

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53742; File No. SR-NSCC-2006-04)

April 28, 2006

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to Trade Submission Requirements and Fees and Pre-Netting

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> notice is hereby given that on March 15, 2006, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on March 22, 2006, amended the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

NSCC is seeking to: (1) require that all locked-in trade data submitted to NSCC for trade recording be submitted on a real-time basis; (2) prohibit pre-netting and other practices that prevent real-time trade submissions; and (3) establish a new fee model for equity trade recording and netting services.

II. Self-Regulatory Organization’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 change. The text of these statements may be examined at the places specified in Item IV

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>2</sup>

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Real-Time Trade Submission

NSCC processes approximately 25 million transaction sides per day with a gross value of nearly \$500 billion.<sup>3</sup> These transactions are submitted primarily on a locked-in basis by self-regulatory organizations ("SROs") (such as the New York Stock Exchange, American Stock Exchange, Nasdaq Stock Market Inc., and the regional exchanges) and Qualified Special Representatives ("QSRs"). Generally a QSR is a member that (i) operates an automated execution system where the member is always the contra side to every trade, (ii) has a parent corporation or an affiliated corporation that operates an automated execution system where the member is always the contra side to every trade, or (iii) clear for a broker-dealer that operates an automated execution system where the broker-dealer is always the contra side to every trade and the subscribers to the system enter into an agreement with the broker-dealer and the member that acknowledges the member's role in the clearance and settlement of trades executed on the system.<sup>4</sup>

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<sup>2</sup> The Commission has modified the text of the summaries prepared by NSCC.

<sup>3</sup> Data based upon second quarter, 2005, volumes.

<sup>4</sup> The remaining original trade data received by NSCC is submitted by members for trade comparison and consists of OTC equity trades and OTC fixed income trades submitted through the Fixed Income Clearing Corporation ("FICC") Real-Time Trade Matching System. In 2005, an average of approximately 43,000 equity and fixed income sides per day were submitted to NSCC for trade comparison.

The New York Stock Exchange, the American Stock Exchange, and The Nasdaq Stock Market Inc. currently submit trades executed on their respective markets to NSCC on a real-time basis. Archipelago Exchange is scheduled to begin submitting locked-in trades on a real-time basis before the end of 2006. Accordingly, before the end of 2006, more than 70% of the trades submitted to NSCC for trade recording will be submitted on a real-time basis. However, the remaining regional exchanges and most of the QSRs currently submit their trades either on a multi-batch or end-of-day basis. NSCC understands that some of these exchanges and QSRs are in the process of developing real-time trade submission capabilities.

The proposed rule change would modify NSCC's Procedure II (Trade Comparison and Recording Service) to require that all locked-in trades submitted for trade recording by SROs and QSRs be submitted on a real-time basis.<sup>5</sup> The term "real-time" when used with respect to trade data submission will be defined in Procedure XIII (Definitions) as the submission of trade data on a trade-by-trade basis promptly after trade execution in any format and by any communication method acceptable to NSCC.<sup>6</sup>

This requirement will reduce systemic risk for a number of reasons, including the following:

- (1) **Business Continuity.** Requiring real-time submission of locked-in trade data reduces operational risk and promotes

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<sup>5</sup> NSCC is not at this time modifying Procedure III (Trade Recording Service (Interface Clearing Procedures)), so files submitted to NSCC by The Options Clearing Corporation relating to option exercises and assignments will not be required to be submitted on a real time basis. OCC's process of assigning option assignments is and will continue to be an end-of-day process.

<sup>6</sup> As part of the proposal, Addendum N (Interpretation of the Board of Directors: Locked-In Data From Qualified Special Representatives) would be deleted as it would no longer be relevant.

business continuity by promoting safe storage of transaction data at the clearing agency level. Without real-time submission, should an event occur after trade execution that disrupts trade input, submission of trade data could be significantly delayed or trade data could be lost.

