## 1. Text of the Proposed Rule Change

(a) Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] National Securities Clearing Corporation ("NSCC") is filing with the Securities and Exchange Commission ("Commission") a proposed rule change to amend the NSCC Rules & Procedures ("Rules") concerning the receipt of securities from NSCC's Continuous Net Settlement system ("CNS") to improve the overall clarity of NSCC's Rules concerning CNS long allocations. The proposed modifications to the Rules are shown in Exhibit 5.[3]

(b) Not applicable.

(c) Not applicable.

## 2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by a Deputy General Counsel of NSCC on December 18, 2024, pursuant to delegated authority from NSCC's Board of Directors.

## 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

The purpose of this proposed rule change is to amend the NSCC Rules concerning the receipt of securities from CNS to improve the overall clarity of NSCC's Rules concerning CNS long allocations, particularly during the night cycle.

**Background**

*Continuous Net Settlement System (CNS)*

CNS is an automated accounting and securities settlement system that centralizes and nets the settlement of compared and recorded securities transactions and maintains an orderly flow of security and money balances.[4] CNS provides clearance for equities, corporate bonds, unit investment trusts, and municipal bonds that are eligible for book-entry transfer at The Depository Trust Company ("DTC"), an affiliate of NSCC.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Capitalized terms not defined herein shall have the meaning assigned to such terms in the Rules, available at www.dtcc.com/legal/rules-and-procedures.

4 See NSCC Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation), supra note 3.

Within CNS, all eligible compared and recorded transactions for a particular settlement date are netted by issue into one position per Member. The position can be net long (buy), net short (sell) or flat. As a continuous net system, those positions are further netted with positions of the same issue that remain open after their original scheduled settlement date (usually one business day after the trade date or T+1), so that transactions scheduled to settle on any day are netted with fail positions (i.e., positions that have failed in delivery or receipt on the settlement date), which results in a single deliver or receive obligation for each Member for each issue in which the Member has activity.

NSCC Procedure VII (CNS Accounting Operation) describes the receipt and delivery of CNS Securities. CNS relies on an interface with DTC for the book-entry movement of securities. CNS short positions are compared against Members' DTC accounts to determine the availability of securities for delivery. If securities are available, they are transferred from the Member's account at DTC to NSCC's account at DTC to cover the Member's short obligations to CNS. In contrast, the allocation of CNS long positions to receiving Members is generally processed in an order determined by an algorithm built into the system. CNS long positions are allocated to Members as the securities are received by NSCC (i.e., CNS long positions are transferred from the NSCC account at DTC to the accounts of NSCC Members at DTC, in accordance with the algorithm).

For CNS Securities, NSCC uses a modified delivery versus payment mechanism in that when a Member delivers securities to CNS, the Member receives a credit, and when NSCC delivers securities to the long receiving Member (a long allocation), the securities deliveries/movements are not final until the "effective time" occurs pursuant to NSCC Rule 12 (Settlement).[5] Specifically, under the Rules, a CNS delivery transaction is complete and final as to the delivering Member once the securities are debited from the delivering Member's account at DTC and credited to NSCC's CNS account at DTC; however, a CNS delivery transaction does not become final as to the receiving "long" Member until the "effective time."

*Current Allocation Algorithm*

The CNS automatic delivery process occurs in two cycles: the "night cycle," which typically begins the night before settlement date, and the "day cycle," which occurs on settlement date. NSCC employs an algorithm for each cycle to determine the order in which Members with long allocations receive positions from CNS. Members can also submit priority requests that override NSCC's algorithm when they have special needs to receive securities owed to them

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[5] Pursuant to NSCC Rule 12, the "effective time" generally occurs when it is clear that NSCC has either been paid, or is in a credit position with respect to a Member or its Settling Bank, and NSCC has no obligation due with respect to a Member pursuant to the Clearing Agency Cross-Guaranty Agreement. Until the effective time has occurred in accordance with the Rules, NSCC retains ownership rights in the long allocations. See NSCC Rule 12, supra note 3. DTC and NSCC have established certain limited cross-guarantees and arrangements to permit transactions to flow smoothly between DTC and NSCC in a collateralized environment. See DTC Settlement Service Guide, at 17-18, available at www.dtcc.com/legal/rules-and-procedures.

(e.g., the security is undergoing a corporate action, or the Member has an urgent customer delivery). These priority requests can be submitted for the night cycle, the day cycle, or both.

