *supra* note 3, at 69690.

acknowledgment or refusal submission occurs through a designated terminal system.¹⁸

For both EOD Settlement and AIP Settlement, if all of the NSCC Settling Banks submit acknowledgments of their intent to settle, then the Settlement Agent will submit the requisite file to the relevant Federal Reserve Bank (“FRB”) for processing through the NSS.¹⁹

If settling bank notifies the Settlement Agent that it refuses to pay the settlement balance for a member, then NSCC will exclude that member’s settlement balance and the Settlement Agent will provide the settling bank with a new settlement balance that no longer includes the excluded amount. The settling bank must then immediately send a message to the Settlement Agent acknowledging the new amount.²⁰ The Settlement Agent will then submit the requisite file to the FRB for processing through the NSS.

For EOD Settlement, the current deadline for Settling Banks to acknowledge or refuse net-net settlement balances is the later of 4:15 p.m. or 30 minutes after net-net settlement balances are made available to the Settling Bank.²¹ For AIP Settlement, the current deadline is 9:30 a.m. for debit acknowledgment or refusal and is 12:30 p.m. for credit acknowledgment or refusal.²² If a settling bank does not acknowledge or refuse by

¹⁸ See Section D of Procedure VIII of NSCC’s Rules, supra note 4.

¹⁹ See Section D.2 of Procedure VIII of NSCC’s Rules, supra note 4.

²⁰ See Section D.1 of Procedure VIII of NSCC’s Rules, supra note 4.

²¹ The net-net settlement balances are made available at approximately 3:45 p.m., and the NSS execution time for EOD Settlement is 4:30 p.m. See DTC’s Settlement Service Guide, supra note 14.

²² NSCC has posted AIP Settlement times on its website, which provide that AIP Settling Banks first pay debits to NSCC at approximately 11 a.m., and then NSCC pays credits to AIP Settling Banks at approximately 2 p.m. See NSCC’s

the applicable deadline, the Settlement Agent will use the most recent contact information available to contact the settling bank. If the Settlement Agent is unable to make contact or does not receive a response from the settling bank as to the acknowledgment or refusal, NSCC states that it must then determine whether to request an NSS extension while also determining whether to remove the settling bank's settlement balance from the NSS file.²³

Under the current process, a settling bank's failure to timely respond to the Settlement Agent after the Settlement Agent posts final settlement numbers creates uncertainty with respect to timely completion of settlement at NSCC. NSCC states that it designed the proposed rule change to address this issue, as discussed below.²⁴

B. Proposed Rule Change

NSCC proposes to establish an "Acknowledgment Cutoff Time" for EOD Settlement and an "AIP Acknowledgment Cutoff Time" for AIP Settlement after which NSCC would apply the passive acknowledgment process if it is unable to reach a settling bank. NSCC proposes that, since EOD Settlement is centralized with DTC Settlement,²⁵ the Acknowledgment Cutoff Time will be the Acknowledgment Cutoff Time established

Transaction Flows (as of 2021 – 01), available at <https://www.dtcc.com/wealth-management-services/alternative-investment-products/aip>.

²³ See Notice, supra note 3, at 69689.

²⁴ See id.

²⁵ See supra note 13.

by DTC in its Settlement Service Guide.²⁶ The “AIP Acknowledgement Cutoff Time” would be the later of (i) 30 minutes after the AIP Settling Bank has been notified of its AIP Debit Balance or AIP Credit Balance, and (ii) 30 minutes prior to the settlement deadline established by NSCC.²⁷

1. Passive Acknowledgement Process

If a settling bank (i) does not submit either (1) an acknowledgement that it would settle its settlement balance with NSCC, or (2) a refusal to pay the settlement balance, by the Acknowledgement Cutoff Time, and (ii) has not been in contact with the Settlement Agent,²⁸ then the Settlement Agent would attempt to contact the settling bank. This passive acknowledgement process would also apply in situations where the settling bank receives a new settlement balance after such settling bank’s refusal to pay a settlement balance for one or more members. Additionally, to facilitate the Settlement Agent’s ability to contact settling banks, NSCC proposes to revise the Rules to state that each settling bank must ensure that it maintains accurate contact details with the Settlement Agent so that the Settlement Agent may contact the settling bank regarding this settlement process and any settlement issues.

If the settling bank cannot be reached, then the settling bank would be deemed to have acknowledged that it will settle such settlement amounts with NSCC. The settling

²⁶ See DTC’s Settlement Service Guide, supra note 14. See also supra text accompanying note 21.

²⁷ See supra note 22 and accompanying text. NSCC also proposes to add a statement to its Rules that it would post the settlement deadlines for AIP Settlement on the NSCC Website as it currently does.

²⁸ Passive acknowledgment will not apply if the Settling Bank has notified the Settlement Agent that it cannot yet acknowledge or refuse its settlement balance.

bank's settlement balance will then, in the ordinary course of settlement processing, be debited from or credited to its FRB account through the NSS process along with the other settling banks.

2. Definition of "AIP Settling Bank"

NSCC proposes to amend the definition of AIP Settling Bank to mirror the definition of Settling Bank and remove AIP Settling Bank Only Member as a membership category. NSCC represents that, since the inception of AIP, there have been no AIP Members that have acted as AIP Settling Banks and there have been no entities that have become AIP Settling Bank Only Members.²⁹ In addition, NSCC proposes to maintain a list of Members and Settling Bank Only Members that have agreed to act as AIP Settling Banks.

3. Certain Settlement Processes

NSCC proposes to retain its discretion to remove the settling bank's settlement balance from the NSS file if: (1) passive acknowledgement does not apply because the settling bank has notified the Settlement Agent that it cannot yet acknowledge or refuse its settlement balance, and (2) the payment deadline (i.e., the time by which it must execute settlement via the NSS)³⁰ established by NSCC is approaching. According to NSCC, its discretion in this circumstance would facilitate timely processing of the NSS file for the other settling banks.³¹

²⁹ See Notice, supra note 3, at 69691.