(2) Straight through processing. Real-time trade submission promotes straight through processing and will support the movement by the securities industry to shortened settlement cycles.

(3) Risk Mitigation. Receipt of trade data on a real-time basis permits NSCC's Risk Management staff to begin analysis of trades earlier and thereby monitor members' market risks as they evolve during the trading day.

(4) Trade Reconciliation. Receipt of trade data on a real-time basis will enable NSCC to record and report to its members trade data earlier in the day thereby promoting intraday reconciliation of transactions at the member level.

## 2. Prohibition of Pre-Netting and Clarification of Correspondent Clearing Service

In order to effectively move to a real-time trade input environment, practices that prevent real-time submission would also be prohibited. Among such practices that NSCC has identified are the practice of "pre-netting" and the inappropriate use of its Correspondent Clearing Service. A review of QSR trade practices indicates that certain QSRs "pre-net" trades before they submit trade data to NSCC on a locked-in basis. Pre-netting is done on a bilateral basis between a QSR and its customer, both NSCC members. In addition, any pre-netting practices, whether being "summarization" (combining like-sided trades by executing/correspondent broker), "compression" (combining like-sided trades by clearing broker), netting, or any other practice that combines two or more trades prior to their submission to NSCC, prevent the submission to NSCC of transactions on a trade-by-trade basis and cause submitting firms to delay submission of their trades. Delayed submission of trade data creates business continuity risk for members

and their users and settlement risk for NSCC should some event occur that subsequently disrupts trade input and prevents NSCC from monitoring market risks as they evolve during the trading day. For these reasons, NSCC is proposing to require real-time trade submission and to prohibit pre-netting activity by members submitting trade data on a locked-in basis.<sup>7</sup>

Accordingly, NSCC proposes to amend Rule 7 (Comparison and Trade Recording Operation) to make clear that locked-in trade data from SROs and QSRs must be submitted on a trade-by-trade basis in the original form in which the trades are executed and to make clear that pre-netting is prohibited.<sup>8</sup>

For these same reasons, NSCC is modifying its Procedure IV (Special Representative Service) to clarify its appropriate use. The Special Representative Service (the Correspondent Clearing Service of the Special Representative Service in particular) is designed to provide an automated vehicle by which a member, acting as a Special Representative, may “move” a trade that is in the process of being cleared and settled at NSCC to the account of another member (its correspondent) on whose behalf the trade was executed. For example, Member A sells securities for Member B (Member A’s correspondent) on the NYSE. The transaction is submitted to NSCC by the NYSE. As a result, Member A has a CNS obligation to deliver the shares sold.

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<sup>7</sup> The Commission has approved a proposed rule change filed by FICC that allowed FICC to adopt a similar requirement. Securities Exchange Act Release No. 51908 (June 22, 2005), 70 FR 37450 (June 29, 2005). See FICC GSD Rules 11 (Netting System), Section 3 (Obligation to Submit Trades) and 18 (Special Provisions For Repo Transactions), Section 3 (Collateral Substitution).

<sup>8</sup> Trades executed in the normal course of business between a clearing member and its correspondent or between correspondents of the clearing member, which correspondent(s) is not itself a member and settles such obligations through such clearing member (“internalized trades”) are not required to be submitted to NSCC and shall not be considered to violate the “pre-netting” prohibition.

Acting as Special Representative for Member B, its correspondent, Member A then submits new transaction data to NSCC showing itself as a buyer of the securities and Member B, its correspondent, as the seller. As a result, the Special Representative, Member A, nets out in the CNS System, and Member B, the correspondent, has a CNS obligation to deliver. In other words, the service provides a method whereby the correspondent's obligation can be substituted for that of the Special Representative.<sup>9</sup>

The Correspondent Clearing Service was not designed as a mechanism to permit a Special Representative, acting as a QSR or otherwise, to submit original locked-in trade data. Therefore, NSCC is not requiring that Special Representative/Correspondent Clearing input be submitted on a real-time, trade for trade basis. Furthermore, the rule change adds language to Procedure IV to make it clear that the Correspondent Clearing Service is limited to position movements only and may not be used to submit original locked-in trade data.

