

Proposed Rule Change by National Securities Clearing Corporation  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input type="checkbox"/>	Amendment <input checked="" type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input checked="" type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action <input type="checkbox"/>	Date Expires <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**  
Provide a brief description of the proposed rule change (limit 250 characters).

**Contact Information**  
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name  Last Name   
 Title   
 E-mail   
 Telephone  Fax

**Signature**  
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date   
 By  (Name)  
 (Title)

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SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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**Form 19b-4 Information**

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change**

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**Bold underlined text** indicates additions made by Amendment No. 1 to text as filed under SR-NSCC-2007-14.

~~**Bold struck-through text**~~ indicates deletions made by Amendment No. 1 from text as filed under SR-NSCC-2007-14.

**Bold double-underlined text** indicates additions made by this Amendment No. 2 to text as filed under SR-NSCC-2007-14, as amended.

~~**Bold double-struck-through text**~~ indicates deletions made by this Amendment No. 2 from text as filed under SR-NSCC-2007-14, as amended.

1. Text of Proposed Rule Change.

(a) The purpose of the proposed rule filing submitted by National Securities Clearing Corporation (“NSCC”) is to amend the rules of NSCC to provide for the clearance and settlement of institutional transactions in conjunction with The Depository Trust Company (“DTC”) through a service called “ID Net.”

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization.

(a) NSCC received approval from the Board of Directors to make the present filing on September 21, 2007.

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

(a) The purpose of this rule filing is to amend NSCC’s Rules to provide a new service (the “ID Net Service”) which will establish settlement netting functionalities for institutional transactions by leveraging the netting and settlement capabilities of NSCC, in conjunction with existing processing of DTC.

## Summary

Unlike exchange trades and most prime broker trades, most institutional delivery (**“ID”**) transactions do not currently flow through NSCC’s Continuous Net Settlement system (“CNS”).<sup>1</sup> Rather, these institutional transactions settle at DTC. The ID Net Service will allow subscribers to the service to net all eligible affirmed ID transactions against their CNS transactions, if any.

The ID Net Service will accept eligible affirmed institutional transactions from ~~Omgeo LLC or other~~ **clearing agencies registered pursuant to Section 17A of the Securities Exchange Act of 1934, as amended (the “Act”), other entities (such as Omgeo Global Joint Venture Matching Services – US, LLC (hereinafter “Omgeo”)) which have obtained an exemption from such registration from the Commission, and Qualified Vendors as defined in the rules of the New York Stock Exchange, the National Association of Securities Dealers, or other self-regulatory organizations, as applicable, (an “Affirming Agency”)**<sup>2</sup> that are eligible for the ID Net Service and net the broker side of each transaction with the participating broker’s other CNS obligations, if any.

Eligibility for the ID Net Service will require that a participating ~~broker~~ **NSCC Member** be a ~~Member of NSCC~~ **eligible for CNS Processing** and a Participant of DTC (**“ID Net Broker Firm”**), and that a participating bank be a Participant of DTC (**“ID Net Bank”**)(collectively **“ID Net Subscribers”**). In addition, eligibility for ID Net processing will be based on the underlying security being processed, the type of transaction submitted for processing and the timing of affirmation. Participation in the ID Net Service will be voluntary and will be governed by the rules and procedures applicable to the ID Net Service as described below. All ID Net Subscribers will be required to enter into separate ID Net Subscriber agreements with NSCC and/or DTC, as applicable, governing their use of the ID Net Service.

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<sup>1</sup> The National Securities Clearing Corporation’s Continuous Net Settlement System (CNS) is an automated accounting and securities settlement system that centralizes and nets the settlement of compared and recorded security transactions, and maintains an orderly flow of security and money balances. CNS provides clearance for securities, corporate bonds, Unit Investment Trusts and municipal bonds that are eligible for book-entry transfer at The Depository Trust Company.

<sup>2</sup> ~~While the ID Net Service will eventually accept institutional transactions submitted by other Qualified Vendors, the ID Net Service will initially process only Omgeo-affirmed transactions.~~ Omgeo, a joint venture between the Depository Trust & Clearing Corporation and Thomson Financial, is a global provider of post-trade, pre-settlement processing services for the institutional market. ~~Omgeo is a “Qualified Vendor” as defined in the Securities Exchange Act of 1934. Please see Securities Exchange Act Release No. 34-44188 (April 17, 2001), 66 FR 20494 (April 23, 2001) [File No. 600-32] for the order of the Commission granting Omgeo an exemption from registration as a clearing agency.~~

## Current Processing

A typical ~~institutional delivery ID~~ transaction (~~“ID Transaction”~~) is currently processed as follows: an Investment Manager, acting on behalf of its Institutional client, executes a transaction with **Broker Firm A**. The Investment Manager, or a Custodian acting on its behalf, and **Broker Firm A**, submit the transaction data to an Qualified Vendor Affirming Agency (for example, Omgeo) for ~~matching~~ confirmation/affirmation. Once affirmed, the Qualified Vendor’s Affirming Agency’s automated systems transmit standing settlement instructions for the matched transaction to DTC’s Inventory Management System (“IMS”) to be processed.

These ID ~~T~~ transactions are not netted, they are settled on a trade-for-trade basis at DTC.

## Proposed Service

In order to extend netting benefits and efficiencies to institutional transactions, NSCC will extend its clearance and settlement functionalities to net the broker side of institutional transaction with certain other broker-to-broker activity that is eligible for processing through NSCC’s CNS service.

Most equity securities that are eligible for CNS are eligible for ID Net processing. However, ID Net will initially exclude<sup>3</sup> the following: (1) Corporate and municipal bonds and Unit Investment Trust (UIT) issues; (2) New Issue securities; (3) Securities that are IPO tracked since the use of omnibus accounts will bypass the tracking system; (4) Trades in issues that are currently undergoing a mandatory or voluntary reorganization; (5) Trades in CUSIPs with a CNS buy-in; and (6) Trades in securities appearing on the SEC’s Regulation SHO list.

To facilitate the processing of ID Net transactions, two new securities accounts will be established by NSCC at DTC on behalf of all ID Net **Brokers Firms** that have elected to use the ID Net service: the “ID Netting Subscriber Deliver Account” and the “ID Netting Subscriber Receive Account” (collectively referred to as the “ID Netting Subscriber Accounts”). NSCC will be the owner of both accounts, and will act as agent for the ID Net **Brokers Firms**. NSCC will process ID Net transactions through these accounts on behalf of participating ID Net **Brokers Firms**. While NSCC will direct transactions through these accounts on behalf of the ID Net **Brokers Firms**, the ID Net **Brokers Firms**, not NSCC, will be responsible for satisfying applicable DTC risk

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<sup>3</sup> ~~ID Net Brokers Firms will not have the ability to direct transactions to either ID Netting Subscriber Account. All ID Net Broker Firm positions in either the ID Netting Subscriber Deliver Account or the ID Netting Subscriber Receive Account will be recorded separately by NSCC and in no event will securities positions of one ID Net Broker Firm be attributed to another ID Net Broker Firm.~~

NSCC has determined that certain security types may have a relatively high rate of delivery failure or may disrupt normal processing of transactions in the ID Net service. Such securities will initially be excluded from the service; however, as experience with the service grows, the status of such securities may be reevaluated.

management controls and Participant Fund requirements for their respective activity through the ID Netting Subscriber Accounts.

The ID Netting Subscriber Deliver Account will be maintained for all ID Net **Brokers Firms** receiving ID Net Eligible Securities from an ID Net Bank. The ID Netting Member Receive Account will be maintained for all ID Net **Brokers Firms** receiving ID Net Eligible Securities from CNS that are bound for delivery by that ID Net **Broker Firm** to an ID Net Bank.<sup>3,4</sup>

With the establishment of these two new ID Netting accounts, ID Net transactions will be processed as follows: Upon affirmation the **Qualified Vendor Affirming Agency** will check that the transaction is eligible for ID Net processing (eligibility requirements are discussed below). If the transaction qualifies, the **Qualified Vendor Affirming Agency**, prior to submitting that affirmed transaction to IMS, will flag the transaction by populating the delivery instructions third party field with the account number of the ID Netting Subscriber Delivery account.

IMS will facilitate the delivery of the securities, subject to DTC's risk management controls, to the ID Netting Subscriber Deliver Account. On the night of Trade Date Plus Two (T+2), the ID Net **Broker's Firm's** CNS position, if any, will be updated for the quantity and value of the ID Net transaction ~~versus creating~~ and create an open obligation in the ID Netting Subscriber Deliver Account.

For transactions in which the ID Net **Broker Firm** is delivering securities to an ID Net Bank, on the night of T+2, the ID Net **Broker's Firm's** CNS position, if any, will be updated for the quantity and value of the ID Net transaction versus creating an open obligation in the ID Netting Subscriber Receive Account. Once the securities are credited to the ID Netting Subscriber Receive Account, the securities will be delivered, subject to DTC's Risk Management controls, to the ID Net Bank's account.

ID Net transactions not completed for any reason, including due to a party's failure to deliver or pass risk controls, by 11:30 a.m. on settlement date will be "dropped" from ID Net service and instead will be settled trade-for-trade between the original counterparties at DTC, as if the transaction had not been included in the ID Net Service.

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~~<sup>4</sup> NSCC has determined that certain security types may have a relatively high rate of failure or may disrupt normal processing of transactions in the ID Net service. Such securities will initially be excluded from the service; however, as experience with the service grows, the status of such securities may be reevaluated.~~

ID Net Firms will not have the ability to direct transactions to either ID Netting Subscriber Account. All ID Net Firm positions in either the ID Netting Subscriber Deliver Account or the ID Netting Subscriber Receive Account will be recorded separately by NSCC and in no event will securities positions of one ID Net Firm be attributed to another ID Net Firm.

## **Eligibility Requirements**

Eligibility is based on the participants, the underlying security, the type of trade and the timing of the affirmation: (1) The broker/dealer must be both a NSCC Member and a DTC Participant; (2) The custodian bank must be a DTC Participant; (3) The broker/dealer and the custodian bank must both elect to participate in the ID Net Service; (4) The security must be an equity CUSIP eligible for CNS. **Noted exclusions:** (1) Corporate and municipal bonds; (2) Unit Investment Trust (UIT) issues; (3) New issue securities in their first day of trading; (4) IPO securities; (5) Securities that are undergoing a mandatory or voluntary reorganization; (6) Securities in CUSIPs with a pending CNS buy-in; and (7) Regulation SHO securities.

The trade must be affirmed before 9:00 p.m. on Trade Date Plus One (T+1) and the trade must be “regular-way” (i.e., scheduled for T+3 settlement).

After a transaction has been affirmed and deemed eligible for the ID Net Service, DTC will monitor the ID Net transaction’s eligibility up until **approximately 8 p.m. on** the night of T+2. If the transaction becomes ineligible for any reason, the transaction will be exited from the ID Net process, and will be settled on a trade-for-trade basis between the ID Net **Broker Firm** and the ID Net Bank, outside of the ID Net Service, at DTC.

## **Settlement**

Upon receipt of the affirmation of an eligible trade from the ~~Qualified Vendor~~, **Affirming Agency** DTC’s IMS System will automate the following steps: (1) For bank deliveries, IMS will move the “original clearing broker” from the receiver’s field to the Third Party field of the ID delivery instruction and replace it with a new ID Netting Subscriber Delivery account; and (2) For bank receives, IMS will move the “original clearing broker” from the deliverer’s field to the Third Party field of the ID delivery instruction and replace it with a new ID Netting Subscriber Receive account.

Custodian banks will still be able to exempt or authorize ID deliveries in IMS before the night cycle as they do today; and trades that are eligible for ID Net but which are still in a pending state by 11:30 a.m. on settlement date will revert to trade-for trade settlement versus the original clearing ~~broker participant~~ and not settle as part of ID Net. Accordingly, if the bank subsequently authorizes the delivery, it will be sent to the original clearing broker instead of the ID Netting Subscriber Deliver Account.

~~Broker/dealers~~ **ID Net Firms** will still be able to exempt or cancel an ID netted delivery in IMS as they do today, but they will be limited to **instructions transmitted through the Participant Terminal Service and Participant Browser Service** (PTS/PBS) and only on a trade-by-trade basis; and **deliveries** from the ID Netting Subscriber Receive account will be attempted in random order until approximately 10:00 a.m. on settlement date. After that time, the system will attempt to complete any of the deliveries up until 11:30 a.m. in settlement value order - highest value first; ID Net transactions not completed **for any reason** by 11:30 a.m. on settlement date will be

exited from the ID Net Service and instead will settle trade-for trade versus the original clearing broker; deliveries that do not complete will be available for immediate reintroduction from the original clearing broker's account through a new IMS function at 11:30 a.m. Brokers can then create a profile to have these deliveries await authorization or to be processed immediately.

If an ID Net Bank reclaims a transaction from the ID Netting Subscriber Receive Account the reclaims will be processed against the applicable ID Net ~~Broker~~ Firm, not against the ID Netting Receive Account.

### **DTC Risk Management Control Updates**

**In order to protect DTC from having a failure exported from NSCC for liquidity purposes, updates to Participants' net debit caps and collateral monitors will be necessary as described below:**

**A new ID Net collateral monitor and net debit cap balance will be recorded in the processing system for each ID Net Firm. The ID Net collateral monitor will record the net balance of collateral generated for all transactions processed through the ID Net service. If the balance of collateral generated by all ID Net receives and delivers is positive, the ID Net Firm's collateral monitor will not be increased by that amount. However, if an ID Net transaction requires collateral, the system will use the ID Net collateral surplus for that ID Net Firm before attempting to use other collateral from that ID Net Firm. If there is insufficient ID Net collateral for that broker, the system will look to the ID Net Firm's excess collateral in its account.**

**Similar to collateral, the system will create a new ID Net settlement balance for each ID Net Firm. When this balance is a net credit from deliveries on the ID Net Firm's behalf through the ID Netting Subscriber Receive Account, it will only be used to offset incoming ID Net receives to the ID Netting Subscriber Deliver Account omnibus account. If there is an insufficient ID Net credit to absorb the debit of the ID Net delivery to the ID Netting Subscriber Deliver Account for that ID Net Firm, the system will create an ID Net debit that will effectively treat the ID Net debit as a reduction of the ID Net Firm's net debit cap. The ID Net debit will only be used for net debit cap calculation purposes and will not represent a participant's actual settlement balance.**<sup>5</sup>

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<sup>5</sup> **Currently, brokers receive market value credit for deliveries to CNS if the security is received versus payment (RVP) or collateral value (collateral value is market value less the DTC haircut) if the delivery to CNS was from securities in their start of day position or received for free. With respect to the ID Net service, the system will no longer identify if a delivery would have come from a broker's RVP securities or not, and as such, the system will assume the delivery would have come from a broker's start of day position.**

**Likewise, to the extent that ID Net Firms have a net credit for their ID deliveries today, an ID Net Firm's settlement balance is reduced. Since these credits will no longer be generated from the ID Net Firm's account, it may require the need to fund DTC intraday for net debit cap blockage.**

~~Note: Currently, brokers receive market value credit for deliveries to CNS if the security is received versus payment (RVP) or collateral value (collateral value is market value less the DTC haircut) if the delivery to CNS was from securities in their start of day position or received for free. With respect to the ID Net service, the system will no longer identify if a delivery would have come from a broker's RVP securities or not, and as such, the system will assume the delivery would have come from a broker's start of day position.~~