³⁰ See supra notes 21-22.

³¹ See Notice, supra note 3, at 69693.

In addition, NSCC proposes to codify in its Rules certain AIP Settlement procedures, which mirror EOD Settlement procedures.³² NSCC will maintain that (i) DTC will act as Settlement Agent for NSCC and the AIP Settling Banks, and (ii) the AIP acknowledgment³³ or refusal submission will occur through a designated terminal system.³⁴ NSCC will also maintain that AIP Settling Bank that cannot send an acknowledgment or refusal message may contact the Settlement Agent and instruct the Settlement Agent to act on its behalf.

4. Technical and Conforming Changes

NSCC proposes to make certain technical and conforming changes to the Rules to enhance clarity. First, NSCC proposes to revise the Rules to add new defined terms, including (i) “Acknowledgment Cutoff Time,” (ii) “AIP Acknowledgment Cutoff Time,” (iii) “FRB,” (iv) “FRBNY,” (v) “Settlement Balances,” and (vi) “Settlement Members.”³⁵ Second, NSCC proposes to revise certain terms to reflect the appropriate existing defined term, including “AIP Debit Balance,” “AIP Credit Balance,” and “AIP Refusal.”³⁶ Third, NSCC proposes to replace certain references to the “Corporation” with “Settlement Agent” for accuracy and consistency and to clarify the role of the Settlement Agent under

³² See supra note 16.

³³ This requirement will also apply to an AIP Settling Bank’s acknowledgment of new settlement balances following an initial refusal.

³⁴ See supra text accompanying note 18.

³⁵ See Notice, supra note 3, at 69691-93.

³⁶ See id. at 69692-93.

the relevant Rules.³⁷ Fourth, NSCC proposes to add “or the Settlement Agent” in certain provisions to clarify to role of both NSCC and the Settlement Agent in establishing settlement procedures.³⁸ In addition, NSCC proposes to remove outdated references to NSCC, the telephone, and a phone number to reflect the current process in which the settling bank may contact the Settlement Agent and to move certain current subsections and to revise the subsection numbers in the relevant Rules to enhance clarity and accuracy.³⁹

III. DISCUSSION AND COMMISSION FINDINGS

Section 19(b)(2)(C) of the Act⁴⁰ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NSCC. In particular, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act⁴¹ for the reasons described below.

³⁷ See id.

³⁸ See id. See also, Notice cited supra note 17 Notice, supra note 3, at 69690 (representing that because Members are required to also be DTC participants, the Settling Bank Member would be subject to DTC’s rules, including its settlement procedures).

³⁹ See id. at 69692-93.

⁴⁰ 15 U.S.C. 78s(b)(2)(C).

⁴¹ 15 U.S.C. 78q-1(b)(3)(F).

Section 17A(b)(3)(F) of the Act requires, in part, that the rules be designed to promote the prompt and accurate clearance and settlement of securities transactions.⁴² As stated in Section II.A (Background) above, the failure of a settling bank to timely acknowledge that it will settle its settlement balance with NSCC or refuse to pay its settlement balance creates uncertainty with respect to the timely completion of EOD Settlement and AIP Settlement at NSCC. Additionally, as discussed in Section II.B.3 (Certain Settlement Processes) above, circumstances in which a settling bank has notified the Settlement Agent that it cannot yet acknowledge or refuse its settlement balance could create uncertainty with respect to the timely completion of EOD Settlement and AIP Settlement at NSCC via NSS because NSCC would not be able to submit the NSS file that includes the balance of the settling bank that has neither passively nor affirmatively acknowledged its settlement balance.

The introduction of a passive acknowledgement process, in which a settling bank has not responded by the Acknowledgment Cutoff Time or the AIP Acknowledgment Cutoff Time and cannot be reached by the Settlement Agent would be deemed to have passively acknowledged its settlement balance, could enhance settlement certainty because it would allow NSCC to submit the NSS file for settlement of all settling banks' obligations despite an unresponsive settling bank. Additionally, the change to allow NSCC to exclude a settling bank's balance from the NSS file, where the settling bank has notified the Settlement Agent that it cannot yet acknowledge or refuse its settlement balance, would allow NSCC to submit the NSS file without the settling bank's balance and thus complete EOD Settlement or AIP Settlement, as applicable, for all other settling

⁴² Id.

banks. Therefore, the Commission believes the changes are designed to promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.⁴³

Further, as discussed throughout Section II.B (Proposed Rule Change) above, the proposal to amend the definition of AIP Settling Bank and remove AIP Settling Bank Only Members as a membership category, codify certain existing AIP settlement processes, and make certain technical and conforming changes should ensure that the Rules are clear and accurate to NSCC's members. Having clear and accurate Rules should facilitate NSCC members' understanding of those rules and provide members with increased predictability and certainty regarding their obligations. Therefore, the Commission believes the proposed changes would also promote the prompt and accurate clearance and settlement of securities, consistent with Section 17A(b)(3)(F) of the Act.⁴⁴

IV. CONCLUSION

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and, in particular, with the requirements of Section 17A of the Act⁴⁵ and the rules and regulations promulgated thereunder.

⁴³ Id.

⁴⁴ Id.

⁴⁵ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act⁴⁶ that proposed rule change SR-NSCC-2021-013, be, and hereby is, APPROVED.⁴⁷

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁸

J. Matthew DeLesDernier
Assistant Secretary

⁴⁶ 15 U.S.C. 78s(b)(2).

⁴⁷ In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴⁸ 17 CFR 200.30-3(a)(12).