### 3. Technical Clarifications

At this time, as part of updating its Rules and Procedures relative to the Trade Recording and Special Representative Services, NSCC is proposing to also make certain technical corrections, clarifications, and organizational changes. These include the following:

- (1) moving the definitions of "Special Representative," "Qualified Special Representative," and "Index Receipt Agent" from Rule 39 to Rule 7 (where these terms are first used) and titling Rules 7 and 39 accordingly;
- (2) amending Procedure II to (i) clarify the procedures NSCC uses to confirm locked-in trade data (as opposed to editing and comparing trades submitted for comparison directly by members) and (ii) add back language relating to receipt of locked-in trade

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<sup>9</sup> This is generally referred to as a "position movement" to distinguish it from an actual trade.

data from QSRs that was erroneously deleted in File No. SR-NSCC-2003-12;<sup>10</sup> and

(3) amending the definition of “Registered Clearing Agency” in Rule 1 (Definitions) to include an entity that provides electronic trade confirmation or central matching services pursuant to an exemption from registration and to make corresponding changes to applicable cross-references.

#### 4. New Fee Model

In conjunction with the implementation of the real-time trade submission requirement, NSCC plans to implement a new fee model to address certain economic factors that it believes have influenced firms’ trade submission practices described above. The proposed new fee model is designed to respond to trading activity trends, to mitigate the anticipated impact of the proposed real-time submission requirement, and to realign fees with service benefits. The scope of the new fee model includes revised fees for equity Trade Recording, Correspondent Clearing, and Flip Trades, and a new fee structure for trade clearance (i.e., Netting Fee).

The relevant portion of NSCC’s proposed revised fee structure is set forth below. Language proposed to be added is underlined, and language proposed to be deleted is in brackets.

#### Addendum A

#### National Securities Clearing Corporation

#### Fee Structure

#### I. Trade Comparison and Recording Service Fees

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<sup>10</sup> Securities Exchange Act Release No. 48141 (July 8, 2003), 68 FR 42153 (July 16, 2003) [File No. SR-NSCC-2003-12].

C. Trade recording fees will be charged as follows on those items originally compared by other parties, but cleared through the Corporation:<sup>11</sup>

1. Each side of each stock, warrant or right item entered for settlement, but not compared by the Corporation – [\$0.0015 per 100 shares, with a minimum fee of \$0.0045 and a maximum fee of \$0.09] the sum of a) a fixed fee of \$0.0025, and b) a fee of \$0.0006 per 100 shares, with a minimum fee of \$0.0006 per 100 shares and a maximum fee of \$0.60 per 100,000 shares being applicable.
2. Each side of each bond item entered for settlement, but not compared by the Corporation - \$1.00 per side.
3. Each side of a foreign security trade entered for settlement, but not compared by the Corporation - \$.75 per side.

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II. TRADE CLEARANCE FEES - represents fees for netting, issuance of instructions to receive or deliver, effecting book-entry deliveries, and related activity.

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E. Trade Netting [Clearance (netting)] – The sum of \$[.007] .003 per side, plus 1) a “value into the net” fee of \$.19 per million dollars of processed value (i.e. for CNS and Balance Order netting, the sum of the contract amount and any CNS fail value), and 2) a “value out of the net” fee of \$.69 per million dollars of settling value (i.e. the absolute value of the CNS Long and Short Positions).

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<sup>11</sup> Trade Recording Fees will be charged for all OCS and IDC input except for sides originally submitted correctly to the Corporation’s comparison system.

- F. Designated valued deliveries<sup>12</sup> (transaction processing) entered into the clearance system through special representative procedures - \$[.05] .0125 per side.
- G. Flip Trades - \$[.005] .0025 per side.

