

January 7, 2014

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Add a New Service to the National Securities Clearing Corporation's Obligation Warehouse ("OW") Which Would Pair Off and Close Certain Open Obligations, Reducing the Number of Open Obligations in OW

I. Introduction

On November 14, 2013, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change SR-NSCC-2013-11 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> The proposed rule change was published for comment in the Federal Register on November 29, 2013.<sup>3</sup> The Commission did not receive comments on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

NSCC's proposed rule change consisted of amendments to the Rules and Procedures ("Rules") of NSCC to modify its Rules to add a new service to NSCC's Obligation Warehouse ("OW") that will daily apply a pair off methodology to open OW Obligations, designated by Members as eligible for the service, based on the quantity of underlying securities, the final money amount, and the settlement dates of the underlying obligations, the ("Pair Off Function"). Upon making those revisions to NSCC's Rules, this approved, new service to OW will pair off and close certain open obligations, thereby reducing the number of open obligations in OW. The

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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> Securities Exchange Act Release No. 34-70937 (Nov. 25, 2013), 78 FR 71686 (Nov. 29, 2013) (SR-NSCC-2013-11).

effective date of the proposed rule change will be announced via an NSCC Important Notice.

NSCC's OW, implemented in 2011, is a non-guaranteed, automated service that tracks, stores, and maintains unsettled ex-clearing and failed obligations, as well as obligations exited from NSCC's Continuous Net Settlement ("CNS") system, non-CNS Automated Customer Account Transfer Service ("ACATS") Receive and Deliver Instructions, Balance Orders, and Special Trades, as defined in NSCC's Rules (collectively "OW Obligations"). The service provides transparency, serves as a central storage of open (i.e. failed or unsettled) broker-to-broker obligations, and allows users to manage and resolve exceptions in an efficient and timely manner. Simultaneously, OW provides on-going maintenance and servicing of matched obligations that have not been marked by a Member as subject to upcoming delivery, closure, or cancellation. Examples of this on-going maintenance and servicing include: adjustments for certain corporate actions; daily review for CNS eligibility; and regular processing of the Reconfirmation and Pricing Service ("RECAPS") in the OW on days announced by Important Notices. During the daily review for CNS eligibility, OW Obligations that are eligible for CNS are exited from the OW and forwarded to CNS. On days when RECAPS is run in the OW, OW Obligations that are eligible for RECAPS<sup>4</sup> are re-netted and, if appropriate, marked to the current market price<sup>5</sup> and provided with an updated settlement date of the next business day. The Pair

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<sup>4</sup> Obligations that are matched and have a settlement date of at least two days prior to the date on which the RECAPS process commences will be considered for inclusion in the RECAPS process, and therefore, fail items not already in the OW and eligible for RECAPS processing must be submitted by the Member prior to RECAPS processing.

<sup>5</sup> In the event that the current market price for a security is not available, the obligation's price details will be unchanged from when it was previously matched.

Off Function will run once a day, immediately following the completion of the review for CNS eligibility.<sup>6</sup>

Today, in order to reduce the number of obligations that remain on their books and records, Members may take actions away from NSCC to close out these open obligations in OW. Those Members would then close the obligations in OW. The Pair Off Function will facilitate the close out of any OW Obligations that Members designate as eligible for the service. By facilitating the close out of these obligations in an automated manner within the OW, the Pair Off Function should add transparency to the life cycle of these obligations that may otherwise be closed out away from NSCC. With respect to obligations that are removed from the OW as a result of the Pair Off Function, Members' administrative costs associated with maintaining these obligations in OW should be reduced.

NSCC Members will have the opportunity to designate certain OW Obligations that are in "Open" status in the OW, to which they are a party, to be eligible to be paired off with other OW Obligations in the same CUSIP, and ultimately closed.<sup>7</sup> NSCC may, in its discretion, exclude certain obligations from the Pair Off Function, and will announce by Important Notice which obligations are excluded. Initially, the following obligations will be excluded: (1) OW Obligations in which the underlying security is a mutual fund, a when-issued security,<sup>8</sup> or is part

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<sup>6</sup> NSCC will announce by Important Notice days on which Pair Off function will not run, which may include days on which the RECAPS process is run in the OW.

