



SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information (required)**

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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 (required)**

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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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Exhibit Sent As Paper Document

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.

1. Text of Proposed Rule Change.

(a) The proposed rule change is annexed hereto as Exhibit 5 and consists of modifications to the Rules & Procedures (the “Rules”) of National Securities Clearing Corporation (“NSCC” or the “Corporation”) with regard to the enhancement of the Reconfirmation and Pricing Service (“RECAPS”), which includes the creation of new functionality to be known as the Obligation Warehouse.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization.

(a) The proposed change was approved by the Board of Directors of NSCC at a meeting duly called and held on December 16, 2009.

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

**Background**

RECAPS is NSCC’s automated fail clearance system for eligible securities. Through RECAPS, Members are provided with an opportunity, on a quarterly basis, to reconfirm and reprice compared transactions which remain unsettled (i.e., fail transactions). The proposed rule change will modify RECAPS to run on a more frequent basis, and will enhance the RECAPS process, and rename it as, the Obligation Warehouse (“OW” or “OW Service”). As more fully described below, the enhanced service will provide: (i) comparison of transactions that are not otherwise submitted by the applicable marketplaces or Members themselves for trade comparison or recording through other NSCC trade capture services, (ii) tracking, storage and maintenance of unsettled obligations either compared through the service or forwarded to it from other NSCC services in accordance with the Rules (including securities exited from NSCC’s Continuous Net Settlement (“CNS”) system, as well as for Non-CNS Automated Customer Account Transfer Service (“ACATS”) items,<sup>1</sup> NSCC Balance Order transactions<sup>2</sup> and Special Trades) (collectively “OW Obligations”), and (iii) for the repricing and netting of fail obligations. The tracking, storage and maintenance functionality of the OW will provide transparency and make information available to its users, serving as a central depository of open (i.e. failed or unsettled) broker-to-broker obligations, and will allow users to manage and resolve exceptions (“don’t know” or “DK” obligations) in an efficient and timely manner. Simultaneously, OW will provide on-going maintenance and servicing of open OW Obligations, such as adjustments for

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<sup>1</sup> Only non-CNS eligible ACATS and CNS-eligible ACATS that have been designated as ex-CNS shall be forwarded to the OW. Non-CNS ACATS that receive and deliver instructions for mutual funds, limited partnerships and safekeeping items, however, will not be eligible for OW.

<sup>2</sup> Balance Orders will be forwarded to the OW after netting and allotting has occurred in accordance with NSCC’s Procedures.

corporate actions and a regular scan of OW Obligations for CNS eligibility.<sup>3</sup>

### **Current RECAPS Service**

RECAPS allows Members to periodically reconfirm open aged fails (fails that are five days or older), re-price such fails to the current market value and, when possible, net the reconfirmed and re-priced fails. All NSCC Members who are also members of the Financial Industry Regulatory Authority (“FINRA”) are required to participate in the RECAPS service;<sup>4</sup> however the service is available to all Members. As part of the RECAPS process, those CNS-eligible reconfirmed fails are forwarded to CNS for processing and settlement. Transactions in non-CNS eligible issues are repriced, netted and allotted, when applicable, and Balance Orders are generated or the transactions are designated to settle trade-for-trade.

RECAPS provides Reject and DK capabilities for advisories received and requires Members to effectively respond to all open fails submitted by a counterparty via a batch overnight submission. Advisories that are either “unresponded to” or “DK’d” are subject to close-out action under the rules of the appropriate marketplace. RECAPS provides for a one-day settlement capability for all compared fails.

Currently, the RECAPS processing procedures are as follows:

- On a Friday evening, at the time and in the manner established by NSCC, Members submit RECAPS fail information (“RECAPS Input”).
- On the following Monday morning, NSCC produces RECAPS Contracts indicating compared, un-compared and advisory items. Members: (i) must respond to all advisories that they receive as a result of the initial fail submission (either by submitting an advisory, a “DK” or a Reject), and (ii) may submit an “as-of” trade if the Member failed to timely submit a transaction to RECAPS. As-of trades are compared only if there is an exact match; no trade resolution process is available. NSCC then produces supplemental RECAPS Contracts showing items compared on Monday’s input, as well as CNS and Non-CNS Compared Trade Summaries for those items that compared as a result of Monday’s submission.
- Fails that matched on the Friday submission will settle on Monday. Fails that compared on the Monday submission will settle on Tuesday.
- A RECAPS Activity Report is made available to Members at the end of the RECAPS cycle.
- The net cash adjustment (the difference between the aggregate value of the

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<sup>3</sup> These functionalities will be made available at a date no less than 10 business days following announcement of implementation by Important Notice.

<sup>4</sup> FINRA Rule 11190(a).

original fails and the aggregate value of the reconfirmed trades) will settle the day the underlying RECAPS Contract settles and is included as part of the Member's daily money settlement with NSCC.

- RECAPS, however, is not a guaranteed service of NSCC, so if NSCC does not receive payment from a Member, the Corporation, may, in its discretion, reverse in whole or part any credit previously given to any Member who is the contra side to a trade reconfirmed and repriced through RECAPS.

### **Obligation Warehouse**

Currently, many of the transactions submitted to RECAPS by Members are subject to non-centralized, manual processes for purposes of comparison of fail details and fail confirmation. NSCC proposes to enhance and rename the RECAPS service as the Obligation Warehouse, to which Members may submit, and subsequently maintain and manage, their unsettled transactions. As part of these enhancements, NSCC proposes to provide a trade matching and confirmation process pursuant to which Members may submit to NSCC information on certain obligations that are not otherwise submitted to NSCC by the applicable marketplaces or Members themselves through its other trade comparison or recording services.<sup>5</sup> Comparison of transactions submitted through the OW will occur in real-time. Obligations will be tracked and maintained within the Obligation Warehouse and be made available for RECAPS processing (as described below) until settled or otherwise cancelled. In addition, transactions exited from CNS, non-CNS-eligible ACATS items, as well as NSCC Balance Orders and Special Trades will also be forwarded to the OW for storage and maintenance, and RECAPS processing.<sup>6</sup> Compared items stored in the OW (whether compared by the OW or forwarded to it from other NSCC services or systems) are referred to as "OW Obligations". As more fully described below, in order to further reduce manual processing by Members, NSCC may automatically adjust any OW Obligations for certain mandatory reorganization events, which will be initially limited to adjustments for forward splits, name changes, redemptions, mergers (both cash and stock) and full calls with respect to bonds.<sup>7</sup>

The OW Service will forward to CNS on a daily basis (or such other timeframe as

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<sup>5</sup> See Procedure II (Trade Comparison and Recording Service) which sets forth the procedures for comparison of direct submissions by Members and trade recording of locked-in transactions. Members should note that in accordance with Municipal Securities Rulemaking Board (MSRB) rules, NSCC reports transactions in municipal securities compared through its Real-time Trade Matching service ("RTTM") to the MSRB on behalf of Members; however transactions submitted through the OW will not be reported to the MSRB. In order to remain compliant with MSRB reporting requirements, submissions subject to MSRB rules should continue to be made through RTTM.

<sup>6</sup> Such items will be subject to the validation criteria of the systems/services that forwarded them to the OW and therefore the matching/validation criteria (which are set forth in footnote 9 below) will not apply.

<sup>7</sup> Adjustments for mandatory reorganization events are expected to be available shortly after February 4, 2011, or a date no less than 10 business days following announcement of its implementation by Important Notice.

NSCC determines from time to time) OW Obligations in CNS-eligible securities.<sup>8</sup> However, the OW will not be a guaranteed service, and an obligation forwarded to CNS will only be guaranteed to the extent that the Member meets its settlement obligation on the date the item is originally scheduled to settle in CNS. Transactions eligible for submission must have a valid CUSIP or ISIN and be denominated in U.S. Dollars, or such other currencies as NSCC may designate from time to time. NSCC may determine from time to time, and shall announce by Important Notice, which items are eligible for submission to Obligation Warehouse. Initially, government, mortgage-backed, and foreign securities will all specifically not be eligible. Further, cash trades will be processed by Obligation Warehouse only after settlement failure of these trades.