~~Likewise, to the extent that ID Net Firms have a net credit for their ID deliveries today, an ID Net Firm's settlement balance is reduced. Since these credits will no longer be generated from the ID Net Firm's account, it may require the need to fund DTC intraday for net debit cap blockage.~~

If the broker has insufficient collateral or net debit cap, the transaction will pend until 11:30 a.m. on settlement date.<sup>6</sup>

### NSCC Clearing Fund Offset and Mark-to-Market

ID Net transactions will be used to offset the balance of any other CNS transactions, and the "net" of those transactions will be used for purposes of determining

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<sup>6</sup> As an example of how DTC risk controls would be applied to ID Net Subscribers, assume that Investment Manager A sells 10 shares of Common Stock X using ID Net Firm B (a broker). If B sells the shares on an exchange for \$20, and the trade is affirmed and the shares are delivered by A's Custodian Bank C, then C would receive a credit in DTC for \$20 and the ID Netting Subscriber Deliver Account (owned by NSCC as agent for B) would have a DTC debit of \$20. In this case, B's net debit cap would be reduced by \$20 and its collateral monitor is reduced by the net of the \$20 debit and the collateral value of the securities (e.g. with a 10 percent haircut the collateral value would be \$18), or \$2. When the ID Netting Subscriber Deliver Account delivers the shares to CNS it receives a credit for \$20. This credit is offset with the DTC debit of \$20 at end-of-day. Additionally, assume A then buys 10 shares of Commons Stock Y through B at \$30. On the night of T+2, CNS will deliver the shares to the ID Netting Subscriber Receive Account and that account will be debited in CNS for \$30. C would then receive 10 shares of Y from the ID Netting Subscriber Receive Account. C receives a debit in DTC for \$30 and the ID Netting Subscriber Receive Account is credited at DTC for \$30. B's account has its DTC net debit cap increased by \$20 to offset the previous decrease of \$20 (for the sale of Common Stock X) (and not \$30 since the net of the ID Net receive relating to the sale of Common Stock X above of \$20 and the delivery of Common Stock Y for \$30 is a \$10 credit and B's net debit cap is decremented only when the net balance is a debit. C will not receive a net credit, but will receive an offset of previous ID Net debits with ID Net credits) and the same for its collateral monitor which is increased only up to the amount it was debited for ID Net transactions (absent its participation in the ID Net service, B would have received a \$3 credit to the collateral monitor which equals the net of the \$30 credit and the collateral value of the securities \$27 (\$30 market value less a 10% haircut)). In this case, B would only receive a collateral credit of \$2, but the ID Net credit balance of \$1 will be registered to absorb future ID Net receives that have a collateral deficiency. If C was at its net debit cap or collateral monitor limit due to other receives, the ID Net transaction would recycle or pend in the system until the deficiency could be satisfied or until 11:30 a.m., when it would drop out of ID Net.

Clearing Fund obligations pursuant to NSCC's current procedures, subject to a revised mark-to-market calculation applicable to ID Net **Brokers Firms**.

The revised mark-to-market calculation for ID Net **Brokers Firms** will add the value computed pursuant to: (x) the currently existing mark-to-market component (which will exclude ID Net transactions), and (y) a mark-to-market component calculated with respect to ID Net-related positions; however any positive value derived from either (x) or (y) will be set to zero.<sup>78</sup>

### **Prioritization**

In order to reduce the **potential** number and value of fails in the ID Net Service, deliveries from CNS to the ID Netting Subscriber Receive Account will be given a higher delivery priority, pursuant to ~~an~~ **the allocation algorithm set forth in NSCC's Procedure VII (CNS Accounting Operation)**, than other CNS deliveries with the exception of buy-in deliveries, **and corporate action deliveries and deliveries of component securities of index receipts.**<sup>9</sup> **NSCC is also modifying this Procedure to clarify that deliveries of the component securities for index receipts shall have the same priority as deliveries to the ID Netting Subscriber Receive Account.**

Any ID Net transactions that cannot be completed will be exited from the ID Net Service and instead will settle trade-for-trade between the ID Net **Broker Firm** and the ID Net Bank (the original counterparties) at DTC.

### **Fee**

~~The current applicable DTC ID and IMS fees will be maintained for deliveries going to or from the applicable ID Netting Subscriber Account. There will be no charge for CNS deliveries to or from the applicable ID Netting Subscriber Account.~~

**ID Net Banks and ID Net Firms will be charged a reduced DTC ID Net fee of \$0.025 for each completed delivery and receive processed versus the ID delivery or receive fee of \$0.05. Additionally, deliveries that are exited from the**

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<sup>7</sup> Similar to the existing mark-to-market component, the new mark-to market component applicable to ID Net transactions will equal the net of each day's difference between (x) the contract price of the Member's net positions relating to ID Net activity, and (y) the Current Market Price for such positions.

<sup>8</sup> **For example, if an ID Net Firm has a "regular" mark-to-market debit of \$500,000 and an ID Net mark-to-market debit of \$100,000, then these debits would be added together and the ID Net Firm's total mark-to-market obligation would equal a debit of \$600,000. However, if that same ID Net Firm's ID Net mark-to-market calculation results in a credit of \$100,000, then the value of that credit would be set to zero and therefore the total mark-to-market would equal a debit \$500,000 (the amount of the broker's regular mark-to-market debit).**

<sup>9</sup> **Currently, institutional deliveries processed through the DTC system from ID Net Firms to banks may be prioritized by ID Net Firms through IMS and/or via exempting their deliveries to CNS in order to ensure that available inventory will be used for such deliveries. Including transactions in the proposed service allows for the "automation" of such prioritization through the CNS Accounting Operation**

**ID Net service will not be charged a drop fee. ID Net deliveries pend cancelled by ID Net Firms from the ~~Account #919~~ ID Netting Subscriber Receive Account will continue to be charged the \$0.45 pend cancel fee. ID Net deliveries to and from CNS on behalf of the ID Net Firms will not be charged.**

### **Proposed Rule Changes**

Under the proposed rule change, a new Rule ~~53~~ **65** and Procedure XVI (both titled “ID Net Service”) will be added to NSCC’s Rules, and additional conforming changes will be made elsewhere throughout NSCC’s Rules, as needed to provide consistency with the new Rule ~~53~~ **65**. These additional changes include the following:

#### *Rule 3 – Lists to be Maintained*

A subsection will be added to Rule 3 to provide that NSCC will maintain a list of Eligible ID Net Securities and may from time to time add or delete applicable CNS Securities from the list.

#### *Procedure VII – CNS Accounting Operation*

Procedure VII will be revised to incorporate the processing of transactions in Eligible ID Net Securities into the CNS Accounting Operation. The revisions will also reflect: (i) that Member’s will not be able to exempt deliveries from an ID Netting Subscriber account, (ii) the prioritization of ID Net deliveries **and deliveries of the component securities of index receipts** in the CNS allocation algorithm behind deliveries associated with reorganizations and buy-ins, and (iii) that ID Net transactions will be recorded on the Miscellaneous Activity Report on the night of T+2, and removals of such transactions from the ID Net Service will also be recorded on that report.

#### *Procedure XV – Clearing Fund Formula and Other Matters*

Procedure XV will be revised to indicate the exclusion of ID Net transactions from the ID offset process for the purposes of calculating the volatility component of a subscriber’s Clearing Fund requirement. In addition language will be revised and added with respect to the calculation of mark-to-market to reflect the changes to the formula as described above.

(b) The proposed rule change is consistent with the requirements of the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to DTC in that it promotes the prompt and accurate clearance and settlement of securities transactions by leveraging ~~the efficiencies of~~ the **capabilities of the** DTC and NSCC systems **to provide for more streamlined securities deliveries and extend netting benefits and efficiencies to ID transactions.**

#### 4. 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.

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

Written comments relating to the proposed rule change have not yet been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

6. Extension of Time Period for Commission Action.

NSCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Act for Commission action.

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

(a) Not applicable.

(b) Not applicable.

(c) Not applicable.

(d) Not applicable.

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

The proposed rule change is based upon similar proposed changes to the rules of the Depository Trust Company.

9. Exhibits

Exhibit 1 - Notice of proposed rule change for publication in the Federal Register (incorporating the changes noted in Item No. 3 above).

Exhibit 4 - ~~N/A~~ Changes to the Rules and Procedures of NSCC as amended by Amendment No. 1 (marked against Exhibit 5 of SR-NSCC-2007-14). No additional changes to the text of the Rules and Procedures are proposed by this Amendment No. 2.

Exhibit 5 - Changes to the Rules and Procedures of NSCC (showing cumulative changes made by SR-NSCC-2007-14 and this Amendment No. 1.)

**SECURITIES AND EXCHANGE COMMISSION**

**(Release No. 34-\_\_\_\_\_ ; File No. SR-NSCC-2007-14)**

**SELF-REGULATORY ORGANIZATIONS**

Proposed Rule Change by the National Securities Clearing Corporation (“NSCC”) relating to the provision of a new service called “ID Net” to provide for the settlement of institutional transactions in conjunction with The Depository Trust Company (“DTC”).

Comments requested within \_\_\_\_ days after the date of this publication.

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Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”), 15 U.S.C. 78s(b)(1), notice is hereby given that on \_\_\_\_\_, NSCC filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

As stated above, and as more fully described below, the proposed rule change being filed by NSCC proposes a new service called “ID Net” to provide for the settlement of institutional transactions in conjunction with DTC.

**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. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

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

The purpose of this rule filing is to amend NSCC's Rules to provide a new service (the "ID Net Service") which will establish settlement netting functionalities for institutional transactions by leveraging the netting and settlement capabilities of NSCC, in conjunction with existing processing of DTC.

**Summary**

Unlike exchange trades and most prime broker trades, most institutional delivery ("ID") transactions do not currently flow through NSCC's Continuous Net Settlement system ("CNS").<sup>1</sup> Rather, these institutional transactions settle at DTC. The ID Net Service will allow subscribers to the service to net all eligible affirmed ID transactions against their CNS transactions, if any.

The ID Net Service will accept eligible affirmed institutional transactions from clearing agencies registered pursuant to Section 17A of the Securities Exchange Act of

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<sup>1</sup> The National Securities Clearing Corporation's Continuous Net Settlement System (CNS) is an automated accounting and securities settlement system that centralizes and nets the settlement of compared and recorded security transactions, and maintains an orderly flow of security and money balances. CNS provides clearance for securities, corporate bonds, Unit Investment Trusts and municipal bonds that are eligible for book-entry transfer at The Depository Trust Company.

1934, as amended (the “Act”), other entities (such as Global Joint Venture Matching Services – US LLC (hereinafter “Omgeo”)) which have obtained an exemption from such registration from the Commission, and Qualified Vendors as defined in the rules of the New York Stock Exchange, the National Association of Securities Dealers, or other self-regulatory organizations, as applicable, (an “Affirming Agency”)<sup>2</sup> that are eligible for the ID Net Service and net the broker side of each transaction with the participating broker's other CNS obligations, if any.

Eligibility for the ID Net Service will require that a participating NSCC Member be eligible for CNS Processing and a Participant of DTC (“ID Net Firm”), and that a participating bank be a Participant of DTC (“ID Net Bank”)(collectively “ID Net Subscribers”). In addition, eligibility for ID Net processing will be based on the underlying security being processed, the type of transaction submitted for processing and the timing of affirmation. Participation in the ID Net Service will be voluntary and will be governed by the rules and procedures applicable to the ID Net Service as described below. All ID Net Subscribers will be required to enter into separate ID Net Subscriber agreements with NSCC and/or DTC, as applicable, governing their use of the ID Net Service.

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<sup>2</sup> Omgeo, a joint venture between the Depository Trust & Clearing Corporation and Thomson Financial, is a global provider of post-trade, pre-settlement processing services for the institutional market. Please see Securities Exchange Act Release No. 34-44188 (April 17, 2001), 66 FR 20494 (April 23, 2001) [File No. 600-32] for the order of the Commission granting Omgeo an exemption from registration as a clearing agency.

### **Current Processing**

A typical ID transaction is currently processed as follows: an Investment Manager, acting on behalf of its Institutional client, executes a transaction with Firm A. The Investment Manager, or a Custodian acting on its behalf, and Firm A, submit the transaction data to an Affirming Agency (for example, Omgeo) for confirmation/affirmation. Once affirmed, the Affirming Agency's automated systems transmit standing settlement instructions for the matched transaction to DTC's Inventory Management System ("IMS") to be processed.

These ID transactions are not netted, they are settled on a trade-for-trade basis at DTC.

### **Proposed Service**

In order to extend netting benefits and efficiencies to institutional transactions, NSCC will extend its clearance and settlement functionalities to net the broker side of institutional transaction with certain other broker-to-broker activity that is eligible for processing through NSCC's CNS service.

Most equity securities that are eligible for CNS are eligible for ID Net processing. However, ID Net will initially exclude<sup>3</sup> the following: (1) Corporate and municipal bonds and Unit Investment Trust (UIT) issues; (2) New Issue securities; (3) Securities that are IPO tracked since the use of omnibus accounts will bypass the tracking system; (4) Trades in issues that are currently undergoing a mandatory or voluntary

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<sup>3</sup> NSCC has determined that certain security types may have a relatively high rate of delivery failure or may disrupt normal processing of transactions in the ID Net service. Such securities will initially be excluded from the service; however, as experience with the service grows, the status of such securities may be reevaluated.

reorganization; (5) Trades in CUSIPs with a CNS buy-in; and (6) Trades in securities appearing on the SEC's Regulation SHO list.

To facilitate the processing of ID Net transactions, two new securities accounts will be established by NSCC at DTC on behalf of all ID Net Firms that have elected to use the ID Net service: the "ID Netting Subscriber Deliver Account" and the "ID Netting Subscriber Receive Account" (collectively referred to as the "ID Netting Subscriber Accounts"). NSCC will be the owner of both accounts, and will act as agent for the ID Net Firms. NSCC will process ID Net transactions through these accounts on behalf of participating ID Net Firms. While NSCC will direct transactions through these accounts on behalf of the ID Net Firms, the ID Net Firms, not NSCC, will be responsible for satisfying applicable DTC risk management controls and Participant Fund requirements for their respective activity through the ID Netting Subscriber Accounts.

The ID Netting Subscriber Deliver Account will be maintained for all ID Net Firms receiving ID Net Eligible Securities from an ID Net Bank. The ID Netting Member Receive Account will be maintained for all ID Net Firms receiving ID Net Eligible Securities from CNS that are bound for delivery by that ID Net Firm to an ID Net Bank.<sup>4</sup>

With the establishment of these two new ID Netting accounts, ID Net transactions will be processed as follows: Upon affirmation the Affirming Agency will check that the transaction is eligible for ID Net processing (eligibility requirements are discussed

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<sup>4</sup> ID Net Firms will not have the ability to direct transactions to either ID Netting Subscriber Account. All ID Net Firm positions in either the ID Netting Subscriber Deliver Account or the ID Netting Subscriber Receive Account will be recorded separately by NSCC and in no event will securities positions of one ID Net Firm be attributed to another ID Net Firm.

below). If the transaction qualifies, the Affirming Agency, prior to submitting that affirmed transaction to IMS, will flag the transaction by populating the delivery instructions third party field with the account number of the ID Netting Subscriber Delivery account.