<sup>7</sup> Members may either participate in the Pair Off Function on an account level, designating all OW Obligations in an "Open" status in the OW to which they are a party as eligible for the Pair Off function and then opt out of the function with respect to certain OW Obligations, or they may designate only certain OW Obligations as eligible for pair off.

<sup>8</sup> A transaction in a "when issued" security is made conditionally because the underlying security has been authorized but not yet issued, and will only settle after the security has been issued.

of a syndicate; (2) OW Obligations that are identified in OW as an ACATS Receive and Deliver Instruction; (3) obligations that, as of the time the Pair Off Function runs, are identified in the OW as being subject to a corporate action; and (4) an obligation that is marked in the OW as being in “Open” status but has already been sent to The Depository Trust Company’s Inventory Management System (IMS) as a pending delivery.

The Pair Off Function will use a matching methodology that will pair off eligible OW Obligations based on the quantity of underlying securities, the final money amount, and the settlement dates of the underlying obligations. The Pair Off Function will only match OW Obligations that have been designated as eligible for pair off by both Members that are party thereto, and that are in the same CUSIP and have the same counterparties, where the counterparties have offsetting long and short obligations. The methodology will pair off eligible OW Obligations in order by first pairing off those obligations that have the most criteria in common. For example, the methodology will first pair off eligible OW Obligations where the quantity of underlying securities, the settlement dates of the obligations, and the final money amounts are identical. The methodology will continue to review eligible OW Obligations subject to certain rules, beginning with eligible OW Obligations with the oldest settlement date, and eligible OW Obligations with the smallest number of underlying securities.

Eligible OW Obligations will be paired off where the quantity of underlying securities, the final money amount, or the settlement dates of the underlying obligations may not be identical, and, in certain cases, one OW Obligation may be paired off against multiple OW Obligations. However, a pair off would never occur if it would result in: (1) a negative quantity of underlying securities in either of the original obligations; (2) a negative final money amount; or (3) at least one of the obligations subject to the pair off to remaining open, with a reduced

quantity of underlying securities and a final money amount of zero or less than zero.

Additionally, OW Obligations in municipal bonds would only be eligible for pair off where the quantity of the underlying securities in the obligations subject to the pair off is identical and no underlying securities remain.

When the pair off criteria are met, the OW Obligations will either be closed or, when the quantities of underlying securities are not exactly matched between obligations being paired off, the pair off will result in one or more of the obligations being reduced by the quantity of securities that were paired off. Those obligations will remain in “Open” status in OW and will be adjusted to reflect the reduced number of underlying securities. Where the underlying final money amounts are not exactly matched between obligations being paired off, the pair off will result in a cash adjustment, which will be reflected in the Members’ money settlement with NSCC on the following business day.

### III. Discussion and Commission Finding

Section 19(b)(2)(C) of the Act<sup>9</sup> 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 rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act<sup>10</sup> requires that the rules of a clearing agency to be designed to, among other things, “promote the prompt and accurate clearance and settlement of securities transactions and ... to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.”<sup>11</sup> Further, Section

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<sup>9</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>10</sup> 12 U.S.C. 78q-1(b)(3)(F).

<sup>11</sup> 15 U.S.C. 78q-1(b)(3)(F).

17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to, “perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.”<sup>12</sup> The Commission finds that NSCC’s proposed rule change is consistent with these requirements because: the Pair Off Function is designed to provide for greater efficiency and transparency with respect to obligations processed through the OW; and to improve NSCC’s current mechanism for the clearance and settlement of securities transactions that are placed in the OW.

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Id.

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 Act<sup>13</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR-NSCC-2013-11 be, and it hereby is, APPROVED.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>13</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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