### **OW Comparison and Trade Resolution Procedures**

Once a party enters the required transaction information<sup>9</sup>, the counterparty will receive an advisory, to which it must respond by submitting identical transaction details to facilitate a compared obligation, or by submitting a DK.<sup>10,11</sup> If a Member does not act on an advisory submitted against it by the close of business on the day after submission, NSCC may impose a fee upon the Member. If the deliverer and receiver submit trade data that matches in all required respects, the trade will be deemed compared if it meets money tolerances to be announced by NSCC from time to time.<sup>12</sup> The Corporation may permit un-compared trade details to be modified or cancelled by the submitter on the submission date through the use of the appropriate instruction.<sup>13,14</sup> Upon comparison, NSCC may permit obligations to be cancelled if both receiver and deliverer agree by submitting a cancel request bilaterally, or if one party accepts the other party's cancel request. Each OW Obligation will receive an "OW Control Number" to facilitate tracking the obligation through its settlement, cancellation or closure.

NSCC will have no responsibility for determining whether any trade submission is duplicative of an earlier trade submission and any such input will be treated as a separate submission. NSCC may delete trade input which is not matched by such timeframes as it determines from time to time.

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<sup>8</sup> This functionality is anticipated to be rolled out in early March 2011.

<sup>9</sup> Data required for a valid submission will include security identification, quantity to which party is deliverer or receiver, contra-broker, deliverer's final money, settlement date, market participation identification (MPID) (if applicable), Member's unique reference number ("x-ref"), whether a transaction should be excluded from CNS processing and other identifying details as NSCC may require or permit.

<sup>10</sup> Obligations will be able to be submitted to the OW in real-time. Required matching criteria will include the specific criteria listed in footnote 9 above (except for the x-ref), and other identifying details as NSCC may require or permit.

<sup>11</sup> Any submission of a DK must include the applicable reason code pertaining to the Member's disagreement with the transaction.

<sup>12</sup> Initially, if the deliverer and receiver submit trade data that matches in all required respects, the trade will be deemed compared if it meets a money tolerance of \$5 per million, though this amount is subject to change as NSCC determines from time to time.

<sup>13</sup> Modification of transaction details will result in the cancellation of the existing entry and the opening of a new submission.

<sup>14</sup> Please note that transaction details that have been DK'd by a counterparty will be deleted from processing in accordance with timeframes specified by the Corporation from time to time. Initially, such transaction details will be deleted on the fifth business day following submission of the DK by the counterparty.

### **Maintenance and Tracking**

The OW service will permit Members to track each OW Obligation for the life of the obligation until it has been (i) settled, (ii) cancelled by Members party to the obligation, or (iii) otherwise closed in the OW Service by the Corporation pursuant to the Rules (e.g., when the obligation becomes CNS-eligible and is sent to CNS for settlement).

NSCC may adjust any compared OW Obligation with respect to certain mandatory reorganization events; these will initially be limited to forward splits, name changes, redemptions, mergers (both cash and stock) and full calls with respect to bonds. In the case of such a mandatory reorganization, at such time on or after the effective date of the reorganization as NSCC shall determine, and to the extent NSCC has the relevant information, the affected OW Obligation may be adjusted in accordance with the terms of the reorganization event. With respect to name changes and forward splits, OW positions in the subject security will be converted into the equivalent positions of the new securities and/or cash and a new obligation will be created automatically as part of the processing in the OW. Any cash component associated with a mandatory reorganization will be included as part of the Member's daily money settlement with the Corporation.<sup>15</sup>

Unless otherwise excluded by a Member, all CNS-eligible OW Obligations that reach the status of settlement date minus one ("SD-1") or that have reached or passed their scheduled settlement date, may be forwarded to CNS by NSCC on a daily basis.<sup>16</sup> However, the settlement of any such item forwarded to CNS will be guaranteed only to the extent that the Member pays its full settlement obligation on the date the item is scheduled to settle in CNS. An item forwarded to CNS from the OW may be exited from the CNS Accounting Operation to the extent the Member fails to complete its settlement obligation. If NSCC exits an item, any credits received by a Member arising from the corresponding payment obligation shall be reversed and settlement of the item shall be effected between the receiving and delivering Member and not through the facilities of the Corporation.

OW Obligations for which deliveries are made through The Depository Trust Company ("DTC") via either The New York Window ("NYW") or electronic book-entry deliver order and include the OW Control Number will be updated to indicate that they have settled in accordance with proper instructions from DTC or the Member, respectively. In order to give effect to such an update, Members must provide DTC with instructions in accordance with DTC's procedures, and include the OW Control Number. In the event of a partial delivery through DTC, NSCC will update the records for the respective OW Obligation accordingly, based on information received either from DTC or the Member's update to their own OW Obligation records. Other items will be recorded as settled upon the submission of appropriate instructions by the counterparties.

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<sup>15</sup> In the event that the Corporation ceases to act for a Member pursuant to Rule 18, the Corporation will reverse credits and debits relating to such a cash adjustment.

<sup>16</sup> This functionality is expected to be rolled out by March 2011, or on a date no less than 10 business days following announcement of its implementation by Important Notice.

Obligations that have been reflected in the OW as settled may be re-opened (either partially or fully), as a result of a delivery reclaim message sent by either party to the obligation to OW. Updates to reflect reclaims of settled transactions will be made once one party enters details of the original transaction,<sup>17</sup> and the original transaction's OW Control Number. Once these details are submitted, an advisory of the reclaim will be sent to the contraparty, who must either submit identical transaction details to facilitate the reclaim and re-open the obligation in OW, or submit notification that it does not accept the reclaim details entered by the initiating party. Updates for reclaims may only be submitted to the OW for a period of two business days following the actual settlement date of the relevant obligation. If the reclaim message is not accepted by the contraparty, it will be deleted from the OW, and the parties will need to generate a new reclaim message in OW. If the original obligation has been settled for longer than two business days, any reclaim message will be rejected.

If NSCC ceases to act for a Member, all open activity relating to that Member will be deleted from the OW; however the reports relating to such activity will be maintained in accordance with NSCC's record retention requirements.

### **Modified RECAPS Process**

Under the proposal, the existing RECAPS process will continue to function in a modified form.<sup>18</sup> Upon implementation of OW, the RECAPS process will be incorporated into OW and will require one day to complete. It is anticipated that the process will occur more frequently than the current quarterly schedule.<sup>19</sup>

On a day specified by the Corporation, each OW Obligation eligible for RECAPS<sup>20</sup> will be re-priced, if appropriate,<sup>21</sup> re-netted and allotted, if appropriate, the settlement date will be updated to the next business date and a new OW Obligation will be opened. Securities that are not CNS-eligible or are designated as trade-for-trade will not be netted and allotted. Obligations eligible for RECAPS in the OW can be excluded from the RECAPS process if so designated by the Member.

All new obligations arising from the RECAPS process will be tracked and processed in accordance with the OW procedures described above. If a fail was open over an interest payment date, the parties to the trade will be required to settle that interest payment outside of the OW.

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<sup>17</sup> Transaction details required will be identical to those required when comparing an obligation, set out in footnote 9 above.

<sup>18</sup> It is expected that the first RECAPS process in the OW will run in late March or early April 2011.

<sup>19</sup> Upon implementation of the changes described herein, NSCC anticipates operating the RECAPS process on a monthly cycle. Members will be notified of changes in the processing cycle, if any, via an NSCC Important Notice.

<sup>20</sup> Obligations that are matched and have a settlement date of at least two days prior to the date on which the RECAPS process commences will be considered for inclusion in the RECAPS process, and therefore, fail items not already in the OW and eligible for RECAPS processing must be submitted by the Member prior to RECAPS processing.

<sup>21</sup> In the event that the current market price for a security is not available, the obligation will be priced at the amount at which the obligation was previously matched.

Any net cash adjustments resulting from the RECAPS process will be sent to NSCC Settlement as they are under the current process.

### **Reporting**

Each Member will receive real-time updates regarding their OW activity. In addition, NSCC will make available to each Member an end-of-day report that reflects all end-of-day positions of such Member in OW, which may be accessed by Members through NSCC's systems. Accordingly, NSCC will discontinue issuance of all RECAPS reports (e.g., RECAPS Contracts/Supplemental Contracts and RECAPS Compared Trade Summaries).

### **Proposed Rule Changes**

NSCC will create a new Rule 51 (Obligation Warehouse) and Procedure IIA (Obligation Warehouse) to reflect the changes and enhancements as described above. Rule 51 provides: (i) a general description of the OW service, (ii) a provision relating to the settlement of OW Obligations and the non-guaranteed nature of the service, and (iii) a limitation of liability on the part of NSCC with respect to obligations processed through the OW. Furthermore, the provisions of Procedure IIA will supersede those set forth in Procedure II, Section F (RECAPS) and thus Section F will be deleted.