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These proposed fee changes are the result of an extensive analysis of the business practices, rules, fee structure, and the associated revenue flows for NSCC's clearing services. The current clearing fee schedule has a legacy that fundamentally dates back more than two decades and is primarily based on a transaction count. The bias towards transaction counting has led to a disproportionate growth in revenues as transaction activity has grown. In addition, analysis of transaction input shows a clear trend over time to smaller trade sizes. This trend is a function of decimalization, increased algorithmic trading activities, and the proliferation of new trading platforms. As a result, approximately 70% of equity trades currently submitted to NSCC are for 300 shares or less.

While the proposed fee changes are designed to be revenue-neutral to NSCC, the mixture of these fees will change. Trade Recording, Correspondent Clearing, and Flip Trade fees will be reduced. The current trade clearance fee will be replaced with a new Netting Fee. The current trade clearance fee is a flat transaction fee that neither factors in the netting benefits of NSCC's CNS and Balance Order systems nor reflects the relative risk of members' netted obligations to NSCC. The new Netting Fee will reflect both the value of NSCC's netting and the relative risk

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<sup>12</sup> A designated value delivery is an instruction from a Special Representative to CNS to transfer a valued position from one participant to another participant or to a non-participant through a clearing interface.

presented thereby. Collectively, these fees are less volume sensitive and establish a fair and consistent pricing philosophy for all participants that encourages real-time capture of trade input.

The Trade Recording fee would be modified to: (1) establish a two-element fee based on sides and shares; (2) institute a fixed charge per side; (3) decrease the share minimum per trade from 300 shares to 100 shares; (4) increase share maximum per trade from 6,000 shares to 100,000 shares; and (5) reduce overall fees for the Trade Recording service. The Netting Fee would be modified to establish a multi-element fee based on items and values, including: (1) a fixed fee per side; (2) an “into-the-net” fee based on items and gross value (i.e., the sum of the contract amount and fail value) processed in the CNS and Balance Order nets; and (3) an “out-of-the-net” fee based on the absolute value of the CNS Long and Short Positions. Finally, the “per item” fee for Correspondent Clearing and Flip Trades would be reduced.

#### 5. Implementation Timeframe

NSCC plans to implement all these proposed rule changes, other than the requirement to submit locked-in trade data on a real-time basis, on July 1, 2006, subject to Commission approval. Recognizing that requiring exchanges and QSRs to submit locked-in trade data on a real-time basis will require some of these organizations to make systems changes, NSCC proposes that the requirement to submit locked-in trade data on a real-time basis and corresponding changes (i.e., adding the definition of “Real-time” to Procedure XIII and the deletion of Addendum N, which requires QSRs to submit locked-in trade data on trade date) would become effective on January 1, 2007, in order to provide time for those affected organizations to implement the necessary changes. The proposed rules will note these time frames accordingly.

NSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act<sup>13</sup> and the rules and regulations thereunder applicable to NSCC because it should promote the prompt and accurate clearance and settlement of securities transactions by requiring that all locked-in trade data submitted to NSCC for trade recording be submitted on a real-time basis and by prohibit pre-netting and other practices that prevent real-time trade submissions. In addition, the proposed rule change should provide for the equitable allocation of reasonable dues, fees, and other charges among NSCC's members.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NSCC does not believe that the proposed rule change will have any impact or impose any burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

NSCC has not solicited or received any written comments on this proposal. NSCC will notify the Commission of any written comments it receives.

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

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date 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 such proposed rule change or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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<sup>13</sup> 15 U.S.C. 78q-1.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2006-04 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NSCC-2006-04. 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 Web site (<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 inspection and copying in the Commission's Public Reference Section, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NSCC and on NSCC's Web site at [www.nsc.com/legal](http://www.nsc.com/legal).

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-2006-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

Nancy M. Morris  
Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).