IMS will facilitate the delivery of the securities, subject to DTC's risk management controls, to the ID Netting Subscriber Deliver Account. On the night of Trade Date Plus Two (T+2), the ID Net Firm's CNS position, if any, will be updated for the quantity and value of the ID Net transaction and create an open obligation in the ID Netting Subscriber Deliver Account.

For transactions in which the ID Net Firm is delivering securities to an ID Net Bank, on the night of T+2, the ID Net Firm's CNS position, if any, will be updated for the quantity and value of the ID Net transaction and create creating an open obligation in the ID Netting Subscriber Receive Account. Once the securities are credited to the ID Netting Subscriber Receive Account, the securities will be delivered, subject to DTC's Risk Management controls, to the ID Net Bank's account.

ID Net transactions not completed for any reason, including due to a party's failure to deliver or pass risk controls, by 11:30 a.m. on settlement date will be "dropped" from ID Net service and instead will be settled trade-for-trade between the original counterparties at DTC, as if the transaction had not been included in the ID Net Service.

### **Eligibility Requirements**

Eligibility is based on the participants, the underlying security, the type of trade and the timing of the affirmation: (1) The broker/dealer must be both a NSCC Member and a DTC Participant; (2) The custodian bank must be a DTC Participant; (3) The broker/dealer and the custodian bank must both elect to participate in the ID Net Service; (4) The security must be an equity CUSIP eligible for CNS. **Noted exclusions:** (1) Corporate and municipal bonds; (2) Unit Investment Trust (UIT) issues; (3) New issue securities in their first day of trading; (4) IPO securities; (5) Securities that are undergoing a mandatory or voluntary reorganization; (6) Securities in CUSIPs with a pending CNS buy-in; and (7) Regulation SHO securities.

The trade must be affirmed before 9:00 p.m. on Trade Date Plus One (T+1) and the trade must be “regular-way” (i.e., scheduled for T+3 settlement).

After a transaction has been affirmed and deemed eligible for the ID Net Service, DTC will monitor the ID Net transaction’s eligibility up until approximately 8 p.m. on the night of T+2. If the transaction becomes ineligible for any reason, the transaction will be exited from the ID Net process, and will be settled on a trade-for-trade basis between the ID Net Firm and the ID Net Bank, outside of the ID Net Service, at DTC.

### **Settlement**

Upon receipt of the affirmation of an eligible trade from the Affirming Agency DTC’s IMS System will automate the following steps: (1) For bank deliveries, IMS will move the “original clearing broker” from the receiver’s field to the Third Party field of the ID delivery instruction and replace it with a new ID Netting Subscriber Delivery

account; and (2) For bank receives, IMS will move the “original clearing broker” from the deliverer’s field to the Third Party field of the ID delivery instruction and replace it with a new ID Netting Subscriber Receive account.

Custodian banks will still be able to exempt or authorize ID deliveries in IMS before the night cycle as they do today; and trades that are eligible for ID Net but which are still in a pending state by 11:30 a.m. on settlement date will revert to trade-for trade settlement versus the original clearing participant and not settle as part of ID Net. Accordingly, if the bank subsequently authorizes the delivery, it will be sent to the original clearing broker instead of the ID Netting Subscriber Deliver Account.

ID Net Firms will still be able to exempt or cancel an ID netted delivery in IMS as they do today, but they will be limited to instructions transmitted through the Participant Terminal Service and Participant Browser Service (PTS/PBS) and only on a trade-by-trade basis; and deliveries from the ID Netting Subscriber Receive account will be attempted in random order until approximately 10:00 a.m. on settlement date. After that time, the system will attempt to complete any of the deliveries up until 11:30 a.m. in settlement value order - highest value first; ID Net transactions not completed for any reason by 11:30 a.m. due to a party’s failure to deliver or pass risk controls on settlement date will be exited from the ID Net Service and instead will settle trade-for trade versus the original clearing broker; deliveries that do not complete will be available for immediate reintroduction from the original clearing broker’s account through a new IMS function at 11:30 a.m. Brokers can then create a profile to have these deliveries await authorization or to be processed immediately.

If an ID Net Bank reclaims a transaction from the ID Netting Subscriber Receive Account the reclaims will be processed against the applicable ID Net Firm, not against the ID Netting Receive Account.

### **DTC Risk Management Control Updates**

In order to protect DTC from having a failure exported from NSCC for liquidity purposes, updates to Participants' net debit caps and collateral monitors will be necessary as described below:

A new ID Net collateral monitor and net debit cap balance will be recorded in the processing system for each ID Net Firm. The ID Net collateral monitor will record the net balance of collateral generated for all transactions processed through the ID Net service. If the balance of collateral generated by all ID Net receives and delivers is positive, the ID Net Firm's collateral monitor will not be increased by that amount. However, if an ID Net transaction requires collateral, the system will use the ID Net collateral surplus for that ID Net Firm before attempting to use other collateral from that ID Net Firm. If there is insufficient ID Net collateral for that broker, the system will look to the ID Net Firm's excess collateral in its account.

Similar to collateral, the system will create a new ID Net settlement balance for each ID Net Firm. When this balance is a net credit from deliveries on the ID Net Firm's behalf through the ID Netting Subscriber Receive Account, it will only be used to offset incoming ID Net receives to the ID Netting Subscriber Deliver Account omnibus account. If there is an insufficient ID Net credit to absorb the debit of the ID Net delivery

to the ID Netting Subscriber Deliver Account for that ID Net Firm, the system will create an ID Net debit that will effectively treat the ID Net debit as a reduction of the ID Net Firm's net debit cap. The ID Net debit will only be used for net debit cap calculation purposes and will not represent a participant's actual settlement balance.<sup>5</sup>

If the broker has insufficient collateral or net debit cap, the transaction will pend until 11:30 a.m. on settlement date.<sup>6</sup>

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<sup>5</sup> Currently, brokers receive market value credit for deliveries to CNS if the security is received versus payment (RVP) or collateral value (collateral value is market value less the DTC haircut) if the delivery to CNS was from securities in their start of day position or received for free. With respect to the ID Net service, the system will no longer identify if a delivery would have come from a broker's RVP securities or not, and as such, the system will assume the delivery would have come from a broker's start of day position.

Likewise, to the extent that ID Net Firms have a net credit for their ID deliveries today, an ID Net Firm's settlement balance is reduced. Since these credits will no longer be generated from the ID Net Firm's account, it may require the need to fund DTC intraday for net debit cap blockage.

<sup>6</sup> As an example of how DTC risk controls would be applied to ID Net Subscribers, assume that Investment Manager A sells 10 shares of Common Stock X using ID Net Firm B (a broker). If B sells the shares on an exchange for \$20, and the trade is affirmed and the shares are delivered by A's Custodian Bank C, then C would receive a credit in DTC for \$20 and the ID Netting Subscriber Deliver Account (owned by NSCC as agent for B) would have a DTC debit of \$20. In this case, B's net debit cap would be reduced by \$20 and its collateral monitor is reduced by the net of the \$20 debit and the collateral value of the securities (e.g. with a 10 percent haircut the collateral value would be \$18), or \$2. When the ID Netting Subscriber Deliver Account delivers the shares to CNS it receives a credit for \$20. This credit is offset with the DTC debit of \$20 at end-of-day. Additionally, assume A then buys 10 shares of Commons Stock Y through B at \$30. On the night of T+2, CNS will deliver the shares to the ID Netting Subscriber Receive Account and that account will be debited in CNS for \$30. C would then receive 10 shares of Y from the ID Netting Subscriber Receive Account. C receives a debit in DTC for \$30 and the ID Netting Subscriber Receive Account is credited at DTC for \$30. B's account has its DTC net debit cap increased by \$20 to offset the previous decrease of \$20 (for the sale of Common Stock X) (and not \$30 since the net of the ID Net receive relating to the sale of Common Stock X above of \$20 and the delivery of Common Stock Y for \$30 is a \$10 credit and B's net debit cap is decremented only when the net balance is a debit. C will not receive a net credit, but will receive an offset of previous ID Net debits with ID Net credits) and the same for its collateral monitor which is increased only up to the amount it was debited for ID Net transactions (absent its participation in the ID Net service, B would have received a \$3 credit to the collateral monitor which equals the net of the \$30 credit and the collateral value of the securities \$27 (\$30 market value less a 10% haircut)). In this case, B would only receive a collateral credit of \$2, but the ID Net credit balance of \$1 will be registered to absorb future ID Net receives that have a collateral deficiency. If C was at its net debit cap or collateral monitor limit due to other receives, the ID Net transaction would recycle or pend in the system until the deficiency could be satisfied or until 11:30 a.m., when it would drop out of ID Net.

### **NSCC Clearing Fund Offset and Mark-to-Market**

ID Net transactions will be used to offset the balance of any other CNS transactions, and the “net” of those transactions will be used for purposes of determining Clearing Fund obligations pursuant to NSCC’s current procedures, subject to a revised mark-to-market calculation applicable to ID Net Firms.

The revised mark-to-market calculation for ID Net Firms will add the value computed pursuant to: (x) the currently existing mark-to-market component (which will exclude ID Net transactions), and (y) a mark-to-market component calculated with respect to ID Net-related positions; however any positive value derived from either (x) or (y) will be set to zero.<sup>7 8</sup>

### **Prioritization**

In order to reduce the potential number and value of fails in the ID Net Service, deliveries from CNS to the ID Netting Subscriber Receive Account will be given a higher delivery priority, pursuant to the allocation algorithm set forth in NSCC’s Procedure VII (CNS Accounting Operation), than other CNS deliveries with the exception of buy-in deliveries, corporate action deliveries and deliveries of component securities of index receipts.<sup>9</sup> NSCC is also modifying this Procedure to clarify that deliveries of the

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<sup>7</sup> Similar to the existing mark-to-market component, the new mark-to market component applicable to ID Net transactions will equal the net of each day’s difference between (x) the contract price of the Member’s net positions relating to ID Net activity, and (y) the Current Market Price for such positions.

<sup>8</sup> For example, if an ID Net Firm has a “regular” mark-to-market debit of \$500,000 and an ID Net mark-to-market debit of \$100,000, then these debits would be added together and the ID Net Firm’s total mark-to-market obligation would equal a debit of \$600,000. However, if that same ID Net Firm’s ID Net mark-to-market calculation results in a credit of \$100,000, then the value of that credit would be set to zero and therefore the total mark-to-market would equal a debit \$500,000 (the amount of the broker’s regular mark-to-market debit).

<sup>9</sup> Currently, institutional deliveries processed through the DTC system from ID Net Firms to banks may be prioritized by ID Net Firms through IMS and/or via exempting their deliveries to CNS in order to ensure that available inventory will be used for such deliveries. Including transactions in the proposed service allows for the “automation” of such prioritization through the CNS Accounting Operation

component securities for index receipts shall have the same priority as deliveries to the ID Netting Subscriber Receive Account.

Any ID Net transactions that cannot be completed will be exited from the ID Net Service and instead will settle trade-for-trade between the ID Net Firm and the ID Net Bank (the original counterparties) at DTC.

### **Fee**

ID Net Banks and ID Net Firms will be charged a reduced DTC ID Net fee of \$0.025 for each completed delivery and receive processed versus the ID delivery or receive fee of \$0.05. Additionally, deliveries that are exited from the ID Net service will not be charged a drop fee. ID Net deliveries pend cancelled by ID Net Firms from the ID Netting Subscriber Receive Account will continue to be charge the \$0.45 pend cancel fee. ID Net deliveries to and from CNS on behalf of the ID Net Firms will not be charged.

### **Proposed Rule Changes**

Under the proposed rule change, a new Rule 65 and Procedure XVI (both titled “ID Net Service”) will be added to NSCC’s Rules, and additional conforming changes will be made elsewhere throughout NSCC’s Rules, as needed to provide consistency with the new Rule 65. These additional changes include the following:

#### *Rule 3 – Lists to be Maintained*

A subsection will be added to Rule 3 to provide that NSCC will maintain a list of Eligible ID Net Securities and may from time to time add or delete applicable CNS Securities from the list.

*Procedure VII – CNS Accounting Operation*

Procedure VII will be revised to incorporate the processing of transactions in Eligible ID Net Securities into the CNS Accounting Operation. The revisions will also reflect: (i) that Member's will not be able to exempt deliveries from an ID Netting Subscriber account, (ii) the prioritization of ID Net deliveries and deliveries of the component securities of index receipts in the CNS allocation algorithm behind deliveries associated with reorganizations and buy-ins, and (iii) that ID Net transactions will be recorded on the Miscellaneous Activity Report on the night of T+2, and removals of such transactions from the ID Net Service will also be recorded on that report.

*Procedure XV – Clearing Fund Formula and Other Matters*

Procedure XV will be revised to indicate the exclusion of ID Net transactions from the ID offset process for the purposes of calculating the volatility component of a subscriber's Clearing Fund requirement. In addition language will be revised and added with respect to the calculation of mark-to-market to reflect the changes to the formula as described above.

(b) The proposed rule change is consistent with the requirements of the Securities Exchange Act of 1934 (the "Act") and the rules and regulations thereunder applicable to DTC in that it promotes the prompt and accurate clearance and settlement of securities transactions by leveraging the capabilities of the DTC and NSCC systems to provide for more streamlined securities deliveries and extend netting benefits and efficiencies to ID transactions.

**B. Self-Regulatory Organization's Statement on Burden on Competition**

NSCC perceives no impact on competition by reason of the proposed rule change.

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

Written comments from NSCC Participants or others have not been solicited or received on the proposed rule change.

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

Within 35 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 90 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 change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

- Electronic comments may be submitted by using the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>), or by sending an e-mail to [rule-comment@sec.gov](mailto:rule-comment@sec.gov). Please include File No. SR-NSCC-2007-14 on the subject line.

- Paper comments should be sent in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington D.C. 20549-1090.

All submissions should refer to File Number SR-NSCC-2007-14. 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 Room, 100 F Street, NE, Washington D.C. 20549-9303. Copies of such filing also will be available for inspection and copying at NSCC's principal office and on NSCC's Web site at [www.nsc.com](http://www.nsc.com). 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 the file number above and should be submitted within \_\_\_\_\_ days after the date of publication.

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

Nancy M. Morris

**Bold and underlined text indicates proposed additions to Rules text**

~~**Bold and struck-through text indicates proposed deletions from the Rules text**~~

**Bold, underlined and shaded text indicates proposed additions to Rules text from previous rule filings pending SEC approval**

~~**[Bold, bracketed, struck-through, and shaded text indicates proposed deletions from the Rules text from previous rule filings pending SEC approval]**~~

RULES AND PROCEDURES  
OF  
NATIONAL SECURITIES CLEARING CORPORATION

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RULE 1. DEFINITIONS

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**Eligible ID Net Security**

**The term "Eligible ID Net Security" has the meaning specified in Rule 65.**

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**Id Net Subscriber**

**The term "ID Net Subscriber" has the meaning specified in Rule 65.**

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RULE 3 LISTS TO BE MAINTAINED

SEC. 1. (a) The Corporation shall maintain a list of the securities which may be the subject of contracts cleared through the Corporation (hereinafter referred to as "Cleared Securities"), and may from time to time add securities to such list or remove securities therefrom. Unless the Corporation shall otherwise determine, Cleared Securities may only be those issues of securities the issuer of which is subject to, or regularly complies with, Rule 10b-17 of the Securities and Exchange Commission, promulgated pursuant to the Securities Exchange Act of 1934, as amended. The Corporation shall accept an issue of securities as a Cleared Security only

upon a determination by the Corporation that it has the existing operational capability to do so and to continue successfully to provide its services to Members.