In addition, NSCC will make conforming changes to:

- a. Rule 1 (Definitions) to add a definition for "Obligation Warehouse" and "OW Obligation";
- b. Rule 7 (Comparison and Trade Recording Operation) to remove language from the rule relating to submission of data to the Corporation for reconfirmation and repricing of trade data with respect to transactions already compared through the facilities of the Corporation or other facilities, as this service will now occur pursuant to Rule 51 and Procedure XVII;
- c. Rule 11 (CNS System) to provide that obligations arising from Special Trades will be automatically entered into the OW;
- d. Rule 18 (Procedures for When the Corporation Ceases to Act) to reflect that (i) the OW Obligations that have been forwarded to CNS for settlement relating to a Member for which the Corporation has ceased to act will be removed from the CNS Accounting Operation, and that any outstanding OW Obligations of the Member will be removed from the OW service, and (ii) NSCC will reverse any cash adjustments that were forwarded to settlement relating to the OW activity of a Member for which NSCC has ceased to act;
- e. Rule 50 (Automated Customer Account Transfer Service) to reflect

that non-CNS ACATS items (as well as CNS-eligible items designated to be delivered ex-CNS) will be automatically entered into the OW;

- e. Procedure V (Balance Order Accounting Operation) to reflect that Balance Orders will be automatically entered into the OW; and
- f. Procedure VII (CNS Accounting Operation) to reflect (i) the addition of CNS-eligible OW activity to the CNS Miscellaneous Activity Report, and (ii) securities removed from CNS that result in a CNS Receive and Deliver Instructions will be entered into the Obligation Warehouse service.

### **Pilot and Participant Testing**

NSCC implemented a Pilot of the OW process in early February 2010 for firms that had completed systems changes necessary to participate in the process. This Pilot ended at the beginning of June 2010, as additional discussions ensued between the Corporation and its participant Members regarding the additional functionalities sought to be included within the service, which are described in this filing. Prior to implementation of OW, a participant testing period will take place between November 2010 and January 2011. An industry-wide test of the OW RECAPS process is scheduled for March 11, 2011.

### **Implementation timeframe:**

NSCC proposes to implement the changes set forth in this filing for all Members during the first quarter of 2011, with the first settlement date expected to be on January 24, 2011. Mandatory reorganization events are anticipated to be applied to OW Obligations shortly after February 4, 2011, on a date no less than 10 business days following announcement of its implementation by Important Notice. Similarly, at the request of the industry, the functionality providing for OW Obligations in CNS-eligible securities, to be reviewed and sent to CNS, will be implemented several weeks after the initial launch so as to give Members time to familiarize themselves with the OW settlement tracking functionality. Accordingly, after March 4, 2011, or on a date no less than 10 business days following announcement of its implementation by Important Notice, obligations in the OW will be reviewed for CNS-eligibility and, if eligible, will be closed and sent to CNS. The first RECAPS process in the OW will be run in late March or early April 2011. Pending Commission approval, Members will be advised of the implementation dates through issuance of NSCC Important Notices.

(b) The proposed rule change facilitates the prompt and accurate clearance and settlement of securities transactions by providing for greater efficiency and transparency with respect to obligations processed through the OW; and is therefore consistent with the requirements of the Securities Exchange Act of 1934, as amended (the "Act") and the rules and regulations thereunder applicable to NSCC. In addition, the proposal is consistent with the CPSS/IOSCO Recommendations for Central

Counterparties in that it facilitates the prompt and automated confirmation and comparison of trades, and the tracking of fail transactions by the parties thereto through settlement.

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 not based on the rules of another self-regulatory organization or the Commission.

9. Exhibits

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

Exhibit 2 – N/A

Exhibit 3 – N/A

Exhibit 4 – N/A

Exhibit 5 – Proposed Changes to NSCC's Rules

**Exhibit 1**

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-[\_\_\_\_\_]); File No. SR-NSCC-2010-11

October 5, 2010

SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Securities Clearing Corporation (“NSCC”) with regard to the enhancement of the Reconfirmation and Pricing Service (“RECAPS”), which includes the creation of new functionality to be known as the Obligation Warehouse.

Pursuant to Section 19(b)(4) of the Securities Exchange Act of 1934 (“Act”), notice is hereby given that on \_\_\_\_\_ National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the rule change from interested parties.

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

The proposed rule change is annexed hereto as Exhibit 5.

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

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified under the Item IV below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

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

Background

RECAPS is NSCC’s automated fail clearance system for eligible securities. Through RECAPS, Members are provided with an opportunity, on a quarterly basis, to reconfirm and reprice compared transactions which remain unsettled (i.e., fail transactions). The proposed rule change will modify RECAPS to run on a more frequent

basis, and will enhance the RECAPS process, and rename it as, the Obligation Warehouse (“OW” or “OW Service”). As more fully described below, the enhanced service will provide: (i) comparison of transactions that are not otherwise submitted by the applicable marketplaces or Members themselves for trade comparison or recording through other NSCC trade capture services, (ii) tracking, storage and maintenance of unsettled obligations either compared through the service or forwarded to it from other NSCC services in accordance with the Rules (including securities exited from NSCC’s Continuous Net Settlement (“CNS”) system, as well as for Non-CNS Automated Customer Account Transfer Service (“ACATS”) items,<sup>1</sup> NSCC Balance Order transactions<sup>2</sup> and Special Trades) (collectively “OW Obligations”), and (iii) for the repricing and netting of fail obligations. The tracking, storage and maintenance functionality of the OW will provide transparency and make information available to its users, serving as a central depository of open (i.e. failed or unsettled) broker-to-broker obligations, and will allow users to manage and resolve exceptions (“don’t know” or “DK” obligations) in an efficient and timely manner. Simultaneously, OW will provide on-going maintenance and servicing of open OW Obligations, such as adjustments for corporate actions and a regular scan of OW Obligations for CNS eligibility.<sup>3</sup>

#### Current RECAPS Service

RECAPS allows Members to periodically reconfirm open aged fails (fails that are five days or older), re-price such fails to the current market value and, when possible, net the reconfirmed and re-priced fails. All NSCC Members who are also members of the Financial Industry Regulatory Authority (“FINRA”) are required to participate in the RECAPS service;<sup>4</sup> however the service is available to all Members. As part of the RECAPS process, those CNS-eligible recompared fails are forwarded to CNS for processing and settlement. Transactions in non-CNS eligible issues are repriced, netted and allotted, when applicable, and Balance Orders are generated or the transactions are designated to settle trade-for-trade.

RECAPS provides Reject and DK capabilities for advisories received and requires Members to effectively respond to all open fails submitted by a counterparty via a batch overnight submission. Advisories that are either “unresponded to” or “DK’d” are subject to close-out action under the rules of the appropriate marketplace. RECAPS provides for

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<sup>1</sup> Only non-CNS eligible ACATS and CNS-eligible ACATS that have been designated as ex-CNS shall be forwarded to the OW. Non-CNS ACATS that receive and deliver instructions for mutual funds, limited partnerships and safekeeping items, however, will not be eligible for OW.

<sup>2</sup> Balance Orders will be forwarded to the OW after netting and allotting has occurred in accordance with NSCC’s Procedures.

<sup>3</sup> These functionalities will be made available at a date no less than 10 business days following announcement of implementation by Important Notice.

<sup>4</sup> FINRA Rule 11190(a).

a one-day settlement capability for all compared fails.

Currently, the RECAPS processing procedures are as follows:

- On a Friday evening, at the time and in the manner established by NSCC, Members submit RECAPS fail information (“RECAPS Input”).
- On the following Monday morning, NSCC produces RECAPS Contracts indicating compared, uncomparing and advisory items. Members: (i) must respond to all advisories that they receive as a result of the initial fail submission (either by submitting an advisory, a “DK” or a Reject), and (ii) may submit an “as-of” trade if the Member failed to timely submit a transaction to RECAPS. As-of trades are compared only if there is an exact match; no trade resolution process is available. NSCC then produces supplemental RECAPS Contracts showing items compared on Monday’s input, as well as CNS and Non-CNS Compared Trade Summaries for those items that compared as a result of Monday’s submission.
- Fails that matched on the Friday submission will settle on Monday. Fails that compared on the Monday submission will settle on Tuesday.
- A RECAPS Activity Report is made available to Members at the end of the RECAPS cycle.
- The net cash adjustment (the difference between the aggregate value of the original fails and the aggregate value of the reconfirmed trades) will settle the day the underlying RECAPS Contract settles and is included as part of the Member’s daily money settlement with NSCC.
- RECAPS, however, is not a guaranteed service of NSCC, so if NSCC does not receive payment from a Member, the Corporation, may, in its discretion, reverse in whole or part any credit previously given to any Member who is the contra side to a trade reconfirmed and repriced through RECAPS.