The algorithm which governs the allocation of long positions is based on priority groups in descending order, which include the following: (i) long positions in a CNS Reorganization Sub-Account;[6] (ii) long positions against which Buy-In Intent[7] notices are due to expire that day but which were not filled the previous day; (iii) long positions against which Buy-In Intent notices are due to expire the following day; (iv) long positions against the component securities of index receipts (i.e., exchange-traded funds); and (v) in descending sequence, priority levels as specified by Standing Priority Requests and as modified by Priority Overrides.[8]

The allocation algorithm for the night and day delivery cycles is computed separately to allow for different allocation factors used for the night and day cycles as well as the Standing Priority Requests and Priority Overrides, which may have specified different levels of priority for the night and day cycles.

For the day cycle only, when more than one long position in a given security exists within the same priority group, the "oldest" position is allocated first,[9] and when more than one long position in a given security exists within the same priority group, all of which have been long the same number of consecutive days, the allocation rank is determined by a computer-generated random number. Random numbers, which change daily, are computed so that each Member's random number is different for each security.

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6 In the event of a Voluntary Reorganization for a CNS security, a Member with a long position in the subject security may instruct NSCC to provide protection for their long position by moving such long position into a CNS Reorganization Sub-Account. A long position in a subject security in a CNS Reorganization Sub-Account has the highest priority for CNS allocation. See NSCC Procedure VII, Section H.4., supra note 3.

7 In the event a Member has a Long Position in a CNS Security, the Member may demand immediate delivery thereof by submitting a Buy-In Intent. The Member is then given priority for CNS allocation, as set forth in NSCC Procedure VII. See NSCC Rule 11, Section 7, supra note 3.

8 A Standing Priority Request is a request to move the Member's long positions in all securities to a higher rank in the allocation formula every day and remains in effect until canceled or changed by the Member in writing. A Priority Override is an instruction to either override a Member's previously submitted Standing Priority Request or to obtain priority when it has not submitted a Standing Priority Request. Each Priority Override changes the Member's relative rank in the allocation algorithm for its long position in one security only and remains in effect for one day. Standing Priority Requests and Priority Overrides can be submitted for the night cycle only, the day cycle only, or for both the night and day cycles. See NSCC Procedure VII, Section E.1. and E.2., supra note 3.

9 Age is defined as the number of consecutive days during which the position has been long, irrespective of quantity. See NSCC Procedure VII, Section E.4., supra note 3.

For the night cycle, CNS long positions within the same priority group may be further allocated by processes at DTC, which are designed to optimize the number of transactions processed for settlement, (hereinafter referred to as "Settlement Optimization" generally or the "Night Batch Process" [10] with respect to the DTC rules).[11] An algorithm developed for the Night Batch Process evaluates each DTC Participant's available positions and risk management controls, and identifies the transaction processing order that optimizes the number of transactions processed for settlement.[12] At the start of the night cycle, DTC subjects available transactions for processing to the Night Batch Process, which is run in an ''offline'' batch that is not visible to Participants, allowing DTC to run multiple processing scenarios until the optimal processing scenario is identified. The results of the Night Batch Process are incorporated back into DTC's core processing environment on a transaction-by-transaction basis. Transactions that do not process in the night cycle are entered into processing for the day cycle.

**Re-evaluation of Settlement Optimization**

Following the recent shortening of the settlement cycle from two business days after trade date (''T+2'') to one business day after trade date (''T+1'')[13] and in consideration of the ongoing efforts by NSCC and DTC to modernize their systems, DTC has reevaluated the operation of its Night Batch Process and determined that greater flexibility in the application of Settlement Optimization processes is necessary to reflect DTC's settlement practices.

With the move to a T+1 settlement cycle, NSCC and DTC have observed an increase in the number of systemic issues relating to Settlement Optimization. These issues have been precipitated in significant part by downstream impacts of processing delays associated with the compressed operational and processing timelines for DTC, NSCC, and their respective participants under the T+1 settlement cycle. The issues have been exacerbated by the rigid and outdated technical platform and functionality on which the DTC Night Batch Process operates. The result has been various processing delays that have required DTC to bypass the Night Batch

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[10] DTC's Night Batch Process is discussed in the DTC Settlement Service Guide. See DTC Settlement Service Guide, supra note 5, at 66.

[11] NSCC and DTC adopted rules to implement Settlement Optimization in January 2020. See Securities Exchange Act Release Nos. 87023 (Sept. 19, 2019), 84 FR 50532 (Sept. 25, 2019) (SR-NSCC-2019-002); 87755 (Dec. 16, 2019), 84 FR 70258 (Dec. 20, 2019) (SR-NSCC-2019-005); 87022 (Sept. 19, 2019), 84 FR 50541 (Sept. 25, 2019) (SR-DTC-2019-005); and 87756 (Dec. 16, 2019), 84 FR 70256 (Dec. 20, 2019) (SR-DTC-2019-012).