A Cleared Security that the Corporation in its discretion determines no longer meets the requirements imposed pursuant to this Section 1 shall cease to be a Cleared Security. In addition, the Corporation may determine that a Cleared Security shall cease to be a Cleared Security in the event that: (1) such Cleared Security shall have been suspended from trading in the over-the-counter market or on any national securities exchange by the Securities and Exchange Commission pursuant to Section 12(k) of the Securities Exchange Act of 1934, as amended, or has been suspended from trading by another regulatory authority or by a self-regulatory organization (as defined in Section 3(a)(26) of the Securities Exchange Act of 1934, as amended), which has authority to suspend such activity; or (2) the Corporation finds that the level of activity in the security during the period of three consecutive months preceding that determination is insufficient to produce benefits commensurate with the costs to the **[Settling]** Members arising from its continued inclusion as a Cleared Security; or (3) the Corporation determines that there may exist a legal impediment to the validity or legality of the issuance or continued transfer or delivery of the security; or (4) the Corporation determines, after discussion with the appropriate marketplace regulator, where possible, that continued clearance and settlement by the Corporation presents unacceptable risks to the Corporation and/or its participants; or (5) the Corporation determines that the location of the transfer agent(s) for the security or such transfer agent's capability for reissuing certificates for the security is such as to impair the efficient operation of clearing procedures.

(b) The Corporation shall also maintain a list of Cleared Securities that are eligible for book-entry transfer on the books of each Qualified Securities Depository and are subject to clearance and settlement in the CNS System and may from time to time add Cleared Securities to such list or remove Cleared Securities therefrom.

**(c) The Corporation shall maintain a list of funds and other pooled investment entities which may be the subject of orders processed through the Corporation's Mutual Fund Services (hereinafter referred to as "Fund/Serv Eligible Funds") and may from time to time add funds and other pooled investment entities to such list or remove Fund/Serv Eligible Funds therefrom. Unless the Corporation shall otherwise determine, a Fund/Serv Eligible Fund must be assigned a CUSIP number, and may only be: (i) an investment company regulated under the Investment Company Act of 1940, as amended; (ii) a fund or other pooled investment entity that is subject to regulation under applicable federal and state banking and/or insurance law; or (iii) a fund or other pooled investment entity subject to regulation under other applicable law which meets criteria established by the Corporation from time to time.**

**(d) The Corporation shall maintain a list of insurance products and retirement or other benefit plans or programs which may be the subject of orders processed through the Insurance and Retirement Processing Services (hereinafter referred to as "IPS Eligible Products") and may from time to time add IPS Eligible Products to such list or remove IPS Eligible Products therefrom. An IPS Eligible Product must have been assigned a CUSIP number.**

(e) The Corporation shall maintain a list of government securities which may be the subject of contracts processed through the Corporation (hereinafter referred to as “Eligible Government Securities”) and may from time to time add government securities to such list or remove government securities therefrom. An Eligible Government Security may only be: an unmatured, marketable debt security in book-entry form that is a direct obligation of the United States Government; such other security issued or guaranteed by the United States, a U.S. government agency or instrumentality, or a U.S. government-sponsored corporation; or, such other security as determined by the Corporation from time to time.

(f) The Corporation shall maintain a list of Eligible ID Net Securities as defined in Rule 65 and may from time to time add CNS Securities to such list or remove CNS Securities therefrom.

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## RULE 65

### ID NET SERVICE

#### SEC. 1. General

(a) The Corporation may offer a service to provide a means by which a Member can clear certain of its customer-side activity in Eligible ID Net Securities (as defined in this Rule 65) that is transmitted to or from the Corporation’s agency accounts established on behalf of the Member at a Qualified Securities Depository. Such activity is processed through the CNS accounting system of the Corporation when the customer is a contra-side participant of a Qualified Securities Depository, and such participant has agreed with the applicable Qualified Securities Depository to the delivery of applicable securities directly to the agency accounts established on behalf of Members participating in this service. Such a Member meeting the qualifications of this Rule (an “ID Net Subscriber”) may participate in this service which shall be known as the “ID Net Service,” and shall be accomplished in accordance with this Rule.

The rights, liabilities and obligations of ID Net Subscribers in their capacity as such shall be governed by this Rule 65 in addition to the Rules of the Corporation as they apply to them in their capacity as Members; except that in the event of a conflict between such Rules, Rules applying to ID Net Subscribers in their capacity as Members generally shall govern.

#### SEC.2. Qualifications of ID Net Subscribers

An ID Net Subscriber must meet the qualifications set forth in this Rule. An ID Net Subscriber must be: (i) an existing Member of the Corporation, and (ii) eligible for CNS processing.

**SEC. 3. Documentation and Requests for Status as an ID Net Subscriber**

**(a) Each Member that wishes to become an ID Net Subscriber shall complete and deliver to the Corporation documentation, in such form as prescribed by the Corporation from time to time and shall provide such other reports and information as the Corporation may determine or appropriate. The applicant shall sign and deliver to the Corporation an agreement or acknowledgement, the form of which shall be determined by the Corporation from time to time, whereby the applicant shall agree to the terms and conditions of this Rule 65 and such other terms not inconsistent with this Rule 65 that are deemed by the Corporation to be necessary to protect itself or its participants. An applicant shall provide such reports and information as the Corporation may determine is appropriate.**

**(b) The Corporation shall approve a request of a Member to become an ID Net Subscriber pursuant to this Rule 65 upon a determination by the Corporation that the Member has satisfied the qualifications and requirements for ID Net Subscribers as set forth in this Rule 65.**

**SEC. 4. Eligible ID Net Securities**

**Subject to limitations set forth by the Corporation from time to time, any CNS Security shall be an “Eligible ID Net Security”.**

**SEC. 5. Obligations and Rights applicable to an ID Net Subscriber**

**(a) An ID Net Subscriber covenants to the Corporation as follows:**

**(i) to abide by the Rules of the Corporation applicable to an ID Net Subscriber and the use of the ID Net service, and to be bound by all the provisions thereof, and that the Corporation shall have all the rights and remedies contemplated by the applicable Rules of the Corporation;**

**(ii) that the applicable Rules of the Corporation shall be a part of the terms and conditions of every transaction which the ID Net Subscriber submits to the Corporation;**

**(iii) to pay to the Corporation such fees, charges and other amounts as may be established by the Corporation in connection with the ID Net Subscriber’s use of ID Net Service or its status as an ID Net Subscriber, and to pay such fines or penalties as may be imposed in accordance with this Rule 65; and**

(iv) to be bound by any amendment to the applicable Rules of the Corporation subsequent to the time such amendment takes effect as fully as though such amendment were now a part of the Rules of the Corporation, provided, however, that no such amendment shall affect its right to cease to be an ID Net Subscriber unless before such amendment becomes effective, it is given an opportunity to give written notice to the Corporation of its election to cease to be an ID Net Subscriber.

(b) The Corporation may determine to remove a Member's status as an ID Net Subscriber, or to suspend, limit or restrict its access to the ID Net Service, under the following circumstances:

(i) if the ID Net Subscriber is in such financial or operating difficulty that the Corporation has determined, in its discretion, that such action is necessary for the protection of the Corporation and its participants;

(iv) the ID Net Subscriber has failed to comply with any requirement of the Corporation, or if it no longer meets the qualifications for status as an ID Net Subscriber set forth in this Rule;

(v) if the ID Net Subscriber is "insolvent" as defined in Rule 20 of these Rules; or

(vi) under any circumstances in which, in the reasonable discretion of the Corporation, adequate cause exists to do so.

Such action may be taken summarily if the Corporation determines in its reasonable discretion that such summary action is in the interests of the Corporation or its participants.

#### SEC. 6. ID Net Processing

Transactions submitted through the ID Net Service shall be processed as set forth in Procedure XVI.

#### SEC. 7. Limitations on Liability

(a) Notwithstanding any other provision in the Rules of the Corporation: The Corporation will not be liable for any action taken, or any delay or failure to take any action, hereunder or otherwise to fulfill the Corporation's obligations to its ID Net Subscribers, other than for losses caused directly by the Corporation's gross negligence, willful misconduct, or violation of federal securities laws for which there is a private right of action. Under no circumstances will the Corporation be liable for the acts, delays, omissions, bankruptcy, or insolvency, of any third party, including, without limitation, any

**depository, custodian, sub-custodian, Settling Bank, Registered Clearing Agency, Affirming Agency, data communication service or delivery service (“Third Party”), unless the Corporation was grossly negligent, engaged in willful misconduct, or in violation of federal securities laws for which there is a private right of action in selecting such Third Party.**

**(b) Under no circumstances will the Corporation be liable for any indirect, consequential, incidental, special, punitive or exemplary loss or damage (including, but not limited to, loss of business, loss of profits, trading losses, loss of opportunity and loss of use) howsoever suffered or incurred, regardless of whether the Corporation has been advised of the possibility of such damages or whether such damages otherwise could have been foreseen or prevented.**

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## PROCEDURE VII. CNS ACCOUNTING OPERATION

### A. Introduction

The CNS Accounting Operation processes transactions in CNS Securities. **Subject to the provisions of Procedure XVI, and for the purposes of this Procedure VII, references to CNS Securities shall include Eligible ID Net Securities.**

Transactions in CNS Securities which are reported as compared or recorded on the various report output issued through such time on Settlement Date, as the Corporation may determine (or, with respect to debt security transactions compared or recorded pursuant to Procedure II. D, through SD-1)<sup>1</sup>, as well as transactions recorded through Trade Recording (Interface Clearing) and those submitted by Special Representatives, are reported on Consolidated Trade Summaries. The netted obligations are then entered into the CNS Accounting Operation.

CNS is an on-going accounting system which nets today's Settling Trades with yesterday's Closing Positions, producing new short or long positions per security issue for each Member. The Corporation is always the contra side for all positions. The positions are then passed against the Member's Designated Depository positions and available securities are allocated by book-entry. This allocation of securities is accomplished through an evening cycle followed by a day cycle. Positions which remain open after the evening cycle may be changed as a result of trades accepted for settlement that day. Members may control the receipt and delivery of their securities through the use of Exemptions (for deliveries) or Priorities (for receipts).

Money settlement is not associated with the individual security movements but is the result of comparing the Closing Money Balance to the Closing Net Market Value of the Member's CNS account.

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<sup>1</sup> At the current time, as-of trades in debt securities compared or recorded via the real-time trade matching system (“RTTM”) after the cutoff time on SD-1 will not settle in the normal cycle. They will instead be assigned a new settlement date, which will be the settlement day following the day the trade is compared or recorded by the Corporation.

Dividends and interest are credited or charged to the Member's account according to the security positions that exist on record date. The record date positions are automatically updated for "As-Of" trades and appropriate due bill activity.

## **B. Consolidated Trade Summary**

All compared and recorded transactions in CNS Securities (excluding Special Trades) are processed through the CNS Accounting Operation. This includes transactions compared under the provisions of Section II, recorded under the provisions of Section III, or entered by Special Representatives under Section IV. Purchases and sales due for settlement on a given day are summarized on the Consolidated Trade Summary.

The Consolidated Trade Summary (or "CTS") is issued in the evening of each settlement day and contains, with respect to CNS Securities:

(i) those trades compared or recorded through T+1 up to the Corporation's cutoff time on that day which are due to settle on the following settlement day (i.e. if the report is issued late Monday evening, it will show trades due to settle on Wednesday), and

(ii) with respect to trades due to settle on the same settlement day (i.e. Tuesday), T+2 and older as-of trades and next day settling trades not previously reported on the prior day's CTS or on any Supplemental CTS, in each case in CUSIP order, reported as broad buys and sells by marketplace or source, netted by issue, quantity and money.

Supplemental Consolidated Trade Summaries are also issued on each settlement day, and report supplemental activity compared or recorded after the evening cutoff time for CTS report processing (including cash trades), up until the Corporation's daytime cutoff time which are due to settle on that same day.

**Note:** any T+3 or older as-of trades compared or recorded after such cutoff time on settlement day (or, with respect to debt securities compared or recorded by RTTM, any T+2 or older as-of trades compared or recorded after the RTTM cutoff time on T+2) will settle on the next settlement day and appear on that night's Consolidated Trade Summary.

Net quantities purchased or sold in each security issue are entered into the CNS Stock Record together with their associated contract monies at the beginning of the Settlement Date processing cycle. Subsequent obligations (reflecting supplemental activity), together with their associated contract monies, are entered into the CNS stock record thereafter during such processing cycle until such cutoff time as the Corporation may determine.

The total page of the Consolidated Trade Summary shows totals for all equity and debt transactions and is subdivided by marketplace of execution or source of trade input.

## **C Receipt and Delivery of Securities**

### **1. Stock Record Update**

Each day, Settling Trades shown on the Consolidated Trade Summary are netted with the Closing Positions which have been carried forward from the previous day. The resulting net positions represent the quantity of each security due for settlement by the Member on Settlement Date. A long position represents the quantity owed to the Member by the Corporation (the Member's fail-to-receive). A short position represents the quantity

owed to the Corporation by the Member (the Member's fail-to-deliver). The Corporation is the contra side to all long and short positions. Each long and short position contains an indicator identifying Exemptions, Priority Requests and Buy-Ins (see subsections D and E of this Section). These indicators do not alter positions or effect securities movement, but serve solely to control the settlement process.

**2. Selection of Depository**

Each Member must select a Qualified Securities Depository for purposes of CNS settlement (the Member's "Designated Depository"). All short positions must be satisfied by, and long positions allocated to, the Member's account at the Designated Depository.

**3. Evening Cycle**

After the procedures described in paragraph 1 have been completed, each Member's positions are passed to the Designated Depository. Subject to the limitations imposed by Exemptions (see subsection D) **and Procedure XVI**, securities are transferred from the Member's **applicable** Designated Depository account to satisfy its short positions. If the quantity on deposit is insufficient to settle the entire short position, a partial movement occurs. Securities received from Members in settlement of short positions are placed in the Corporation's **applicable** account at the Designated Depository. The Corporation then provides instructions to deliver those securities from its account at that depository to the Designated Depository accounts of those Members which have long positions.

The results of the evening allocation are recorded on the CNS Settlement Activity Statement distributed the following morning. All security movements in Designated Depositories are made on a "free" basis. Money settlement associated with such security movements is accounted for by the Corporation as a separate function. The Current Market Value of each entry is shown on the Settlement Activity Statement for informational purposes.

**4. Day Cycle**

Positions which remain open after the evening allocation, or become open as a result of subsequent activity, are recycled on the following day. As additional securities are made available in Members' Designated Depository accounts, additional receipts and deliveries are made against long and short positions. The daytime recycle functions essentially the same as the evening allocation except that the process is continual, entries being effected every few minutes.

In order to notify Members of settlement activity as quickly as possible, Settlement Activity tickets are issued periodically during the day. These tickets are produced by the Designated Depository which actually made the entry to the Member's account, and are made available to the Member shortly after the entry is made.

In addition, in order to notify Member of changes in their positions due to same day **(including cash)** settling trades or miscellaneous activity, the Corporation will make available information in respect of such activity and new net settling positions as a result thereof, in such form as the Corporation may determine.