#### Obligation Warehouse

Currently, many of the transactions submitted to RECAPS by Members are subject to non-centralized, manual processes for purposes of comparison of fail details and fail confirmation. NSCC proposes to enhance and rename the RECAPS service as the Obligation Warehouse, to which Members may submit, and subsequently maintain and manage, their unsettled transactions. As part of these enhancements, NSCC proposes to provide a trade matching and confirmation process pursuant to which Members may

submit to NSCC information on certain obligations that are not otherwise submitted to NSCC by the applicable marketplaces or Members themselves through its other trade comparison or recording services.<sup>5</sup> Comparison of transactions submitted through the OW will occur in real-time. Obligations will be tracked and maintained within the Obligation Warehouse and be made available for RECAPS processing (as described below) until settled or otherwise cancelled. In addition, transactions exited from CNS, non-CNS-eligible ACATS items, as well as NSCC Balance Orders and Special Trades will also be forwarded to the OW for storage and maintenance, and RECAPS processing.<sup>6</sup> Compared items stored in the OW (whether compared by the OW or forwarded to it from other NSCC services or systems) are referred to as “OW Obligations”. As more fully described below, in order to further reduce manual processing by Members, NSCC may automatically adjust any OW Obligations for certain mandatory reorganization events, which will be initially limited to adjustments for forward splits, name changes, redemptions, mergers (both cash and stock) and full calls with respect to bonds.<sup>7</sup>

The OW Service will forward to CNS on a daily basis (or such other timeframe as NSCC determines from time to time) OW Obligations in CNS-eligible securities.<sup>8</sup> However, the OW will not be a guaranteed service, and an obligation forwarded to CNS will only be guaranteed to the extent that the Member meets its settlement obligation on the date the item is originally scheduled to settle in CNS. Transactions eligible for submission must have a valid CUSIP or ISIN and be denominated in U.S. Dollars, or such other currencies as NSCC may designate from time to time. NSCC may determine from time to time, and shall announce by Important Notice, which items are eligible for submission to Obligation Warehouse. Initially, government, mortgage-backed, and foreign securities will all specifically not be eligible. Further, cash trades will be

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<sup>5</sup> See Procedure II (Trade Comparison and Recording Service) which sets forth the procedures for comparison of direct submissions by Members and trade recording of locked-in transactions. Members should note that in accordance with Municipal Securities Rulemaking Board (MSRB) rules, NSCC reports transactions in municipal securities compared through its Real-time Trade Matching service (“RTTM”) to the MSRB on behalf of Members; however transactions submitted through the OW will not be reported to the MSRB. In order to remain compliant with MSRB reporting requirements, submissions subject to MSRB rules should continue to be made through RTTM.

<sup>6</sup> Such items will be subject to the validation criteria of the systems/services that forwarded them to the OW and therefore the matching/validation criteria (which are set forth in footnote 9 below) will not apply.

<sup>7</sup> Adjustments for mandatory reorganization events are expected to be available shortly after February 4, 2011, or a date no less than 10 business days following announcement of its implementation by Important Notice.

<sup>8</sup> This functionality is anticipated to be rolled out in early March 2011.

### OW Comparison and Trade Resolution Procedures

Once a party enters the required transaction information<sup>9</sup>, the counterparty will receive an advisory, to which it must respond by submitting identical transaction details to facilitate a compared obligation, or by submitting a DK.<sup>10,11</sup> If a Member does not act on an advisory submitted against it by the close of business on the day after submission, NSCC may impose a fee upon the Member. If the deliverer and receiver submit trade data that matches in all required respects, the trade will be deemed compared if it meets money tolerances to be announced by NSCC from time to time.<sup>12</sup> The Corporation may permit un-compared trade details to be modified or cancelled by the submitter on the submission date through the use of the appropriate instruction.<sup>13,14</sup> Upon comparison, NSCC may permit obligations to be cancelled if both receiver and deliverer agree by submitting a cancel request bilaterally, or if one party accepts the other party's cancel request. Each OW Obligation will receive an "OW Control Number" to facilitate tracking the obligation through its settlement, cancellation or closure.

NSCC will have no responsibility for determining whether any trade submission is duplicative of an earlier trade submission and any such input will be treated as a separate submission. NSCC may delete trade input which is not matched by such timeframes as it determines from time to time.

### Maintenance and Tracking

The OW service will permit Members to track each OW Obligation for the life of the obligation until it has been (i) settled, (ii) cancelled by Members party to the obligation, or (iii) otherwise closed in the OW Service by the Corporation pursuant to the Rules (e.g., when the obligation becomes CNS-eligible and is sent to CNS for settlement).

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<sup>9</sup> Data required for a valid submission will include security identification, quantity to which party is deliverer or receiver, contra-broker, deliverer's final money, settlement date, market participation identification (MPID) (if applicable), Member's unique reference number ("x-ref"), whether a transaction should be excluded from CNS processing and other identifying details as NSCC may require or permit.

<sup>10</sup> Obligations will be able to be submitted to the OW in real-time. Required matching criteria will include the specific criteria listed in footnote 9 above (except for the x-ref), and other identifying details as NSCC may require or permit.

<sup>11</sup> Any submission of a DK must include the applicable reason code pertaining to the Member's disagreement with the transaction.

<sup>12</sup> Initially, if the deliverer and receiver submit trade data that matches in all required respects, the trade will be deemed compared if it meets a money tolerance of \$5 per million, though this amount is subject to change as NSCC determines from time to time.

<sup>13</sup> Modification of transaction details will result in the cancellation of the existing entry and the opening of a new submission.

<sup>14</sup> Please note that transaction details that have been DK'd by a counterparty will be deleted from processing in accordance with timeframes specified by the Corporation from time to time. Initially, such transaction details will be deleted on the fifth business day following submission of the DK by the counterparty.

NSCC may adjust any compared OW Obligation with respect to certain mandatory reorganization events; these will initially be limited to forward splits, name changes, redemptions, mergers (both cash and stock) and full calls with respect to bonds. In the case of such a mandatory reorganization, at such time on or after the effective date of the reorganization as NSCC shall determine, and to the extent NSCC has the relevant information, the affected OW Obligation may be adjusted in accordance with the terms of the reorganization event. With respect to name changes and forward splits, OW positions in the subject security will be converted into the equivalent positions of the new securities and/or cash and a new obligation will be created automatically as part of the processing in the OW. Any cash component associated with a mandatory reorganization will be included as part of the Member's daily money settlement with the Corporation.<sup>15</sup>

Unless otherwise excluded by a Member, all CNS-eligible OW Obligations that reach the status of settlement date minus one ("SD-1") or that have reached or passed their scheduled settlement date, may be forwarded to CNS by NSCC on a daily basis.<sup>16</sup> However, the settlement of any such item forwarded to CNS will be guaranteed only to the extent that the Member pays its full settlement obligation on the date the item is scheduled to settle in CNS. An item forwarded to CNS from the OW may be exited from the CNS Accounting Operation to the extent the Member fails to complete its settlement obligation. If NSCC exits an item, any credits received by a Member arising from the corresponding payment obligation shall be reversed and settlement of the item shall be effected between the receiving and delivering Member and not through the facilities of the Corporation.

OW Obligations for which deliveries are made through The Depository Trust Company ("DTC") via either The New York Window ("NYW") or electronic book-entry deliver order and include the OW Control Number will be updated to indicate that they have settled in accordance with proper instructions from DTC or the Member, respectively. In order to give effect to such an update, Members must provide DTC with instructions in accordance with DTC's procedures, and include the OW Control Number. In the event of a partial delivery through DTC, NSCC will update the records for the respective OW Obligation accordingly, based on information received either from DTC or the Member's update to their own OW Obligation records. Other items will be recorded as settled upon the submission of appropriate instructions by the counterparties.