[12] See DTC Settlement Service Guide, supra note 5, at 66.

[13] See Securities Exchange Act Release No. 96930 (Feb. 15, 2023), 88 FR 13872 (Mar. 6, 2023) (S7-05-22) (Shortening the Securities Transaction Settlement Cycle). See also Securities Exchange Act Release No. 100048 (May 2, 2024), 89 FR 38929 (May 8, 2024) (SR-NSCC-2024-002).

Process, in favor of other standard processes, from time to time, in order continue night cycle processing for both NSCC and DTC.

As a result of these considerations, DTC has filed a proposed rule change with the Commission to provide greater flexibility on how settlement processing can operate, which better reflects DTC's settlement processing practices.[14] DTC's proposed rule change would, among other things, remove references to and descriptions of the Night Batch Process and replace it with text that provides (i) more flexibility regarding the application of its Settlement Optimization processes and (ii) more clarity around DTC's settlement cycles and the processes run during those cycles, all of which better reflect current settlement processing at DTC.

In light of DTC's proposed rule change, NSCC also proposes conforming changes to its Rules to provide additional clarity regarding the CNS allocation methodologies used in both the night and day cycles, particularly in scenarios where Settlement Optimization processes may or may not be run during the night cycle.

**Proposed Changes**

NSCC proposes to revise Section E.4. of Procedure VII concerning the algorithms governing the allocation of long positions in CNS to provide additional clarity regarding the allocation algorithms used during the night and day cycles, including how night cycle allocations are performed with and without the Settlement Optimization process.

NSCC proposes to revise the beginning of Section E.4. of Procedure VII to clarify that the algorithm governing the initial allocation of CNS long positions for both the day and night cycle is based on the following priority groups in descending order: (i) long positions in a CNS Reorganization Sub-Account; (ii) long positions against which Buy-In Intent notices are due to expire that day but which were not filled the previous day; (iii) long positions against which Buy-In Intent notices are due to expire the following day; (iv) long positions against the component securities of index receipts; and (v) in descending sequence, priority levels as specified by Standing Priority Requests and as modified by Priority Overrides, as currently set forth in the NSCC Rules. NSCC would also update the Rules to include a defined term for these "Priority Groups." In addition, NSCC would add rule text to clarify that the results of the initial allocation based on the Priority Groups may be subject to further allocations depending on whether results are processed in the night or day delivery cycles. NSCC would also relocate certain language, with non-substantive clarifying and drafting revisions, which explains that the allocation algorithms for the night and day delivery cycles are computed separately to allow for different allocation factors that may be used in the cycles as well as Standing Priority Requests and Priority Overrides, which may specify different levels of allocation priority for the night and day cycles.

NSCC also proposes to create a new subsection of Section E.4. of Procedure VII to specifically discuss the night cycle allocation process. The proposed rule change would clarify that, during the night cycle, long positions are first allocated by the Priority Groups set forth

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14 See DTC proposed rule change filing SR-DTC-2024-016.

above. The proposed rule change would also provide that long positions may then be further allocated through processes used by the Designated Depository (i.e., DTC), which may include processes designed to optimize the number of transactions processed for settlement. The proposed rule change would also clarify, however, that in the event that DTC does not run an optimization process during the night cycle, long positions would be allocated using the same allocation algorithm used during the day cycle.

Finally, NSCC also proposes to create a new subsection of Section E.4. of Procedure VII to specifically discuss the day cycle allocation process. This new subsection would further clarify that, during the day cycle, long positions are allocated based on the Priority Groups discussed above and may be further allocated based upon the age of position within a Priority Group. It would also include existing rule text, with minor, non-substantive drafting modifications, that describes how positions are further allocated based upon the age of position within a Priority Group and random numbers within age groups during the day cycle.

(b) Statutory Basis

NSCC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. Section 17A(b)(3)(F) of the Act[15] requires that the rules of a clearing agency be designed to, among other things, promote the prompt and accurate clearance and settlement of securities transactions. NSCC believes the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F) of the Act for the reasons stated below.