At the end of the daytime recycle, all daytime activity is summarized on the CNS Settlement Activity Statement.

#### **D. Controlling Deliveries to CNS**

As noted in subsection C, the delivery of securities from a Member's Designated Depository account to satisfy short positions is an automatic process and requires no action on the part of the Member. Securities are removed from the Member's Designated Depository account to the extent that a sufficient quantity is on deposit.

In order for a Member to avoid segregation violations and to meet other delivery needs, a procedure is provided to control this automatic system. The first phase of this procedure provides the Member with its projected positions due for settlement the following day. The second phase involves the submission of instructions by the Member indicating which short positions it does not wish to settle. Additionally, transactions compared or received on **[T+2] SD-1** or thereafter, **including cash or next day transactions** which are processed for next day or same day settlement and which create or increase a short position will automatically be exempted by the Corporation from the delivery. This exemption shall hereinafter be referred to as the "One Day Settling Exemption".

#### **1. Projection Report**

Each morning, a Projection Report is distributed to each Member. This report shows, as of the time of its preparation, the Member's long position or short position for each security, settling trades for the next day, plus any miscellaneous activity and stock dividends payable on the next day; and may include long and short positions due to settle that day. Throughout the day the Corporation will make available updates to this information, in such formats as it may determine.

Long and short positions reflect the Member's status in each security issue as of the time the Projection Report is prepared. These positions may change due to same day settling trades and/or miscellaneous activity, and as the settlement cycle on the day the report is issued continues. If a Member's long and short positions change during the day, the projection position will also change. The Member must, therefore, update these positions based on same day settling trade and settlement activity which occurs during the course of the day.

#### **2. Exemptions**

**Except as described below, each** ~~Each~~ Member has the ability to elect to deliver all or part of any short position. It controls this process by Exemptions. By indicating a particular quantity as an Exemption, the Member directs the Corporation not to settle certain short positions or portions thereof. Exemptions govern short positions in the CNS Stock Record and not Designated Depository positions. All short positions or positions thereof for which no Exemption is indicated are settled automatically to the extent that the Member has made such securities available in the Member's Designated Depository account or they become available in its Designated Depository account through other depository activity. **Notwithstanding the above, a Member may not exempt delivery**

**of any securities available in an agency account established at a Qualified Securities Depository for the processing of transactions through the ID Net Service.**

## (a) Types of Exemption

The CNS system provides for two levels of Exemption. By proper use of the Projection Report and Exemptions, Members can utilize current inventory as well as securities received from other sources on settlement day in order to satisfy delivery requirements.

(i) Level 1 Exemption - By submitting a Level 1 Exemption, the Member indicates that the portion of the short position exempted should not be automatically settled against its current Designated Depository position or against any securities which may be received into its Designated Depository account as a result of other depository activity.

(ii) Level 2 Exemption - The submission of a Level 2 Exemption is an instruction by the Member that the portion of the short position exempted should not be automatically settled against its current depository position. Such a position may be satisfied, however, by certain types of "qualified" activity in its Designated Depository account.

## (b) Qualified Activity

There are four types of qualified activity which allow short positions carrying Level 2 Exemptions to be settled:

(i) Coded Deposits - The Member deposits securities into its Designated Depository account in the normal manner, but by using a special deposit ticket which indicates that these securities are available for settling Level 2 Exemption quantities.

(ii) Coded Collateral Loan Releases - A Member may release securities from its Designated Depository collateral loan account and wish those securities to be used in settling a Level 2 Exemption quantity. In this case, the Member uses a special Collateral Loan Release form which authorizes such use.

(iii) Receipts from Banks - All securities received against payment from banks are eligible to settle Level 2 Exemption quantities. Settlement of such items is automatic and no special instruction by the Member is required.

(iv) Receipts from Member's Sub-Account - As a result of CNS sub-accounting (see subsection I of this Section), a Member may have a long position in a given security in one CNS account and a short position in the same security in another CNS account. Since both CNS accounts settle against a single Designated Depository Account, the Member may receive securities from itself. If a Member is allocated securities from one CNS account, those securities will automatically override any Level 2 Exemption placed on the short position in its other CNS account.

## (c) Methods of Submitting Exemptions

Exemptions may be submitted by using such form or automated means as are acceptable to the Corporation from time to time. Exemptions must either indicate the quantity to be exempted, or indicate all, and designate that quantity as Level 1 or Level 2. A Member may submit daily Exemption instructions to the Corporation. If a Member has no Exemptions on a given day, instructions may be submitted indicating no Exemptions for either Level 1 or Level 2.

A Member must submit standing Exemption instructions to the Corporation. Standing Exemption instructions will govern all of the Member's short positions for any day on which (i) specific daily Exemption instructions are not submitted to the Corporation, (ii) are not received by the Corporation, or (iii) are unable to be processed by the Corporation. In the absence of such standing Exemption instructions or specific Exemption instructions for that day, the Corporation assigns a Level 1 Exemption to all short positions of that Member.

Exemptions may be submitted by Members through the facilities of service bureaus and other agencies provided that the service bureau or agency has been authorized by the Corporation to act on behalf of its Member.

Exemptions must be submitted for each CNS Sub-Account maintained by the Member (see subsection I of this Section).

(d) Exemption Override

With respect to one day and same day settling transactions, Members may select a standing Exemption override to permit all such short positions to be delivered. Additionally, during the daytime cycle, a Member may override the One Day Settling Exemption as well as other Exemptions entered by the Member the previous evening. To do so, the Member should prepare a Delivery Order (DO) and submit it to its Designated Depository in the normal manner. If the Designated Depository is DTC, the receiving Member must be designated as 888.

The securities designated to be delivered on the DO are first applied to any quantity covered by a Level 1 Exemption and the One Day Settling Exemption. Any remaining quantity (or if no Level 1 Exemption existed, the entire delivery) is applied to any quantity covered by a Level 2 Exemption. If there is still a remaining quantity, that quantity is not processed.

**E. Controlling Receipts from CNS**

After securities are received by the Corporation from Members with short positions, they are allocated to other Members which have long positions. The allocation of these securities is governed by an algorithm which changes daily so as not to benefit any one Member. Members may change their relative rank within this algorithm by submitting Priority Requests. The submission of a Buy-In Notice will also affect the priority of a Member's long position in that particular security.

**1. Standing Priority Request**

A Member may enter a Standing Priority Request which moves its 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 Member may enter a Standing Priority Request for the evening cycle only, the day cycle only, or both the evening and day cycles in respect of its general account or any sub-account.

**2. Priority Overrides**

A Member may override a Standing Priority Request which it has previously submitted, or obtain priority when it has not submitted a Standing Priority Request by submitting a Priority Override. Each Priority Override changes the Member's relative rank in the allocation algorithm for its long position in one security only. The Priority Override remains in effect for one day.

The Member may submit a Priority Override for the specified security for the evening cycle only, the day cycle only, or for both the evening and day cycles.

**3. Buy-In Notices**

A Member which submits a Buy-In Notice in accordance with the provisions of subsection J of this Section is assigned to a higher relative rank in the allocation algorithm for the quantity of securities specified on the Buy-In Notice than those Members which have requested high priority through the use of a Standing Priority Request or Priority Override.

**4. Allocation Algorithm**

The algorithm which governs the allocation of long positions is based on priority groups in descending order, age of position within a priority group and random numbers within age groups.

Priority groups include the following:

(a) long positions in a CNS Reorganization Sub-Account established pursuant to paragraph H.4. of this Section VII of these Procedures;

(b) long positions against which Buy-In Notices are due to expire that day but which were not filled the previous day;

(c) long positions against which Buy-In Notices are due to expire the following day;

**(d) long positions in a receiving ID Net Subscriber's agency account established at a Qualified Securities Depository, and (ii) long positions against the component securities of index receipts;**

~~(d)~~**(e)** in descending sequence, priority levels as specified by Standing Priority Requests and as modified by Priority Overrides.

When more than one long position in a given security exists within the same priority group, the "oldest" position is allocated first. Age is defined as the number of consecutive days during which the position has been long, irrespective of quantity.

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.

The allocation algorithm for the evening and day delivery cycles is computed separately to allow for Standing Priority Requests and Priority Overrides which have specified different levels of priority for evening and day cycles.

## **5. Fully-Paid-For Account**

(Procedures for Movements to the Long Free Account other than for the Stock Borrow Program)

The Corporation's processing day is divided into two parts. It begins with an evening cycle on the evening preceding the settlement day for which the work is being processed and is followed by a day cycle which ends on the settlement day for which the work is processed. If a Member with a long position and/or a position due for settlement on the next settlement day, in anticipation of receiving securities from the Corporation (other than municipal securities, as that term is defined by the Securities Exchange Act of 1934, as amended), as a result of the allocation process during the evening or day cycle for that settlement day, instructs that securities within its possession or control (other than municipal securities) be delivered on the next day and is subsequently not allocated the securities during the evening or following day cycle, the Member may, in order to meet the "customer segregation" requirements of SEC Rule 15c3-3, instruct the Corporation, during the day cycle for that settlement day by the time specified by the Corporation, to transfer the position(s) which has not been allocated to a special CNS sub-account (the "Long Free Account"). The Corporation will then debit the Member's settlement account for the value of the position in the Long Free Account. The Long Free Account will be guaranteed by the Corporation and will be marked daily.

All funds which the Corporation receives from debiting the Member's settlement account for the value of a position moved into the Long Free Account and all marks credited to the Long Free Account as a result of marking positions to the market daily, will be segregated by the Corporation from all other funds received by the Corporation. Any time that a Member determines that he no longer needs the position(s) in the Long Free Account for 15c3-3 purposes, he may instruct the Corporation to transfer back the position(s) to its Long Valued Account and make the appropriate adjustment to its settlement account.

**NOTE:** The SEC has stated that: "any broker/dealer that takes advantage of proposed rule NSCC-82-25 must recall deficits from bank loan within shorter time intervals than those presently allowed under SEC Rule 15c3-3(d)(1). In the case of bank loan,

broker/dealers will be expected to effect a recall within one business day instead of the two business days presently allowed.

## **F. Computation of CNS Money Settlement**

The computation of the Net CNS Money Settlement Amount is based on the Accounting Summary and the Cash Reconciliation Statement. The Net CNS Money Settlement is then recorded in the Settlement Statement (described in Section VIII) and is netted with settlement obligations resulting from other services.

### **1. Accounting Summary**

CNS accounting is completed with the issuance of an Accounting Summary at the end of the settlement day. This report is divided into two parts. The first part deals with CNS Stock Record security movements and positions; the second part summarizes money activity and balances. Security and money accounting are two distinct functions under CNS and are performed separately.

The part of the Accounting Summary which deals with security accounting shows the Member's Opening Position, Settling Trades, stock dividends and miscellaneous activity, receipts and deliveries, Closing Position, and Current Market Value of Closing Positions for each security in which it had a position or activity that day. The Current Market Value of closing long positions and closing short positions is totaled at the end of the report. The net of these two figures is the Net Market Value of the Member's account at the end of the day and represents the net value of securities which the Member owes to the Corporation or which the Corporation owes to the Member.

The last section of the Accounting Summary reflects the Member's Opening Money Balance, net money amounts for Settling Trades, cash dividends and interest, miscellaneous activity which may include Clearing Fund calculations and Closing Money Balance. The Closing Money Balance represents the net amount of money which the Member owes to the Corporation or which the Corporation owes to the Member.

The net CNS Money Settlement Amount is calculated by subtracting the Net Market Value from the Closing Money Balance. The effect of this calculation is to bring the Member's money balance into agreement with the market value of its Closing Positions.

The Accounting Summary is the final report produced by the CNS system for each Settlement Date. Members are required to reconcile all security and money balances shown thereon by comparing the Accounting Summary to their own records and promptly reporting any difference to the Corporation for reconciliation.

### **2. Cash Reconciliation Statement**

Although the Accounting Summary constitutes the official record of all CNS activity, positions and settlements, it is produced too late in the afternoon to be used by the Member to determine its money settlement obligations. In order for members to effect a timely settlement, a separate report known as the Cash Reconciliation Statement is used for money calculation.

Although the Cash Reconciliation Statement is a different method of computing the settlement amount arrived at on the Accounting Summary, it relies on the same concepts in that the value of Closing Positions is compared to the money balance for that day, the difference being the Member's money settlement amount. In the case of the Cash Reconciliation Statement, the money settlement is computed in the early morning and is continuously updated throughout the day cycle to reflect activity which takes place during the day. The Corporation will make such updated information available to Members throughout the day cycle in such manner as it may from time to time determine.

The results of the daytime delivery cycle are summarized on a Settlement Activity Statement issued on the afternoon of Settlement Date. Each entry is valued at the Current Market Price with totals at the end of the report. These totals must be posted by the Member to the Cash Reconciliation Statement. When these totals are netted with the preliminary figure shown on the report, the result will be the final Net CNS Money Settlement Amount.

A final Cash Reconciliation Statement is issued on the afternoon of each settlement day, and shows all information shown on the Preliminary Cash Reconciliation Statement updated for daytime activity to arrive at a final settlement amount.

#### **G. CNS Dividend Accounting**

Dividend Accounting within the CNS system is based primarily on the Member's Closing Position on the record date for the dividend, distribution, etc. Cash dividends, stock dividends, spinoffs, etc. are calculated and reported to the Member on the morning after record date. On payable date, the appropriate debit or credit is applied to the Member's CNS account.

Stock splits and interest are charged to or credited in a similar manner, but calculations are based on the CNS record date positions updated through the Due Bill period.

##### **1. Record Date Report**

Each day the Corporation issues a Record Date Report advising Members of the Closing Positions on record date for the previous day. Appropriate dividend, distribution and interest data including dates, rates and calculated amounts are also shown. The purpose of this report is to advise the Member of the pending dividends which will be applied to its account at a later date. These record date positions should be compared by the Member against its internal records for accuracy.

##### **2. Dividend Activity Report**

Cash and stock dividends which are to be applied to a Member's account are shown on the Dividend Activity Report usually produced on the day before payable date. Dividends are calculated according to record date closing positions updated for As-Of Trades. As-Of Trades submitted up to two days prior to payable date and which have an original trade date before ex-dividend date are automatically included in the payment calculation.

Stock dividends shown on this report appear on the Accounting Summary.

The net of all cash dividends appears on the Dividend Activity Report as well as the Accounting Summary and the Cash Reconciliation Statement.

Fractional shares resulting from stock dividends are credited and charged in cash. The cash in-lieu amount is shown on the Dividend Activity Report and is included in the overall total along with cash dividends. Fractional shares are valued using the Current Market Price for the day the report is produced.

Distributions for stock splits and interest calculations are not reflected on this report as updating is necessary during the Due Bill period.

### **3. Due Bill Accounting**

The credit or charge to Members for interest, stock splits, rights distributions or any other distribution which involves trading of a CNS Security with Due Bills, is processed in a different manner. The Designated Depositories automatically account for security receipts and deliveries during a Due Bill period through an interim accounting system. The Corporation, therefore, credits or debits a Member's CNS account for the appropriate securities or money based only on the Member's Closing Position on Due Bill Redemption Date in the case of stock splits and distributions, and the day prior to payable date in the case of interest.

The quantity or money due to or from each Member appears on a separate Dividend Activity Report which is issued on the morning after Due Bill Redemption Date. Share quantities are added to each Member's long or short position prior to the night delivery cycle for the day's settlement. Cash-in-lieu of fractions, as well as interest amounts, are included in that day's money settlement.