Obligations that have been reflected in the OW as settled may be re-opened (either partially or fully), as a result of a delivery reclaim message sent by either party to the obligation to OW. Updates to reflect reclaims of settled transactions will be made

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<sup>15</sup> In the event that the Corporation ceases to act for a Member pursuant to Rule 18, the Corporation will reverse credits and debits relating to such a cash adjustment.

<sup>16</sup> This functionality is expected to be rolled out by March 2011, or on a date no less than 10 business days following announcement of its implementation by Important Notice.

once one party enters details of the original transaction,<sup>17</sup> and the original transaction's OW Control Number. Once these details are submitted, an advisory of the reclaim will be sent to the counterparty, who must either submit identical transaction details to facilitate the reclaim and re-open the obligation in OW, or submit notification that it does not accept the reclaim details entered by the initiating party. Updates for reclaims may only be submitted to the OW for a period of two business days following the actual settlement date of the relevant obligation. If the reclaim message is not accepted by the counterparty, it will be deleted from the OW, and the parties will need to generate a new reclaim message in OW. If the original obligation has been settled for longer than two business days, any reclaim message will be rejected.

If NSCC ceases to act for a Member, all open activity relating to that Member will be deleted from the OW; however the reports relating to such activity will be maintained in accordance with NSCC's record retention requirements.

#### Modified RECAPS Process

Under the proposal, the existing RECAPS process will continue to function in a modified form.<sup>18</sup> Upon implementation of OW, the RECAPS process will be incorporated into OW and will require one day to complete. It is anticipated that the process will occur more frequently than the current quarterly schedule.<sup>19</sup>

On a day specified by the Corporation, each OW Obligation eligible for RECAPS<sup>20</sup> will be re-priced, if appropriate,<sup>21</sup> re-netted and allotted, if appropriate, the settlement date will be updated to the next business date and a new OW Obligation will be opened. Securities that are not CNS-eligible or are designated as trade-for-trade will not be netted and allotted. Obligations eligible for RECAPS in the OW can be excluded from the RECAPS process if so designated by the Member.

All new obligations arising from the RECAPS process will be tracked and processed in accordance with the OW procedures described above. If a fail was open over an interest payment date, the parties to the trade will be required to settle that

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<sup>17</sup> Transaction details required will be identical to those required when comparing an obligation, set out in footnote 9 above.

<sup>18</sup> It is expected that the first RECAPS process in the OW will run in late March or early April 2011.

<sup>19</sup> Upon implementation of the changes described herein, NSCC anticipates operating the RECAPS process on a monthly cycle. Members will be notified of changes in the processing cycle, if any, via an NSCC Important Notice.

<sup>20</sup> Obligations that are matched and have a settlement date of at least two days prior to the date on which the RECAPS process commences will be considered for inclusion in the RECAPS process, and therefore, fail items not already in the OW and eligible for RECAPS processing must be submitted by the Member prior to RECAPS processing.

<sup>21</sup> In the event that the current market price for a security is not available, the obligation will be priced at the amount at which the obligation was previously matched.

interest payment outside of the OW.

Any net cash adjustments resulting from the RECAPS process will be sent to NSCC Settlement as they are under the current process.

### Reporting

Each Member will receive real-time updates regarding their OW activity. In addition, NSCC will make available to each Member an end-of-day report that reflects all end-of-day positions of such Member in OW, which may be accessed by Members through NSCC's systems. Accordingly, NSCC will discontinue issuance of all RECAPS reports (e.g., RECAPS Contracts/Supplemental Contracts and RECAPS Compared Trade Summaries).

### Proposed Rule Changes

NSCC will create a new Rule 51 (Obligation Warehouse) and Procedure IIA (Obligation Warehouse) to reflect the changes and enhancements as described above. Rule 51 provides: (i) a general description of the OW service, (ii) a provision relating to the settlement of OW Obligations and the non-guaranteed nature of the service, and (iii) a limitation of liability on the part of NSCC with respect to obligations processed through the OW. Furthermore, the provisions of Procedure IIA will supersede those set forth in Procedure II, Section F (RECAPS) and thus Section F will be deleted.

In addition, NSCC will make conforming changes to:

- a. Rule 1 (Definitions) to add a definition for "Obligation Warehouse" and "OW Obligation";
- b. Rule 7 (Comparison and Trade Recording Operation) to remove language from the rule relating to submission of data to the Corporation for reconfirmation and repricing of trade data with respect to transactions already compared through the facilities of the Corporation or other facilities, as this service will now occur pursuant to Rule 51 and Procedure XVII;
- c. Rule 11 (CNS System) to provide that obligations arising from Special Trades will be automatically entered into the OW;
- d. Rule 18 (Procedures for When the Corporation Ceases to Act) to reflect that (i) the OW Obligations that have been forwarded to CNS for settlement relating to a Member for which the Corporation has ceased to act will be removed from the CNS Accounting Operation, and that any outstanding OW Obligations

of the Member will be removed from the OW service, and (ii) NSCC will reverse any cash adjustments that were forwarded to settlement relating to the OW activity of a Member for which NSCC has ceased to act;

- e. Rule 50 (Automated Customer Account Transfer Service) to reflect that non-CNS ACATS items (as well as CNS-eligible items designated to be delivered ex-CNS) will be automatically entered into the OW;
- e. Procedure V (Balance Order Accounting Operation) to reflect that Balance Orders will be automatically entered into the OW; and
- f. Procedure VII (CNS Accounting Operation) to reflect (i) the addition of CNS-eligible OW activity to the CNS Miscellaneous Activity Report, and (ii) securities removed from CNS that result in a CNS Receive and Deliver Instructions will be entered into the Obligation Warehouse service.

#### Pilot and Participant Testing

NSCC implemented a Pilot of the OW process in early February 2010 for firms that had completed systems changes necessary to participate in the process. This Pilot ended at the beginning of June 2010, as additional discussions ensued between the Corporation and its participant Members regarding the additional functionalities sought to be included within the service, which are described in this filing. Prior to implementation of OW, a participant testing period will take place between November 2010 and January 2011. An industry-wide test of the OW RECAPS process is scheduled for March 11, 2011.

#### Implementation timeframe:

NSCC proposes to implement the changes set forth in this filing for all Members during the first quarter of 2011, with the first settlement date expected to be on January 24, 2011. Mandatory reorganization events are anticipated to be applied to OW Obligations shortly after February 4, 2011, on a date no less than 10 business days following announcement of its implementation by Important Notice. Similarly, at the request of the industry, the functionality providing for OW Obligations in CNS-eligible securities, to be reviewed and sent to CNS, will be implemented several weeks after the initial launch so as to give Members time to familiarize themselves with the OW settlement tracking functionality. Accordingly, after March 4, 2011, or on a date no less than 10 business days following announcement of its implementation by Important Notice, obligations in the OW will be reviewed for CNS-eligibility and, if eligible, will be closed and sent to CNS. The first RECAPS process in the OW will be run in late

March or early April 2011. Pending Commission approval, Members will be advised of the implementation dates through issuance of NSCC Important Notices.

The proposed rule change facilitates the prompt and accurate clearance and settlement of securities transactions by providing for greater efficiency and transparency with respect to obligations processed through the OW; and is therefore consistent with the requirements of the Securities Exchange Act of 1934, as amended (the "Act") and the rules and regulations thereunder applicable to NSCC. In addition, the proposal is consistent with the CPSS/IOSCO Recommendations for Central Counterparties in that it facilitates the prompt and automated confirmation and comparison of trades, and the tracking of fail transactions by the parties thereto through settlement.

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

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

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

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 rule change should be disapproved.

IV. Solicitation of Comments

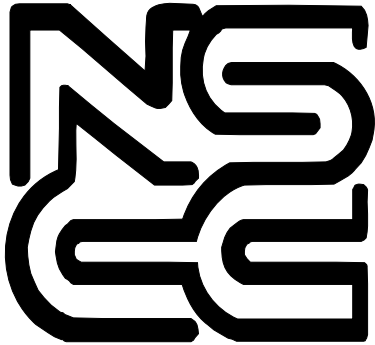
Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

- Electronic comments may be submitted by using the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>), or send an e-mail to [rule-comment@sec.gov](mailto:rule-comment@sec.gov). Please include File No. SR-NSCC-2010-11 on the subject line.
- Paper comments should be sent in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549-1090.

