

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52772; File No. SR-NSCC-2005-13)

November 14, 2005

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Modify and Consolidate Clearing Fund Rules

I. Introduction

On September 20, 2005, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NSCC-2005-13 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on October 11, 2005.² On October 21, 2005, NSCC amended the proposed rule change.³ The Commission received one comment letter in response to the proposed rule change.⁴ For the reasons discussed below, the Commission is approving the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 52552 (October 3, 2005), 70 FR 59112.

³ The amendment was clarifying in nature and made no substantive changes to the proposed rule change as originally filed. Therefore, republication of notice is not required.

⁴ Letter from Dennis A. Young, Vice President and Treasurer, Cosse International Securities, Inc. (November 1, 2005). The comment letter did not address the proposed rule change.

II. Description

1. Clearing Fund Formula Enhancements

NSCC's clearing fund formula consists of a number of components designed to calculate NSCC's exposure to participants' unsettled portfolios. For CNS and Balance Order transactions, the clearing fund formula includes, among other components, a mark-to-market calculation and a volatility calculation.⁵

The current mark-to-market calculation includes trades that have not yet reached settlement date but excludes from the calculation trades that have reached T+3 and CNS fail positions (i.e., net positions that did not settle on settlement date). NSCC is enhancing the mark-to-market calculation to include trades that have reached settlement date and net CNS fail positions. This is intended to enable NSCC to more accurately cover its mark-to-market exposure to participants' unsettled portfolios in the event of an intraday insolvency of a participant. When making this calculation, NSCC may but is not required to take into account securities that a participant has delivered to CNS in the night cycle.⁶

The volatility component of the clearing fund formula rule provides that NSCC may exclude from volatility calculations net unsettled positions in classes of securities whose volatility is either less amenable to statistical analysis, such as OTC Pink Sheet issues trading

⁵ The other components for CNS and Balance Order activity are a CNS fail charge, a charge for market maker domination, and special charges.

⁶ The October 21, 2005, amendment clarified that while NSCC generally intends to take such deliveries into account when making this calculation, it will not do so if it would otherwise cause operational or administrative problems, and it reserves the right not to do so based upon the financial or operational condition of a particular participant at the time such calculation is made.

below \$5.00, or amenable to such analysis only in a complex manner, such as municipal or corporate bonds. The amount of clearing fund required to satisfy the volatility component for these positions is determined as a percentage haircut (currently 2% for municipal and corporate bonds).

NSCC is enhancing its volatility component and is replacing the 2% haircut for corporate and municipal bonds with a fixed income volatility calculation. NSCC will continue to use a haircut for fixed income securities in circumstances it deems appropriate, such as where sufficient market or security information is not available.

2. Technical Clarifications

When NSCC revised its clearing fund formula in 2001 to move to a risk-based calculation,⁷ it applied the revised formula to participants on a rolling basis. To accommodate this transition, NSCC's rules retained two versions of Addendum B (Standards of Financial Responsibility and Operational Capability) and two versions of Procedure XV (Clearing Fund Formula and Other Matters). Version 1 of both Addendum B and Procedure XV was non-risk-based and Version 2 was risk-based. Version 2 is currently located in Appendix 1.

With limited exception, all participants are now subject to the clearing fund provisions of Version 2 of Procedure XV and Version 2 of Addendum B. Accordingly, in order to simplify the rules and enable participants to locate provisions applicable to them more readily, NSCC is restructuring its Addendums, Procedures, and Rules.

As Version 1 of Procedure XV now has limited applicability, NSCC is redesignating it as Version 2 of Procedure XV and moving it to Appendix 1. NSCC will retain only those

⁷ Securities Exchange Act Release No. 44431 (June 15, 2001), 66 FR 33280.

provisions thereof (and of Version 1 of Addendum B⁸) that remain applicable. Because Version I of Procedure XV always contained a mark-to-market component, it is also being revised to include in the mark-to-market calculation trades that have reached T+3 and CNS fail positions. The provisions of Appendix 1 (Version 2 of Procedure XV and Version 2 of Addendum B) will be moved into the body of the rules in place of Version 1 of Procedure XV and Version 1 of Addendum B where they will appear in numerical order.

As part of these clarifications, Rule 4 (Clearing Fund) is also being corrected to make clear that participants may request a return of any excess clearing fund on any day that NSCC has determined that the participant's actual deposit exceeds its required deposit. Finally, certain technical corrections are being made to Rule 4 and to the clearing fund formula to provide consistent terminology and delete obsolete references.

III. Discussion

Section 19(b) of the Act 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. Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is

⁸ Both versions of Addendum B are substantially identical with the exception of certain provisions of current Version 1 relating to the timing for calculating and collecting clearing fund. The substance of those provisions of Version 1 of Addendum B are added as a note to Version 1 of Procedure XV that will be moved to Appendix 1 and will be renamed Version 2. The rest of Version 1 of Addendum B will be deleted. All participants remain subject to the provisions of Version 2 of Addendum B, which NSCC is moving to the body of its rules from Appendix 1 and redesignating Version 1.

responsible.⁹ The Commission believes that NSCC's rule change is consistent with this Section because it will permit NSCC to better assure the safeguarding of funds and securities which are in its custody or control or for which it is responsible by allowing NSCC to more precisely identify the risks posed by a participant's unsettled portfolio and more quickly adjust and collect additional needed clearing fund collateral than it could using the old formula. As a result NSCC should be better protected from the risk associated with a participant's default because the clearing fund deposits it collects should more accurately reflect NSCC's exposure.

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 Section 17A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NSCC-2005-13) be and hereby is approved.

⁹ 15 U.S.C. 78q-1(b)(3)(F).

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Jonathan G. Katz
Secretary

¹⁰ 17 CFR 200.30-3(a)(12).