In the case of stock splits, the Current Market Price is adjusted by the rate of the split during the last two days prior to the Due Bill Redemption Date. This process synchronizes the application of additional quantities to the Member's account with the valuation of that security at the new price.

If a particular distribution is not eligible for processing through the interim accounting systems of the Designated Depository, the Corporation records the record date position of the security carrying the Due Bill as well as all receipt and delivery activity during the Due Bill period. Based on the net of these amounts, the Corporation computes the amount to be debited or credited to each Member and records such quantities on the Dividend Activity Report.

### **4. Optional Dividends**

Dividends which may be paid in the form of securities or cash at the option of the holder are processed as follows:

Record date positions are initially recorded in the CNS Dividend Accounting system using the option specified by the issuer as the "default option" (the "default option" is the form in which payment will be made by the issuer if instructions to the contrary are not received).

Each Member with a long position as of the close of business on record date may change the form of payment for all or part of its position by submitting an Optional Dividend Instruction. The Optional Dividend Instruction must be received by the Corporation no later than the cutoff time and date specified by DTC. If an Optional Dividend Instruction is not received from a Member with a long position on record date, that Member will be credited on the basis of the default option.

The Corporation will charge Members with short positions on record date according to the options selected by members with long positions on record date using a random method of allocation. Members with short positions will be advised of the form by which they will be charged only if that form differs from the default option.

## **H. Miscellaneous CNS Activity**

Certain types of activity occur within the CNS system which are reflected on Miscellaneous Activity Reports. Each entry shown on these reports is identified by legend as to type, e.g., reorganization, journal entry, etc. Security entries also appear on the Accounting Summary identified as "miscellaneous". Money entries are netted to a single figure on the Miscellaneous Activity Reports and are identified as "miscellaneous" on the Accounting Summary.

### **1. Removal of Eligible Securities from CNS**

When the Corporation declares a security ineligible for processing through CNS, all net positions in that security are removed from the CNS Stock Record on the effective date. Any pending positions (trades, stock dividends, etc.) are removed as soon as they are posted to the CNS Stock Record. Such entries are posted to the Member's next available Miscellaneous Activity Report issued on the date of removal. The Current Market Value of the security, as of the date of removal, appears on the next available Miscellaneous Activity Report and is posted to the Member's Money account.

**When** a security is removed from CNS, a random allocation procedure matches Members with long positions to Members with short positions. CNS Receive and Deliver Instructions are produced instructing a Member to receive securities from or deliver securities to another Member of the Corporation or a participant of an interfacing clearing corporation. CNS Receive and Deliver Instructions for equities and corporate bonds are considered Balance Orders (see Section V) and are due for settlement on the date issued and must be settled in the same manner as are Balance Orders. Municipal Bond Receive and Deliver Instructions are subject to the rules of the MSRB and the settlement thereof are the responsibility of the parties to the Receive and Deliver Instructions.

### **2. Journal Entries**

Occasionally, it is necessary to adjust positions within the CNS system. These entries appear on the applicable Miscellaneous Activity Report which identifies, by legend, the type of Journal Entry made.

### **3. Member Mergers**

If two or more Members merge their operations, or if one Member assumes the obligations of one or more other Members, all CNS Stock Record positions and money

balances are merged under the new Member number. Such entries are made at the opening of business on the effective date, and appear on the Miscellaneous Activity Report with the legend "Member Merger".

#### **4. Corporate Reorganizations**

Through the facilities of the CNS Reorganizations Processing System, the Corporation offers Members the ability to process within the CNS System transactions in certain securities undergoing corporate reorganizations. For the purpose of this System, reorganizations are divided into two categories: "mandatory" reorganizations, consisting of mergers, redemptions, liquidations, reverse splits and name changes; and "voluntary" reorganizations, consisting of tender or exchange offers (collectively "tender offers").

All securities subject to the reorganizations listed above (hereinafter referred to as "the subject security") are included in the CNS Reorganization Processing System except for: (i) securities subject to redemption if there is a conversion privilege attached; (ii) securities subject to a reorganization where baby bonds are issued; and (iii) securities made ineligible for processing at a Qualified Securities Depository during a corporate reorganization. In addition, a security may not be eligible for the CNS Reorganization Processing System if the Corporation determines that operational difficulties prevent the processing of the security in the system. A security ineligible for the CNS Reorganization Processing System is removed from the CNS System, and Receive and Deliver Instructions for such security are issued as explained in paragraph 1 above. Notwithstanding the foregoing, the Corporation may, from time to time, process corporate actions through the CNS Reorganization Processing System that would otherwise be ineligible, if the Corporation, in its sole discretion, determines that it has the capability to do so. In such circumstances, the Corporation will issue a notice detailing how such security will be processed.

To the extent the Corporation receives timely notification of a reorganization, each business day, starting two business days before the effective day of a mandatory reorganization, or four business days before the expiration date of the tender offer ("effective day" and "expiration day" hereinafter referred to as "E") through such time as the Corporation shall determine, the reorganization information received by the Corporation appears on the CNS Reorganization Information Report. If the Corporation does not receive sufficient notification of a pending reorganization to permit inclusion of such information on CNS Reorganization Information Reports on the dates prior to E specified above, the Corporation will provide such information on the CNS Reorganization Information Report as soon as practical after receipt of such information. While the Corporation uses its best efforts to ensure that the reorganization information provided is complete and accurate, the information provided is solely an unofficial summary prepared by the Corporation for the convenience of its members, and the Corporation cannot accept responsibility for the completeness and accuracy of the information.

Processing within the CNS Reorganization Processing System differs between securities subject to voluntary and mandatory reorganizations, and is handled in the following manner:

(a) Mandatory Reorganizations

At such time on or after the effective date of the reorganization as the Corporation shall determine, CNS positions in the subject security are converted into the equivalent positions of the new securities and/or cash. Fractional shares resulting from a reorganization are credited and charged in cash, and are valued using the Current Market Price. These conversions appear on Members' CNS Miscellaneous Activity Reports and are identified as to the type of mandatory conversion.

(b) Voluntary Reorganizations

Except where otherwise indicated in this subsection (b), the processing of subject securities with a protect period of three days is the same as for subject securities with a protect period of greater than three days. The processing of subject securities with a protect period of two days or less shall be in accordance with the time frames set forth in the table below.

On E+2, by such time and in such manner as established by the Corporation from time to time, a Member with a long position (including long positions due to settle up to and including the last day of the protect period) at the close of business on such day in the subject security who seeks to have the Corporation provide the protection described below for such long position, must instruct the Corporation to move its long positions into a CNS Reorganization Sub-Account. Instructions by a Member to move a position to a CNS Reorganization Sub-Account constitute a formal request by the Member for the Corporation to provide such protection for the position moved.

After the night cycle on E+2, by such time and in such manner as established by the Corporation from time to time, the Corporation will issue a report (the "Preliminary Liability Report") to Members with short positions (including short positions due to settle up to and including the last day of the protect period) in a subject security advising of their potential liability based on their short positions as of that time in such subject security.

**Note:** Any same day settling trade in such subject security that is received for processing after the night cycle of E+2 will be designated a Special Trade and will be cleared and settled on a Member-to-Member basis between the parties directly.

On E+3, a Member who has given the Corporation instructions to move a long position into a CNS Reorganization Sub-Account receives a Preliminary Protection Report advising the Member of its potential moves to a CNS Reorganization Sub-Account. On E+3 Members may delete long positions which will be moved to the Sub-Account in whole or in part by submitting a Delete instruction to the Corporation in such form and until such time on E+3 as established by the Corporation from time to time.

At the time established by the Corporation after the day cycle on E+3 those long positions for which proper instructions have been received are moved to a CNS Reorganization Sub-Account. Simultaneously, the Corporation moves into the Sub-Account a corresponding number of short positions representing those short Members

with the oldest positions. If more than one short position is of the same age, positions to be moved are selected on a random basis. As a result of this pairing of long and short positions, a Member with a short position could have only a partial allocation of its position to the CNS Reorganization Sub-Account and thus could have short positions both in the Sub-Account and its CNS General Account. The long and short positions moved into the CNS Reorganization Sub-Account are detailed in a Final Protection Report and Final Liability Report on E+4.

In such form and by such time as established by the Corporation a Member with a long position in a subject security may request the Corporation to move the Member's long position from a CNS Reorganization Sub-Account back to the CNS General Account. In that event, the Corporation also shall move a corresponding short position or positions from the CNS Reorganization Sub-Account to the CNS General Account; positions moved are selected on a random basis.

The Corporation establishes a minimum of two separate CNS Reorganization Sub-Accounts for each security subject to multiple tender offers; provided, however, that if applicable, and provided it has the operational capabilities to do so, the Corporation may establish additional Reorganization Sub-Accounts in order to process affected securities. If there are more tender offers for a security than available CNS Reorganization Sub-Accounts, all positions in the subject security, except for positions that have already been moved to CNS Reorganization Sub-Accounts, are removed from the CNS System, and Receive and Deliver Instructions for the security are issued as explained in paragraph H.1 above. If, after a security has been removed from the CNS System, a Member with a long position in a CNS Reorganization Sub-Account submits a Delete instruction instructing the Corporation to move the position back to the CNS General Account, the Corporation shall issue Receive and Deliver instructions for the security, as described in paragraph H.1 above.

Short positions in the CNS Reorganization Sub-Account are marked from the Current Market Price to the tender offer price on E+4 and on each subsequent day; funds received as a result of such mark payments are retained by the Corporation until the conclusion of the tender offer. The Corporation freezes the positions in the Sub-Account; corresponding long and short positions in the Sub-Account only will be moved out of the Sub-Account (i) through the CNS allocation process, as described below, (ii) upon the request of a Member with a long position, as described above, or (iii) upon conclusion of the tender offer. Positions in the CNS Reorganization Sub-Account automatically are returned to the CNS General Account, and the mark to the tender offer price returned to Members with short positions, when a tender offer is canceled.

The regular CNS allocation process takes place through the day cycle on the last day of the protect period or the expiration of the tender offer, whichever is later. Because the CNS Reorganization Sub-Account always will have the highest priority for allocation, allocations to the Sub-Account from Members covering short positions in both the CNS General Account and CNS Reorganization Sub-Account occur. As a result, each day the CNS Reorganization Sub-Account is balanced by moving excess short positions from the CNS Reorganization Sub-Account to the CNS Account; positions moved are selected on

a random basis. In the event that delivery of the subject security is made by the Member with the short position outside the facilities of the Corporation, and the Member does not want its CNS account debited for the securities and/or cash under the terms of the tender offer, both the Members with the long and short positions must, in such form and by such time as established by the Corporation, instruct the Corporation to exit the quantity of shares which has been so delivered from the CNS Reorganization Sub-Accounts of the Members. If the Members do not so instruct the Corporation, the Members' Reorganization Sub-Accounts will not reflect such delivery and the Corporation shall process the credits and debits set forth below based on the position in the Members' CNS Reorganization Sub-Accounts as if the delivery had not occurred. Any adjustments to reflect the delivery must be made between the Members and not through the facilities of the Corporation.

	Date long position member must instruct NSCC to move position to Reorg. Sub-Acct.	Date of short position Preliminary Liability Report	Date of long position Preliminary Protection Report	Last date long members may submit Delete instructions <sup>2</sup>	Date long positions moved to Reorg. Sub-Account	Date of Final Protection Report and Final Liability Report	Short position marked to tender offer price
2 Day Protect	E+1	E+1	E+2	E+2	E+2	E+3	E+3 or thereafter
1 Day Protect	E	E	E+1	E+1	E+1	E+2	E+2 or thereafter
No Protect	E-1	E-1	E	E	E	E+1	E+1 or thereafter

Upon conclusion of the tender offer, at a time determined by the Corporation, the Corporation makes entries unwinding the CNS Reorganization Sub-Account and established positions representing the terms of the tender offer in the CNS General Account by:

(i) crediting a long Member's CNS Account for the securities distributed under the terms of the offer and/or crediting a long Member's settlement account for the cash distributed under the terms of the tender offer;

(ii) debiting a short Member's CNS Account for the securities distributed under the terms of the tender offer and/or debiting a short Member's settlement account for the cash distributed under the terms of the tender offer; and,

(iii) crediting the settlement account of short Members with the mark to the tender offer price being retained by the Corporation.

In the event that not all shares are accepted pursuant to the terms of a tender offer, entries crediting and debiting the securities and/or cash under the terms of the tender offer are made on a pro rata basis, based on the pro rata acceptance ratio of the tender offer as reported to the Corporation by a Qualified Securities Depository. All entries with respect to the tender offer appear on the Member's CNS Miscellaneous Activity Report and are identified as resulting from a tender offer. Fractional shares resulting from a pro rata acceptance are credited and charged in cash, and are valued using the tender offer price.

The Corporation will provide protection to the long Member for a position in the CNS Reorganization Sub-Account upon completion of the tender offer, but only to the extent of the monetary difference between the Current Market Price and the terms of the tender

<sup>2</sup> Same input time deadline on the date indicated as for offers with longer protect periods.

offer, and only to the extent of the pro rata acceptance ratio of the tender offer as discussed above. In addition, in the event that a long Member incurs, or anticipates that it will incur, liabilities greater than this amount, the long Member must notify the Corporation as soon as possible. Upon receipt of such notice, the Corporation shall reverse the entries made establishing the positions in the cash and/or securities distributed under the terms of the tender offer with respect to (i) the long Member and (ii) a Member or Members, chosen randomly, who had a corresponding short position in the CNS Reorganization Sub-Account. Such entries will reestablish the long and short positions in the CNS Account for such Members in the security subject to the tender offer. Upon so doing, the Corporation shall remove the positions in the security subject to the tender offer from the CNS System and shall (i) issue Receive and Deliver Instruction, at the tender office price, to the long and short Members, respectively as described in paragraph 1 above; and (ii) credit and debit the appropriate Members' settlement accounts for the terms of the tender offer. Upon giving the Corporation the notice described in this paragraph, the long Member may take such action as it believes to be necessary to protect itself against liability, including executing, without further notice to the short Member or Members, a buy-in of the subject securities pursuant to the provisions of the third paragraph of Section X.B. of these Procedures.

#### **5. Convertible Securities**

A Member with a closing long position in a convertible security may submit to the Corporation a CNS Conversion Instruction instructing the Corporation to convert its closing long position (or a portion thereof) from the convertible security to the underlying security. Such instructions are accepted by the Corporation only on:

- (i) the expiration date of the conversion privilege;
- (ii) the date on which the conversion privilege changes to a less favorable rate; or
- (iii) the dividend record date for the underlying security.

The Member's long position in the convertible security (or a portion of the long position, if the Member so instructs) is removed from CNS and replaced by a long position in the underlying security according to the ratio specified by the issuer.

The Corporation identifies the Members having the oldest short positions in the convertible security. Age is defined as the number of consecutive days during which the position has been short, irrespective of quantity. If the Members in the oldest age group have a greater quantity of short positions than is needed to satisfy the CNS Conversion Instructions, the short positions of one or more such Members is chosen for conversion on a random basis. The short position (or portion thereof) which has been chosen for conversion will be removed from CNS and replaced by a short position in the underlying security according to the ratio specified by the issuer.

Entries for Members with long or short positions in both the convertible and underlying security will appear on the Miscellaneous Activity Report issued the following day. Such

entries are identified by the legend "Conversion". If the conversion results in fractional shares, cash-in-lieu of fractions is credited and debited to the Members involved.