All submissions should refer to File Number SR-NSCC-2010-11. 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 Section 100 F Street, NE, Washington DC 20549-1090. Copies of such filing also will be available for inspection and copying at the principal office of NSCC. 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 Trading and Markets, pursuant to delegated authority.

Elizabeth M. Murphy  
Secretary



NATIONAL  
SECURITIES  
CLEARING  
CORPORATION

RULES & PROCEDURES

TEXT OF PROPOSED RULE CHANGE

**Blue Highlight indicates pending changes in Rule Filing SR-NSCC-2010-09**

**Underlined and boldface** text indicates new text

**~~Strikethrough and boldface~~** indicates deleted text

RULE 1. DEFINITIONS

\* \* \*

**Obligation Warehouse**

**The term “Obligation Warehouse” has the meaning specified in Rule 51.**

**OW Obligation**

**The term “OW Obligation” has the meaning specified in Rule 51.**

\* \* \*

RULE 7. COMPARISON AND TRADE RECORDING OPERATION

(INCLUDING SPECIAL REPRESENTATIVE/INDEX RECEIPT AGENT)

SEC.1. A Member may submit to the Corporation for comparison **or for trade recording**, trade data on any transaction calling for delivery of Cleared Securities between it and another person. The Corporation will, in accordance with this Rule and the Procedures, handle the comparison of transactions reflected in trade data so submitted to it.<sup>1</sup> ~~In addition, in accordance with this Rule and the Procedures, a Member shall submit to the Corporation for reconfirmation and repricing trade data with respect to transactions already compared through the facilities of the Corporation or other facilities.~~

\* \* \*

[Remainder of Rule Unchanged]

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<sup>1</sup> At such time as each exchange and/or marketplace assumes responsibility for trade comparison for transactions executed on or subject to the rules of such exchange and/or marketplace, the Corporation will cease providing comparison services for such transactions.

## RULE 11. CNS SYSTEM

SEC. 1.(a) The CNS System is a system for accounting for and settling CNS Contracts whereby a Member's Settling Trades in CNS Securities are netted so that with respect to each issue of CNS Securities in which the Member has activity, the Member is either obligated to deliver units of that security (a "Short Position") or is entitled to receive units of that security (a "Long Position"), the delivery obligation being to the Corporation and the right to receive being against the Corporation as more specifically set forth in paragraphs (b) and (c) below; whereby Short Positions or Long Positions outstanding in respect of prior activity are brought forward on a perpetual basis and, together with stock dividends or distributions payable or receivable in respect of Short Positions or Long Positions, miscellaneous entries and CNS Securities delivered to or by Members, are merged, netted and carried forward, leaving in each Member's account all transactions which have failed in delivery or receipt; and whereby the contract money of all Settling Trades is netted with cash dividends or distributions receivable and payable and increases and decreases in obligations to the Clearing Fund, if applicable, and miscellaneous items resulting in the closing CNS System money balance for each Member which, for the purpose of computing the CNS System money settlement (including marking any Long or Short Position of a Member at the close of business to the Current Market Price), is adjusted by the net market value of all Closing Positions.

(b) Each obligation of any Member (the "Receiving Member") to pay for securities delivered to that Member by another Member (the "Delivering Member") under a transaction which (i) has been compared or reported by the Corporation and (ii) will be subject to the CNS Accounting Operation (each a "CNS Transaction"), and each obligation of any Delivering Member to deliver securities to any Receiving Member under any such transaction, shall be assumed by the Corporation at the point in the clearance and settlement process determined as set forth in paragraph (c) below. Simultaneously with the assumption of any such obligations by the Corporation, the related rights of the Receiving Member to receive securities from the Delivering Member and the related rights of the Delivering Member to receive payment from the Receiving Member for securities delivered shall be assigned to the Corporation. The assumption of these obligations and the assignment of these rights with respect to any CNS Transaction places the Corporation between the Delivering Member and the Receiving Member, creating an obligation on the part of the Delivering Member to deliver securities to the Corporation and on the part of the Receiving Member to receive and pay for securities delivered by the Corporation, as well as an obligation on the part of the Corporation to receive and pay for securities delivered by the Delivering Member and to deliver securities to the Receiving Member.

(c) The assumptions and assignments referred to in the paragraph (b) of this Section for any CNS Transaction of any Member shall occur when the Corporation's guarantee to complete the transaction becomes effective. For

purposes of the preceding sentence, the Corporation shall be deemed to have guaranteed completion of a CNS Transaction when the clearance and settlement process for the transaction has reached the stage at which the Corporation will complete the CNS Accounting Operation for such transaction notwithstanding that the Corporation may cease to act for the Member. This stage may be designated in the Corporation's Rules or Procedures or in any interpretation or statement of policy relating thereto, and it may be different for different types of transactions.

(d) Whenever the Corporation shall be required to exit or delete any CNS Transaction from the CNS System, the obligation to deliver and/or the obligation to pay for securities delivered, as well as the correlative rights to receive securities and/or to receive payment for securities delivered, shall be further assumed by and assigned to such Members as may be designated by the Corporation, in accordance with its Rules and Procedures, in the appropriate Balance Orders, security orders, reports or as otherwise may be appropriate.

(e) All rights and liabilities with respect to any CNS Transaction other than those specifically assigned and assumed by the Corporation as set forth in paragraph (b) of this subsection shall be retained by the Members who are the original contra-parties to the transaction as compared or reported by the Corporation. It is specifically understood that the rights and liabilities retained by such Members shall not include ownership rights in the securities delivered to the Corporation pursuant to CNS Transactions (all of which ownership rights shall be in the Corporation) and any other rights and liabilities that cannot be legally separated from the rights and liabilities assigned and assumed by the Corporation.

SEC. 2. The Corporation will maintain a position for each Member in each CNS Security for which the Member has a Short Position (reflecting units which the Member is obligated to deliver to the Corporation) or a Long Position (reflecting units which the Member is entitled to receive from the Corporation).

SEC. 3. Pursuant to the instructions of each Member given in the manner prescribed in the Procedures and on the basis of information provided to the Member by the Corporation and information otherwise available to the Member, the Corporation will instruct the Qualified Securities Depository designated by the Member in the manner prescribed by the Corporation to deliver to the Corporation's account at the Qualified Securities Depository on each Settlement Date CNS Securities credited to the Member's account for the purpose of reducing or eliminating Short Positions of the Member; and the Corporation will instruct the Qualified Securities Depository to deliver from the Corporation's account at the Qualified Securities Depository, in accordance with the priorities specified in the Procedures, CNS Securities so received into the Corporation's account at the Qualified Securities Depository to the Member necessary to reduce or eliminate Long Positions of the Member. Notwithstanding the

foregoing, deliveries and receipts of securities may also be effected in such other manner as may be prescribed in the Procedures.

SEC. 4. On each settlement day the Corporation will issue to each Member reports which will show each CNS position in each security due to settle that day and on the next settlement day and such other information as the Corporation may deem advisable. With respect to obligations due to settle on the next settlement day, the obligation of a Member to receive and pay for CNS Securities and the obligation of a Member to deliver CNS Securities pursuant to the CNS Contracts shall be fixed at the time the applicable report is made available to the Member, although it may not in fact have been received by such Member. With respect to obligations due to settle that day, the obligation of a Member to receive and pay for CNS Securities and the obligation of a Member to deliver CNS Securities shall be fixed at each time a net settling position is determined for that Member in accordance with the CNS processing and information in respect of that new net settling position is made available.

SEC. 5. (a) On the morning of each settlement day the Corporation will issue to each Member a Cash Reconciliation Statement showing the amount receivable or payable by the Member in respect of the CNS System for that settlement day on the basis of settlement activity completed prior to the preparation of the Cash Reconciliation Statement. On the morning of each settlement day the Corporation will also issue to each Member a statement which will reflect the receipts and deliveries of securities in settlement of Long or Short Positions for that date which shall have been completed prior to the preparation of the Cash Reconciliation Statement. Thereafter on such settlement day the Corporation will issue to each Member a statement or statements of other receipts and deliveries of securities in settlement of Long or Short Positions which are completed on that date. The Member, on the basis of such statements, shall determine the final amount receivable or payable by the Member in respect of the CNS system for that settlement day in the manner specified in the Procedures.