The proposed rule change would modify the NSCC Rules to provide additional clarity concerning the CNS allocation algorithms used during the night and day cycles. In particular, the proposed rule change would more comprehensively describe the CNS allocation process used during the night cycle in circumstances where (i) DTC may employ Settlement Optimization processes or (ii) DTC may use its more standard settlement process, to facilitate prompt and accurate settlement. In this way, the proposed rule change would provide greater transparency to Members with regard to the use of Settlement Optimization processes and existing settlement practices at NSCC and DTC. For these reasons, NSCC believes the proposed rule change would continue to promote the prompt and accurate clearance and settlement of securities transactions in accordance with Section 17A(b)(3)(F) of the Act.[16]

## 4. Self-Regulatory Organization's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act[17] requires that the rules of the clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the Act. NSCC does not believe the proposed rule change would present a burden on competition. The proposed rule change is intended to provide for a more comprehensive discussion of the application of the

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15 15 U.S.C. 78q-1(b)(3)(F).

16 Id.

17 15 U.S.C. 78q-1(b)(3)(I).

allocation algorithms used during the night and day cycles and provide additional clarity concerning how night cycle allocations operate with and without the Settlement Optimization process. As noted in Section E of Procedure VII, the CNS allocation process is designed so as not to benefit any one Member over another. The general algorithm governing the allocation of long positions is based on priority groups set forth in the Rules, which apply equally to all Members, and includes Standing Priority Requests and Priority Overrides, which are available to all Members. For the night cycle in particular, long positions may be further allocated through special processing employed by DTC, which is designed to optimize the number of transactions processed for settlement. As a result, the CNS long allocation process, both with and without Settlement Optimization, is designed in a manner that does not favor any particular Member over another. Moreover, the proposed rule change is simply intended to provide further clarity and transparency around the use of these existing processes. NSCC therefore believes the proposed rule change would not present any burden on competition.

## 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

NSCC has not received or solicited any written comments relating to this proposal. If any written comments are received by NSCC, they will be publicly filed as an Exhibit 2 to this filing, as required by Form 19b-4 and the General Instructions thereto.

Persons submitting comments are cautioned that, according to Section IV (Solicitation of Comments) of the Exhibit 1A in the General Instructions to Form 19b-4, the Commission does not edit personal identifying information from comment submissions. Commenters should submit only information that they wish to make available publicly, including their name, email address, and any other identifying information.

All prospective commenters should follow the Commission's instructions on how to submit comments, available at https://www.sec.gov/regulatory-actions/how-to-submit-comments. General questions regarding the rule filing process or logistical questions regarding this filing should be directed to the Main Office of the Commission's Division of Trading and Markets at tradingandmarkets@sec.gov or 202-551-5777.

NSCC reserves the right not to respond to any comments received.

## 6. Extension of Time Period for Commission Action

Not applicable.

**7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

(a) The proposed rule change is to take effect immediately upon filing pursuant to Section 19(b)(3)(A) of the Act[18] and Rule 19b-4(f)(4)[19] thereunder.

(b) The proposed rule change would effect a change in an existing settlement service of NSCC that (i) does not adversely affect the safeguarding of securities or funds in the custody or control of NSCC or for which it is responsible and (ii) does not significantly affect the respective rights or obligations of NSCC or persons using the service.

The proposed rule change would not adversely affect the safeguarding of securities or funds in the custody or control of NSCC or for which it is responsible. The proposed rule change is intended to provide a more complete and accurate discussion of the allocation algorithms used during the night and day cycles and would provide additional clarity concerning how night cycle allocations may operate with and without the Settlement Optimization process. The proposed rule change would simply provide further clarity and transparency around these existing processes.

The proposed rule change also would not significantly affect the respective rights or obligations of NSCC or users of NSCC's services. As discussed above, transactions that do not process in the night cycle are entered into processing for the day cycle, and CNS transactions are generally expected to settle by the end of the scheduled settlement date, whether or not processed in the night or day cycles. Furthermore, as noted above, the proposed rule change is simply intended to provide further clarity around these existing processes.

For these reasons, NSCC believes that the proposed rule change would not adversely affect the safeguarding of securities or funds in the custody or control of NSCC or for which it is responsible or significantly affect the respective rights or obligations of NSCC or persons using the service, consistent with Rule 19b-4(f)(4)(i).[20]

(c) Not applicable.

(d) Not applicable.

**8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

Not applicable.

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18 15 U.S.C. 78s(b)(3)(A).

19 17 CFR 240.19b-4(f)(4).

20 17 CFR 240.19b-4(f)(4)(i).

**9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act**

Not applicable.

**10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing, and Settlement Supervision Act of 2010**

Not applicable.

**11. Exhibits**

Exhibit 1 – Not applicable.

Exhibit 1A – Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 – Not applicable.

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the Rules.