If the date on which the CNS Conversion Instruction is received is the dividend record date for either the convertible security or the underlying security, Members' record date positions are adjusted as if the entries had been made prior to the close of business on record date, notwithstanding the fact that the entries are actually made on the following day.

In the event that the Designated Depositories do not provide book-entry conversion service for a particular security, the Corporation reserves the right to declare such securities ineligible for CNS.

**6. Pursuant to Rule 65 and Procedure XVI, the Corporation permits ID Net Subscribers to enter into transactions eligible for the ID Net Service. All such transactions will be recorded on the Miscellaneous Activity Report on the night of T+2. All removals of such transactions from the ID Net Service occurring in either day or evening cycle will also be recorded on the Miscellaneous Activity Report.**

#### **I. CNS Sub-Accounting**

The Corporation provides sub-accounts for Members for use within certain specialized CNS services, e.g., reorganizations of CNS Securities. For the most part, a sub-account functions as if it were a completely separate Member account in that positions in sub-accounts are maintained separately and separate CNS reports are issued in most cases.

Members do not maintain Designated Depository sub-accounts for the purpose of settling CNS sub-account obligations. Before passing long and short positions in sub-accounts to a Designated Depository for security settlement, the Corporation converts the sub-account number to the Member's regular account. All Designated Depository reports, therefore, reflect activity for CNS sub-accounts under the Member's regular number. When the results of Designated Depository activity are received by the Corporation, the information is converted back to the sub-account before it is posted to the CNS Stock Record.

The CNS Cash Reconciliation Statement reflects a consolidation of the Member's regular account and all sub-accounts.

All other reports are issued separately for each CNS sub-account.

#### **J. Recording of CNS Buy-Ins**

1. Except with respect to securities subject to a voluntary corporate reorganization as described in paragraph H.4. of this Section, and except as otherwise provided with respect to municipal securities as set forth in paragraph J.2. below, a Member having a long position at the end of any day may transmit, in such form and within such times as determined by the Corporation from time to time, to the Corporation a Notice of Intention to Buy-In (Buy-In Notice) specifying a quantity of securities not exceeding such long positions which it intends to buy-in (Buy-In Position). With respect to securities subject to a voluntary corporate reorganization, a Member may not transmit a Buy-In Notice after the expiration date of the tender offer until the end of the protection period for the tender offer; provided, however, that at

no time may a Member submit a Buy-In Notice for a long position in a CNS Reorganization Sub-Account. For the purpose of this Section, the day the Buy-In Notice is transmitted is referred to as N, and N+1 and N+2 refer to the succeeding days. Each day commences in the evening and includes an evening allocation of securities and a daytime allocation.

A Buy-In Notice may be filed by a Member on successive days, provided the succeeding Buy-In Notice does not specify a quantity of securities covered by the prior Buy-In Notice and the quantity of securities representing the sum of the Buy-In Notices does not exceed the Member's total long position.

For the purpose of these Procedures, an "Original Buy-In Notice" shall mean a Buy-In Notice transmitted by a Member for which the Member is the original submitter, and a "Buy-In Retransmittal Notice" shall mean a Buy-In Notice submitted by a Member with respect to a Buy-In Position for which the Member has a corresponding obligation as to which it has received a buy-in notice initiated outside of the CNS System. (Unless the context otherwise requires, where these Procedures refer to a "Buy-In Notice" without distinction, such reference refers to both an Original Buy-In Notice and a Buy-In Retransmittal Notice.)

Original Buy-In Notice (expiring on N+2):

A Buy-In Position on an Original Buy-In Notice is given high priority for allocation from N+1 through the daytime allocation on N+2. If a Buy-in Position remains unfilled after the evening allocation on N+1, the Corporation issues CNS Retransmittal Notices on the morning of N+1 to a sufficient number of Members with short positions. CNS Retransmittal Notices are issued in an aggregate quantity at least equal to the Buy-in Position. In no case will the Buy-in liability of a Member exceed the Buy-in Position or the total short position of the Member. If several Members have short Positions with the same age, all such Members are issued CNS Retransmittal Notices, even if the total of their Short Positions exceeds the Buy-in Position.

Buy-In Retransmittal Notice (expiring on N+1):

A Member that has a long position in CNS at the end of any day and that has received a buy-in notice initiated outside of the CNS System in that same CUSIP, may submit a Buy-In Retransmittal Notice to the Corporation for execution on N+1 as described below. The Buy-In Retransmittal Notice shall include such information as the Corporation may determine from time to time, including the identity of the entity that initiated the buy-in against the Member. A Buy-In Position on a Buy-In Retransmittal Notice is given high priority for allocation from N through the daytime allocation on N+1.

Upon receipt of the Buy-In Notice on N, the Corporation issues CNS Retransmittal Notices to a sufficient number of Members with short positions. CNS Retransmittal Notices are issued in an aggregate quantity at least equal to the Buy-in Position. In no case will the Buy-in liability of a Member exceed the Buy-in Position or the total short position of the Member. If several Members have short Positions with the same age, all such Members are issued CNS Retransmittal Notices, even if the total of their Short Positions exceeds the Buy-in Position.

The quantity specified on each Member's CNS Retransmittal Notice is its Buy-In Liability.

A Member's Buy-In Liability may be satisfied by the actual settlement of the short position up to the time on N+1 (for a Buy-In Retransmittal Notice), or N+2 (for an Original Buy-In Notice) as specified below. If a deposit of securities is required to satisfy the short position, that deposit should be made prior to the Designated Depository daytime deposit cut-off time on the expiration date of the Buy-In Notice and prior to the time specified below. Going from a short position to a flat or long position due to settling trades, stock dividends, or other activity on N through N+2 does not free a Member from Buy-In Liability. If the Buy-In Position is not satisfied by 3:00 PM on the expiration date of the Buy-In Notice, or due to market events such earlier time as established by the Corporation upon five Business Days' notice the Buy-In may be executed. See Section X for execution procedures.

2. Notwithstanding the foregoing, a Member that has transmitted a Buy-In Notice to the Corporation with respect to a municipal security shall have its Buy-In Position removed from the CNS System prior to commencement of the CNS night cycle on N+1. The Corporation will remove corresponding short position(s) representing the short Member(s) with the oldest position(s) in an aggregate quantity at least equal to the Buy-in Position, and will produce special close-out receive and deliver orders, which may name Members or a participant of an interfacing clearing corporation as the contra side and which receive and deliver orders will be subject to the rules of the MSRB.

#### **K. Instruments with Exercise Privileges**

A Member with a short position or a short Settling Trade position in a security to which an exercise privilege attaches will be advised of its potential liability based on its short position or short Settling Trade position on its CNS Projection Report starting on T+2.

A Member with a long position or a long Settling Trade position in a security to which an exercise privilege attaches may submit to the Corporation a Notice of Intention to Exercise ("Exercise Notice") specifying a quantity of securities not exceeding such long position or long Settling Trade position, excluding one day settling positions, which it intends to exercise ("Exercise Position") by the time and in a manner established by the Corporation. (Hereinafter such Member is referred to as the "originator".) For the purpose of this subsection, the day the Exercise Notice is submitted is referred to as N, and N+1 refers to the succeeding day. Each day commences in the evening and includes an evening allocation of securities and a daytime allocation.

If an Exercise Position remains unfilled after the daytime allocation on N, the Corporation will remove this position from CNS and will remove a corresponding short position or positions representing those short Members with the oldest position(s) in an aggregate quantity at least equal to the Exercise Position. Age is defined as the number of consecutive days during which the position has been short, irrespective of quantity. If the Members in an age group needed to satisfy the Exercise Position have a greater quantity of short positions than is needed, positions will be removed on a random basis. The Corporation will issue and make available CNS receive and deliver instructions on the morning of N+1 naming a failing to deliver Member and the originator. The failing to deliver Member shall be liable to the originator for any damages that result from the originator's inability to exercise the security. All claims for such damages shall

be made promptly. Liability of the failing to deliver Member shall continue even though exercises of the security may be temporarily suspended. Notwithstanding the foregoing, if the failing to deliver Member is able to deliver the security in sufficient time to allow timely delivery of the security to the tender agent, the liability may be satisfied by delivery of the Exercise Position.

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### PROCEDURE XV CLEARING FUND FORMULA AND OTHER MATTERS<sup>3</sup>

#### I.(A) Clearing Fund Formula for Members

Each Member of the Corporation, except as otherwise provided in this Procedure, is required to contribute to the Clearing Fund maintained by the Corporation an amount calculated by the Corporation equal to:

##### (1) For CNS Transactions

(a)(i) The volatility of such Member's net of unsettled Regular Way, When-Issued ~~and~~ When-Distributed pending positions (i.e., net positions that have not yet passed Settlement Date) and fail positions (i.e., net positions that did not settle on Settlement Date), hereinafter collectively referred to as Net Unsettled Positions. When the Corporation deems it appropriate, the volatility of such positions shall be determined after taking into account offsetting pending transactions that: **(x)** have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation;<sup>4</sup> **and (y) have not been submitted for processing through the ID Net service.** Such calculation shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

(ii) The Corporation shall have the discretion to exclude from the above calculations Net Unsettled Positions in classes of securities whose volatility is (x) less amenable to

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<sup>3</sup> All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

<sup>4</sup> The Corporation may, in its discretion, decline to consider any such transactions, as well as other similar transactions referred to in respect of this Procedure, if it has reason to believe that the institutional counter party may not or cannot settle the transaction.

statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, such as illiquid municipal or corporate bonds. The amount of Clearing Fund required with respect to such Net Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the positions covered by subsection y of this paragraph;

plus

(b) The net of each day's difference between (x) the contract price of such Member's Regular Way, When-Issued and When-Distributed net positions **for transactions not submitted through the ID Net service** that have not yet passed Settlement Date and its fail positions, and (y) the Current Market Price for such positions<sup>5</sup> **(such difference to be known as the "Regular Mark-to-Market")**; provided that: **(i)** the Corporation shall exclude from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), **and provided further, that (ii)** the Corporation may, but shall not be required to, exclude from this calculation any shares delivered by the Member in the night cycle to satisfy all or any portion of a short position, **and (iii) that if the Member is an ID Net Subscriber and if the value of the Regular Mark-to-Market as computed above is a positive number, then the value of the Regular Mark-to-Market shall be zero;**

plus

**(c) If such Member is an ID Net Subscriber, the net of each day's difference between (x) the contract price of the net positions attributable to such Member's transactions submitted through the ID Net service, and (y) the Current Market Price for such positions (such difference to be known as the "ID Net Mark-to-Market"), provided that if the value of the ID Net Mark-to-Market as computed above is a positive number, then the value of the ID Net Mark-to-Market shall be zero.**

plus

(c) If such Member clears for one or more Market Makers<sup>6</sup> (i.e., the Member's Correspondent(s)) or is itself a Market Maker in any security dominated by either the Member or its Correspondent(s) (where domination is calculated for each Member and each of its Correspondent(s) according to criteria determined by the Corporation from

<sup>5</sup> For fail positions, the contract price used for this purpose is the prior day's Market Price.

<sup>6</sup> As used in this Procedure, the term "Market Maker" shall mean a member firm of the National Association of Securities Dealers, Inc. (NASD) that is registered by the NASD as a Market Maker.

time to time), and if the sum of the absolute values of the Net Unsettled Positions in such dominated security or securities of any one or more of such Market Makers exceeds the excess net capital of the respective Market Maker or the Member (whether or not it is a Market Maker), (i.e., such Market Maker's or Member's Excess), the Corporation may then require the Member to contribute an additional Clearing Fund Deposit to the Corporation either in an amount equal to each such Market Maker's or Member's Excess or the sum of each of the absolute values of the Net Unsettled Positions or a combination of both. In performing the calculation, the Corporation may take into account offsetting pending (i.e., non-fail) transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. In addition, where a Market Maker's Net Unsettled Positions in dominated issues are cleared by one or more Members, the Corporation may treat those positions, for purposes of calculations pursuant to this paragraph, as if they were all cleared by the Market Maker's clearing Member, as listed in the records of the Corporation in accordance with Section 3(e) of Rule 3<sup>7</sup>;

plus

(d) An additional payment (Aspecial charge@) from Members in view of price fluctuations in or volatility or lack of liquidity of any security. The Corporation shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time;

plus

(e) 5% or such greater amount, as determined by the Corporation, not to exceed 10% of such Member's long fail CNS positions plus 5%, or such greater amount, as determined by the Corporation, not to exceed 10% of such Member's short fail CNS positions, plus.

(f) an amount for certain activity (referred to as "Specified Activity") based on the average of the Member's three highest aggregate calculated charges for daily Specified Activity measured over the most recent 20 settlement days. For purposes of this calculation, "Specified Activity" means transactions processed by the Corporation on a shortened processing cycle (*i.e.*, otherwise than on a three-day processing and settlement cycle), including T+3 as-of trades,<sup>8</sup> cash trades, next day settling trades, and similar transactions. This charge shall be calculated by: (i) netting Specified Activity by cusip to a single long or short position, and (ii) applying a charge to each such position, using not less than two standard deviations as determined by historic pricing. The standard deviations will be the same as those derived for the daily volatility calculations; provided however, that as is the case with the volatility charge, for those securities whose volatility is either less amenable to statistical analysis, or so amenable only in a complex manner,

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<sup>7</sup> The Corporation may require or permit such Member to deliver some or all shares necessary to complete a short obligation in lieu of part or all of its requirement under this section or subsection I.(A)(2)(c).

<sup>8</sup> That is, as-of trades compared or recorded on T+3 prior to the applicable comparison/recording cut-off time, including trades received after the applicable T+2 cut-off time. With respect to next day settling trades, this includes next day as-of trades.

the Corporation shall instead apply the same percentage charge to those securities as applied pursuant to clause I.(A)(1)(a) above.