(b) On each settlement day the Corporation will issue to each Member an accounting summary which will reflect each CNS Security in which there was activity or in which the Member had an opening Long or Short Position, the Member's opening Long or Short Position, the Member's activity in such CNS Securities for that day, the transactions into and out of its Qualified Securities Depository account or receipts and deliveries otherwise effected as described in Section 3 of this Rule or in the Procedures, the Closing Position for that day in each CNS Security and the Closing Position valued at the Current Market Price, resulting in a net long market value or short market value in CNS Securities. The accounting summary also will show the Member's money activity for that settlement day.

SEC. 6. The Corporation may, when it deems it necessary for the protection of Members in view of the price fluctuations in or volatility or lack of

liquidity of any security require all Members to make additional mark-to-the-market payments on any Long or Short Position in respect of such security or to make mark-to-the-market payments in respect of all transactions in such security prior to the Settlement Date for such transaction.

SEC. 7. (a) In the event a Member has a Long Position in a CNS Security, the Member (the "originator") may demand immediate delivery thereof by filing, at or before the time specified in the Procedures, with the Corporation a Notice of Intention to Buy-In, in the form prescribed by the Procedures. The originator will be given priority, in the manner prescribed by the Procedures, in respect of the allocation by the Corporation of securities covered by the Notice of Intention to Buy-In, in the settlement on the settlement day prior to the expiration of the buy-in and if the securities are not allocated to the originator in that settlement, in the settlement on the settlement day the buy-in expires<sup>1</sup>.

(b) In the event that less than all the securities covered by the Notice of Intention to Buy-In are received by the originator prior to the time specified in the Procedures, the Corporation shall as promptly as possible, but not later than the settlement day after the Notice of Intention to Buy-In is filed with the Corporation, transmit to the Member or Members, determined in accordance with the priorities specified in the Procedures, CNS Retransmittal Notices specifying the originator and the total amount called for in the Notice of Intention to Buy-In which has not been received by the originator pursuant to paragraph (a) of this section (the "remaining securities") and demanding delivery from each such Member of a specified quantity of securities determined in accordance with the Procedures. CNS Retransmittal Notices shall include such information pertaining to the Buy-In as the Corporation may determine from time to time.

(c) Prior to the execution of a Buy-In, the originator must accept and pay for any portion or all the remaining securities delivered to the originator and, if the originator does not so receive all the remaining securities at the opening of business on the settlement day after which the Corporation transmits Retransmittal Notices pursuant to paragraph (b) of this Section, the originator may order the purchase of the portion remaining undelivered in the manner specified in the Procedures.

(d) In the event that a Notice of Intention to Buy-In is presented and sufficient securities are not delivered as provided in paragraph (b) of this Section and subsequently the originator does not order the purchase of the remaining securities, a charge may be levied against the originator in the amount of \$250.

SEC. 8. After receipt of notice by the Corporation that the issuer of a CNS Security has declared a stock or cash dividend on such security or has

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<sup>1</sup> With respect to Buy-Ins of municipal securities, in lieu of receiving CNS priority, the filing of a Notice of Intention to Buy-In will be treated as an instruction to remove the Buy-In Position from the CNS System in accordance with the Procedures.

authorized a stock-split or a distribution of rights or other property with respect to a CNS Security, the Corporation will issue a Record Date Report which will show each Member's record date Long or Short Position in the security at the close of business on the Record Date (herein called "Record Date Position").

(a) On the payable date for a cash dividend (or, if the payable date is not a settlement day, then on the settlement day immediately following such payable date) each Member shall be obligated to pay an amount equal to the dividend on any Short Position included in the Member's Record Date Position and shall be entitled to receive an amount equal to the dividend on any Long Position included in the Member's Record Date Position.

(b) On the payable date for a stock dividend (or, if the payable date is not a settlement day, then on the settlement day immediately following such payable date), the securities position of each Member shall be adjusted to reflect the Member's obligation to deliver the amount of the stock dividend on any Short Position included in the Member's Record Date Position to the Corporation or to reflect the Member's right to receive the amount of the stock dividend on any Long Position included in the Member's Record Date Position from the Corporation. Fractional shares shall not be added to any Short or Long Position in respect of any stock dividend or other distribution. In lieu thereof, the Corporation shall credit or debit, as the case may be, an amount of cash in respect of fractional shares based on the Current Market Price of the security.

(c) The procedure set forth in paragraph (b) shall apply to distributions other than dividends, provided, however, that in the case of stock-splits or distributions in respect of which a CNS Security is traded with due bills after the record date for such stock-split or distribution, the securities position of each Member in such CNS Security shall be adjusted to reflect the Member's obligation to deliver the amount of the stock split or distribution on its Short Position at the close of business on the due bill redemption date (the "Due Bill Redemption Date") to the Corporation or to reflect the Member's right to receive the amount of the stock-split or distribution on its Long Position at the close of business on the Due Bill Redemption Date from the Corporation.

(d) An "as of" trade entered at least two settlement days prior to the payable date in respect of a cash or stock dividend or other distribution not trading with due bills after the record date, provided the original trade date for the trade is before the ex-dividend date for such dividend, will be subject to the same procedures as those set forth above; an "as of" trade entered at least one settlement day prior to the Due Bill Redemption Date in respect of other distributions which trade with due bills after the record date will be subject to the same procedures as those set forth above. Any such trades entered less than two settlement days or one business day, as the case may be, prior to the payable date or the Due Bill Redemption Date shall not be accorded dividend protection in the CNS System.

(e) When a dividend or distribution in securities which are not CNS Securities is declared on a CNS Security or rights which are not CNS Securities are issued in respect of a CNS Security, the items will be reported to each Member having a Long or Short Position in the CNS Security on the close of business on Record Date. Such dividends, distributions or rights shall not, however, be settled in the CNS System; the Corporation shall match the Short and Long Positions in respect thereof in that manner which the Corporation in its discretion may provide and issue receive and deliver security orders in respect thereof, which orders shall have the same status as security balance orders issued in connection with the Balance Order Accounting Operation and will be subject to those provisions of these Rules pertaining to such security balance orders unless otherwise specified by the Corporation.

(f) Dividends which may be paid in the form of securities or cash at the election of the holder will be processed in the manner prescribed in the Procedures.

(g) Notwithstanding the foregoing provisions of this subsection 8, the Corporation may adopt any procedures deemed appropriate by it in respect of any transaction to which such provisions are not fully applicable.

SEC. 9. A trade in a CNS Security or Balance Order Security may be designated a Special Trade in which case it will be cleared and settled on a Member-to-Member basis; the parties to the Special Trade shall notify the Corporation at the time and in manner specified in the Procedures, and the Corporation shall issue receive and deliver security orders in respect thereof, which orders shall be settled by the parties directly. To the extent such Special Trade is for a security that is eligible for book-entry transfer on the books of DTC, and the deliverer has filed with the Corporation a standing instruction, the Corporation will issue an instruction on file to DTC specifying the quantity of such security to be delivered from the deliverer to the receiver and the money settlement amount related thereto. **The Corporation may enter obligations arising from such Special Trades into the Obligation Warehouse service in accordance with timeframes as determined by the Corporation from time to time.**

SEC. 10. A CNS Security shall be removed from the list of CNS Securities upon receipt by the Corporation of written notice from a Qualified Securities Depository that the security is no longer eligible under its rules for transfer by book-entry. A CNS Security may be removed from the list of CNS Securities if in the judgment of the Corporation Members may lose important rights by reason of its continued status as a CNS Security. Any such removal shall be promptly communicated to all Members by the Corporation. In such event, the Corporation shall, on the first settlement day on which such securities are not deliverable through the facilities of all Qualified Securities Depositories and on each subsequent settlement day for any CNS Contracts entered in the CNS Accounting Operation prior to the effective date of removal, or upon such

removal, match with respect to each such settlement day opening Short or Long Positions in such security in that manner which the Corporation in its discretion may provide, issue receive and deliver security orders in respect thereof for any such day, which orders shall have the same status as security balance orders issued in connection with the Balance Order Accounting Operation and will be subject to those provisions of these Rules pertaining to such security balance orders unless otherwise specified by the Corporation and close out such positions in the CNS System.

SEC. 11. (a) A Member with a long position or a long Settling Trade position in a CNS Security to which an exercise privilege attaches who wishes to exercise that privilege (the "originator") may file with the Corporation, at or before the time specified in the Procedures, a Notice of Intention to Exercise in the form prescribed by the Procedures.