(2) For Balance Order Transactions

(a)(i) The volatility of such Member's net of unsettled Regular Way, When-Issued and When-Distributed positions that have not yet passed Settlement Date, hereinafter collectively referred to as Net Balance Order Unsettled Positions. When the Corporation deems it appropriate, the volatility of such positions shall be determined after taking into account offsetting pending transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. Such calculation shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

(ii) The Corporation shall have the discretion to exclude from the above calculations Net Balance Order Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, such as illiquid municipal or corporate bonds. The amount of Clearing Fund required with respect to such Net Balance Order Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the positions covered by subsection y of this paragraph;

plus

(b) The net of each day's difference between the contract price of such Member's Net Balance Order Unsettled Positions, and the Current Market Price for such positions, provided that the Corporation shall exclude from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number);

plus

(c) If such Member clears for one or more Market Makers (i.e., the Member's Correspondent(s)) or is itself a Market Maker in any security dominated by either the Member or its Correspondent(s) (where domination is calculated for each Member and each of its Correspondent(s) according to criteria determined by the Corporation from

time to time), and if the sum of the absolute values of the Net Balance Order Unsettled Positions in such dominated security or securities of any one or more of such Market Makers exceeds the excess net capital of the respective Market Maker or the Member (whether or not it is a Market Maker), (i.e., such Market Maker's or Member's Excess), the Corporation may then require the Member to contribute an additional Clearing Fund Deposit to the Corporation either in an amount equal to each such Market Maker's or Member's Excess or the sum of each of the absolute values of the Net Balance Order Unsettled Positions or a combination of both. In performing the calculation, the Corporation may take into account offsetting pending (i.e., non-fail) transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. In addition, where a Market Maker's Net Balance Order Unsettled Positions in dominated issues are cleared by one or more Members, the Corporation may treat those positions, for purposes of calculations pursuant to this paragraph, as if they were all cleared by the Market Maker's clearing Member, as listed in the records of the Corporation in accordance with Section 3(e) of Rule 3;

plus

(d) An additional payment ("special charge") from Members in view of price fluctuations in or volatility or lack of liquidity of any security. The Corporation shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time, plus

(e) an amount for certain activity (referred to as "Specified Activity") based on the average of the Member's three highest aggregate calculated charges for daily Specified Activity measured over the most recent 20 settlement days. For purposes of this calculation, "Specified Activity" means transactions processed by the Corporation on a shortened processing cycle (i.e., otherwise than on a three-day processing and settlement cycle), including T+3 as-of trades,<sup>9</sup> cash trades, next day settling trades, and similar transactions. This charge shall be calculated by: (i) netting Specified Activity by cusip to a single long or short position, and (ii) applying a charge to each such position, using not less than two standard deviations as determined by historic pricing. The standard deviations will be the same as those derived for the daily volatility calculations; provided however, that as is the case with the volatility charge, for those securities whose volatility is either less amenable to statistical analysis, or so amenable only in a complex manner, the Corporation shall instead apply the same percentage charge to those securities as applied pursuant to clause I.(A)(1)(a) above.

### (3) For Other Transactions

The greater of (i) 2-1/2% of such Member's average daily settlement debits and credits other than CNS and Mutual Fund Services debits and credits or (ii) 5% of such Member's average daily settlement debits other than CNS and Mutual Fund Services debits, for

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<sup>9</sup> That is, as-of trades compared or recorded on T+3 prior to the applicable comparison/recording cut-off time, including trades received after the applicable T+2 cut-off time. With respect to next day settling trades, this includes next day as-of trades.

other transactions (Other Transactions) as determined by the Corporation from time to time, adjusted for broker/dealer Members by a factor that shall be calculated as follows:

Average Daily Settlement Debits As Determined by the Corporation  
Excess Net Capital

The factor calculation shall be adjusted in order to provide a minimum of one with a maximum of three.

(4) For Mutual Fund Transactions

(a) \$5,000 if such Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member;

or

(b) \$10,000 if such Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member;

or

(c) \$20,000 if such Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.

I.(B) Additional Clearing Fund Formula

(1) Additional Deposits for Members on Surveillance

Any **[Settling]** Member who is placed on surveillance status shall be required to make such additional Clearing Fund deposits as determined by the Corporation on the same day as requested by the Corporation within such timeframe as required by the Corporation from time to time.

(2) Excess Capital Premium

If a Member's contribution to the Clearing Fund, as computed pursuant to Section I.(A) of this Procedure (but excluding any charges as set forth in Subsections I.(A)(1)(c), I.(A)(1)(d), I.(A)(2)(c), and I.(A)(2)(d) of this Procedure), plus any amount collected pursuant to 1.(B)(1) above or Rule 15 (such aggregate amount referred to as the "Calculated Amount"), when divided by its excess net capital or capital (as applicable), as defined in the membership standards set forth in Addendum B, is greater than 1.0 (the "Excess Capital Ratio"), then the Corporation may require such Member to deposit, within such timeframe as the Corporation may require, an additional amount (the "Excess Capital Premium") to the Clearing Fund equal to the product of: (a) the amount by which the Calculated Amount exceeds its excess net capital or capital (as applicable), as defined in the membership standards set forth in Addendum B, multiplied by (b) its Excess Capital Ratio.

Notwithstanding the foregoing, the Corporation may: (i) collect an amount less than the Excess Capital Premium (including no premium), and (ii) return all or a portion of the Excess Capital

Premium if it believes that the imposition or maintenance of the Excess Capital Premium is not necessary or appropriate.<sup>10</sup>

I.(C) Clearing Fund Formula for Mutual Fund/Insurance Services Members who use the Mutual Fund Services.<sup>11</sup>

Each Mutual Fund/Insurance Services Member is required to contribute to the Clearing Fund maintained by the Corporation an amount, in cash, approximately equal to:

**~~[(1) If accepted for membership pursuant to Addendum B (Standards of Financial Responsibility and Operational Capability), Section (I)(B):]~~**

(a) \$5,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member;

or

(b) \$10,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member;

or

(c) \$20,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.

I.(D) Clearing Fund Formula for Fund Members, Insurance Carrier/Retirement Services Members and Certain Mutual Fund/Insurance Services Members

The Clearing Fund Formula for each Fund Member, Insurance Carrier/Retirement Services Member and those Mutual Fund/Insurance Services Members who use **[only]** the Corporation's Insurance and Retirement Processing Services shall be established at such time as the Corporation determines appropriate.

## II. Minimum Clearing Fund and Additional Deposit Requirements

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<sup>10</sup> The Corporation has identified the following guidelines or circumstances, which are intended to be illustrative, but not limited, where the premium will not be imposed: (a) where the premium results from charges applied with respect to municipal securities trades settling in CNS, where the member has offsetting compared trades settling on a trade-for-trade basis through DTC; and (b) management will look to see whether the premium results from an unusual or non-recurring circumstance where management believes it would not be appropriate to assess the premium. Examples of such circumstances are a member's late submission of trade data for comparison or trade recording that would otherwise reduce the margined position if timely submitted, or an unexpected haircut or capital charge that does not fundamentally change its risk profile.

<sup>11</sup> This section applies to entities whose use of the Corporation's services are restricted to the Mutual Fund Services and/or the Insurance and Retirement Processing Services. Entities which use or are permitted to use Services other than or in addition to the Mutual Fund Services and Insurance and Retirement Processing Services are covered by section I.(A).

- (A) Each Member of the Corporation ~~[, except for a Mutual Fund/Insurance Services Member,]~~ shall be required to contribute a minimum of \$10,000 (the “minimum contribution”). ~~[Except with respect to a Mutual Fund/Insurance Services Member,]~~ ~~†~~ The first 40% (but no less than \$10,000) of a Member’s Required Deposit must be in cash and ~~[, with respect to]~~ the remaining amount, ~~[no more than 25% of the Required Deposit may be collateralized with a Letter of Credit.]~~ may be evidenced by open account indebtedness secured by the pledge of Eligible Clearing Fund Securities, which shall be valued, for collateral purposes, as set forth in subsection III below. A Mutual Fund/Insurance Services Member’s entire deposit is required to be in cash.

**1. Special Provisions Related to Eligible Clearing Fund Securities:**

**(a) Any deposits of Eligible Agency Securities<sup>10</sup> or Eligible Mortgage-Backed Securities<sup>11</sup>, respectively, in excess of 25 percent of the Member’s Required Deposit will be subject to an additional haircut equal to twice the percentage as specified in the proposed haircut schedule detailed in subsection III below, and**

**(b) No more than 20 percent of a Member’s Required Deposit secured by pledged Eligible Agency Securities may be of a single issuer.**

- (B) All Clearing Fund requirements and other deposit requirements shall be made by Members and Mutual Fund/Insurance Services Members, within one hour of demand unless otherwise determined by the Corporation; provided, however, that to the extent the Member and Mutual Fund/Insurance Services Member is meeting such obligation with a (1) deposit of cash, such deposit shall be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire, and (2) delivery of eligible securities, such delivery shall be received within the deadlines established by a Qualified Securities Depository. At the discretion of the Corporation, cash deposits may be included as part of the Member’s or Mutual Fund/Insurance Services Member’s, daily settlement obligation.
- (C) Additional Clearing Fund deposits shall not be requested unless they exceed such threshold as determined by the Corporation from time to time.
- (D) Where the amount of a Member’s and Mutual Fund/Insurance Services Member’s deficiency is in excess of \$1,000 but less than \$5,000, the Corporation may require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000, the Corporation may require payment in multiples of \$5,000.

III. **Collateral Value of Eligible Clearing Fund Securities**

<sup>10</sup> **A Member that is an Agency may not pledge Eligible Agency Securities of which it is the issuer.**

<sup>11</sup> **With regard to a Member that pledges Eligible Mortgage-Backed Securities of which it is the issuer, such securities will be subject to a premium haircut, as set forth in subsection III below.**

**(A)** ~~[Qualifying bonds]~~ **Eligible Clearing Fund Securities** pledged to secure Clearing Fund deposits shall, **for collateral valuation purposes**, be haircut as follows, or as otherwise determined by the Corporation from time to time:

~~[Security Type:~~

~~US Treasury & Agency Securities, including Government Zero Coupon Bonds:~~

<del>Interest bearing with remaining terms to maturity of up to 10 years</del>	<del>-</del>	<del>2% Haircut</del>
<del>Interest bearing with remaining terms to maturity in excess of 10 years</del>	<del>-</del>	<del>5% Haircut</del>
<del>Zero coupon with remaining terms to maturity of up to 5 years</del>	<del>-</del>	<del>2% Haircut</del>
<del>Zero coupon with remaining terms to maturity in excess of 5 years</del>	<del>-</del>	<del>5% Haircut]</del>

<u>Security Type</u>	<u>Remaining Maturity</u>	<u>Haircut</u>
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### 1. Treasury

<b>Bills, Notes, Bonds, TIPS</b>	<b>Zero to 1 year</b>	<b>2.0%</b>
	<b>1 year to 2 years</b>	<b>2.0%</b>
	<b>2 years to 5 years</b>	<b>3.0%</b>
	<b>5 years to 10 years</b>	<b>4.0%</b>
	<b>10 years to 15 years</b>	<b>5.0%</b>
	<b>15 years or greater</b>	<b>6.0%</b>
<b>Zero Coupon</b>	<b>Zero to 1 year</b>	<b>2.0%</b>
	<b>1 year to 2 years</b>	<b>2.0%</b>
	<b>2 years to 5 years</b>	<b>4.0%</b>
	<b>5 years to 10 years</b>	<b>6.0%</b>
	<b>10 years to 15 years</b>	<b>7.0%</b>
	<b>15 years or greater</b>	<b>9.0%</b>

### 2. Agency\*

<b>Notes, Bonds</b>	<b>Zero to 1 year</b>	<b>2.0%</b>
	<b>1 year to 2 years</b>	<b>3.0%</b>
	<b>2 years to 5 years</b>	<b>4.0%</b>
	<b>5 years to 10 years</b>	<b>5.0%</b>
	<b>10 years to 15 years</b>	<b>6.0%</b>
	<b>15 years or greater</b>	<b>7.0%</b>
<b>Zero Coupon</b>	<b>Zero to 1 year</b>	<b>2.0%</b>
	<b>1 year to 2 years</b>	<b>3.0%</b>
	<b>2 years to 5 years</b>	<b>5.0%</b>
	<b>5 years to 10 years</b>	<b>7.0%</b>
	<b>10 years to 15 years</b>	<b>8.0%</b>

	15 years or greater	10.0%
<b>3. Mortgage-Backed Security</b>		
Pass-Throughs*	Ginnie Mae	6.0%
	Fannie Mae/Freddie Mac	7.0%
Self-issued**		14% (or 21% if <u>Concentration limit is exceed</u> )

**\* Any deposits of Eligible Agency Securities or Eligible Mortgage-Backed Securities in excess of 25 percent of a Member's Required Clearing Fund deposit will be subject to a haircut that is twice the amount of the percentage noted in the haircut schedule. Eligibility requirements will be announced by the Corporation from time to time.**

**\*\* A Member may deposit Eligible Mortgage-Backed Securities of which it is the issuer, however such securities will be subject to a premium haircut. This haircut shall be 14% as an initial matter. If a Member also exceeds the 25% concentration limit, the haircut shall be 21%.**

#### **PROCEDURE XVI. ID NET SERVICE.**

**The ID Net Service utilizes the settlement and delivery services operated by a Qualified Securities Depository for input and affirmation purposes related to transactions qualifying for the ID Net Service as set forth in Rule 65. Certain transactions which are between an ID Net Subscriber and a participant of the Qualified Securities Depository are affirmed through : (i) a Registered Clearing Agency, (ii) other entities which have obtained an exemption from such registration from the Commission, or (iii) Qualified Vendors as defined in the rules of the New York Stock Exchange, the National Association of Securities Dealers, or other self-regulatory organizations, as applicable, (an "Affirming Agency"), in accordance with the applicable procedures of the Affirming Agency, and then confirmed by such Affirming Agency as eligible for processing in the ID Net Service. If the transaction is affirmed and eligible for processing in the ID Net Service, such Affirming Agency then forwards the appropriate delivery instructions to the Qualified Securities Depository, which facilitates the movement of the transaction to an account at the Qualified Securities Depository maintained by the Corporation as agent on behalf of the ID Net Subscriber (the "ID Netting Subscriber Deliver Account"). The transaction is then entered into the CNS Accounting Operation on the evening of T+2 by the Corporation on behalf of the ID Net Subscriber. On the night of T+2, the ID Net Subscriber's CNS position, if any, will be updated for the quantity and value of the transaction versus creating an open obligation in the ID Netting Subscriber Deliver Account. For transactions in which the ID Net Subscriber is delivering securities to a participant at the Qualified Securities Depository, the ID Net Subscriber's position in the CNS Accounting Operation, if any, will be updated**

**for the quantity and value of the transaction versus creating an open obligation in an agency account established for this purpose at the Qualified Securities Depository by the Corporation on behalf of the ID Net Subscriber (the “ID Netting Subscriber Receive Account”). Once the securities are credited to this account, the securities will be delivered to the appropriate participant account at the Qualified Securities Depository.**

**The ID Net Subscriber’s counterparty settles transactions in the ID Net Service through the depository against the ID Netting Subscriber Deliver Account or the ID Netting Subscriber Receive Account, respectively, depending on whether it is delivering or receiving shares from the ID Net Subscriber.**

**If for any reason the full amount of the Eligible ID Net Securities for any ID Net transaction entered into the CNS Accounting Operation with respect to a particular transaction are not delivered to the Corporation prior to the cut-off time established by the Corporation from time to time or if before such cut-off time the securities delivered to the Corporation with respect to a particular transaction pursuant to this Procedure XVI no longer qualify as Eligible ID Net Securities the Corporation will make the following entries in order to remove the transaction from the ID Net Service and the CNS Accounting Operation, leaving the ID Net Subscriber and its counterparty to complete (or terminate) the original trade: (i) the Corporation will create an offsetting position in the ID Netting Receive Account versus the ID Net Subscriber position for the failed delivery in order to “return” the securities to the CNS Accounting Operation for normal allocation processing (pursuant to Section E.4. of Procedure VII), and (ii) the Corporation will post a long position to the ID Net Subscriber in the CNS Accounting Operation.**

**With respect to a particular transaction in the ID Net Service, in the event (i) a participant of the Qualified Securities Depository fails to deliver to the ID Netting Subscriber Deliver Account, and this failure to deliver is allocated pursuant to Section E.4. of Procedure VII to a Member other than the appropriate ID Net Subscriber, or (ii) securities are returned to the Corporation after a cut-off time established by the Corporation from time to time due to a failure of delivery from a ID Netting Subscriber Receive Account to a participant of the Qualified Securities Depository, then the Corporation shall post appropriate offsetting positions in order to exit the transaction from the ID Net Service.**