(b) In the event that the securities covered by the Notice of Intention to Exercise are not received by the originator prior to the time specified in the Procedures, the Corporation will remove the position from CNS and will remove a corresponding short position(s) representing the short Member(s) with the oldest position(s). The Corporation will issue, in the time specified in the Procedures, CNS receive and deliver instructions naming a failing to receive Member and a failing to deliver Member.

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RULE 18. PROCEDURES FOR WHEN THE CORPORATION  
DECLINES OR CEASES TO ACT

SEC. 1. When the Corporation has declined or ceased to act for a Member, Mutual Fund/Insurance Services Member, Municipal Comparison Only Member, Insurance Carrier/Retirement Services Member, TPA Member, Investment Manager/Agent Member, Fund Member, Commission Billing Member, Data Services Only Member or AIP Member (each hereinafter referred to as a "participant" for purposes of this Rule 18) pursuant to Rule 46, it shall provide participants with notice pursuant to the provisions of Section 3 of Rule 45.

SEC. 2. (a) Except as otherwise may be determined by the Board of Directors the following transactions of a Member for which the Corporation has declined or ceased to act shall be excluded from all operations of the Corporation applicable to such transactions:

- (i) any CNS trade which, at the time the Corporation declined or ceased to act for such Member, was not guaranteed by the Corporation pursuant to Addendum K;
- (ii) any Balance Order trade which, at the time the Corporation declined or ceased to act for such Member, was not guaranteed by the Corporation pursuant to Addendum K; **and**
- (iii) any security orders issued in respect of Special Trades and transactions in Foreign Securities;<sup>2</sup>
- (iv) **any Long and Short Positions resulting from OW Obligations of the Member, in whole or in part, that were entered into the CNS Accounting Operation; and**
- (v) **any cash adjustment relating to OW Obligations of the Member forwarded to settlement in accordance with the Obligation Warehouse procedure.**

Any transactions so excluded shall be settled between the parties and not through the Corporation.

(b) All CNS transactions and Balance Order transactions not excluded pursuant to paragraph (a) of this Section shall be handled as provided for in this Rule, **or, if applicable, as may otherwise be provided for in these Rules and Procedures.**

SEC. 3. (a) Notwithstanding any other provision of this Rule, promptly after the Corporation has declined or ceased to act for a Member, the Corporation shall attempt to complete, in accordance with the provisions of this Section, the open RVP/DVP Transactions of such Member. The Corporation shall notify the relevant RVP/DVP Customer and the trustee or receiver of the

Member (if one has been appointed) of the Corporation's intent to attempt to complete such RVP/DVP Transactions. Such notice shall also contain a statement notifying RVP/DVP Customers of the presumed waiver stated in paragraph (f) of this Section. Such notice shall be given by any commercially reasonable means, which shall not be limited to those means specified in Rule 45, and include, but are not limited to, important notice or notification to the RVP/DVP Customer's depository agent or its depository agent's depository.

(b) For purposes of this Rule 18, (i) the "CNS Position" shall be equal to the net of the Member's Long Positions and Short Positions in a CNS Security (which includes, without limitation, any position not excluded by the Corporation pursuant to Section 2), and (ii) the "Net Close Out Position" with respect to a CNS Security shall be equal to the sum of the (X) Long Position or Short Position in such CNS Security plus (Y) the quantity of each RVP/DVP Transaction pertaining to that CNS Security that the Corporation has completed pursuant to this Rule. In determining a CNS Position, the Corporation shall consider Long Positions to be positive numbers and Short Positions to be negative numbers. In determining the Net Close Out Position, the Corporation shall consider any quantity of securities it receives upon completion of an RVP/DVP transaction to be a positive number, and any quantity of securities it delivers upon completion of an RVP/DVP Transaction, to be a negative number.

(c)(i) Subject to paragraph (d) below, the Corporation shall be obligated to attempt to complete all RVP/DVP Transactions in a CNS Security of which the Corporation is aware prior to declining or ceasing to act, but only to the extent that the completion of such RVP/DVP Transactions would not cause the absolute value of the Net Close Out Position in such CNS Security to be greater than the absolute value of the CNS Position in such CNS Security. To the extent that this paragraph requires the Corporation to attempt to complete some but not all of the RVP/DVP Transactions in a particular CNS Security, the Corporation shall determine which of those RVP/DVP Transactions it shall attempt to complete in the same manner that it may, pursuant to subparagraph (ii), determine to attempt to complete any additional RVP/DVP Transactions.

(ii) In determining whether to attempt to complete any additional RVP/DVP Transaction beyond those RVP/DVP Transactions that the Corporation is required to attempt to complete pursuant to subparagraph (c)(i), the Board of Directors may consider any factor it, in its sole discretion, deems appropriate, including the willingness of an RVP/DVP Customer to guaranty fulfillment of its obligation to receive or deliver securities from or to the Corporation, but shall not consider the expected profit or loss arising from any individual RVP/DVP Transaction.

(d) Notwithstanding the provisions of paragraph (c), the Corporation may determine not to complete any open RVP/DVP Transaction pertaining to a particular CNS Security if (i) the Corporation reasonably believes that it cannot complete all RVP/DVP transactions in such CNS Security that it would be

obligated to attempt to complete pursuant to paragraph (c)(i), whether due to the inability of the Corporation or the RVP/DVP Customer to make delivery or payment, the unwillingness of the RVP/DVP Customer to make delivery or payment, or otherwise, (ii) there exists allegations of fraud or otherwise questionable activities with respect to such CNS Security, or (iii) the Corporation believes that the completion of an RVP/DVP Transaction in such CNS Security cannot be consummated on a timely basis. If the Corporation makes such a determination, then it shall have no further obligations with respect to completing such RVP/DVP Transactions, and shall notify the RVP/DVP Customer (or its depository agent or its depository agent's depository) and the trustee or receiver of the Member (if any) of such determination.

(e) The Corporation will apply the same procedures to open positions arising from security Balance Orders<sup>2</sup> with respect to which there are RVP/DVP Transactions, to the extent to do so is practicable.

(f) All notices to RVP/DVP Customers (or the RVP/DVP Customer's depository agent or its depository agent's depository) shall include language to the effect that the RVP/DVP Customer, by completing the RVP/DVP Transaction, shall be conclusively presumed to have waived any claim with respect to such completed RVP/DVP Transaction, including, but not limited to, any net equity claim, against (i) the Member, (ii) the Member's appointed trustee or receiver (or any successor trustee or receiver), if any, or (iii) the Securities Investor Protection Corporation (SIPC), if the Member is subject to a SIPC liquidation order.

(g) The Net Close Out Positions shall be closed out by the Corporation as provided in Section 6.

SEC. 4. (a)(i) After the Corporation has declined or ceased to act for a Member generally, the Corporation may accept from him envelopes to be delivered to other Members (whether such deliveries are pursuant to security balance orders issued by the Corporation or are otherwise provided for in these Rules) or it may decline to accept any such deliveries, in which case such Member shall make such deliveries and obtain payment therefor otherwise than through the Corporation.

(ii) After the Corporation has declined or ceased to act for a Member generally, it shall decline to accept from other Members envelopes or orders to be delivered to such Member, in which case such other Members shall make such deliveries to such Member and obtain payment therefor otherwise than through the Corporation; provided, however, that the Corporation may accept

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<sup>2</sup> The definitions contained in subsection (c)(ii) shall be deemed modified as follows when used in connection with Balance Orders: the term "CNS Position" shall refer to the Member's net Balance Order position, the term "Long Position" shall refer to such Member's net Balance Order receive obligations and the term "Short Position" shall refer to such Member's net Balance Order deliver obligations.

such envelopes in order to complete open RVP/DVP Transactions pursuant to paragraph (e) of Section 3.

SEC. 5 After the Corporation has declined or ceased to act for a Member generally, the Corporation may, in respect of the CNS System, take any of the following actions:

- (i) accept from such Member deliveries through the facilities of a Qualified Securities Depository;
- (ii) continue to instruct the Qualified Securities Depository designated by such Member to deliver CNS Securities from such Member's account at the Qualified Securities Depository to the Corporation's account in respect of such Member's Short Positions; or
- (iii) continue to instruct the Qualified Securities Depository designated by such Member to deliver from the Corporation's account at the Qualified Securities Depository CNS Securities received into the Corporation's account to the Member in respect of his Long Positions and may in connection therewith accord the Member priority, as provided in the Procedures, in respect of all other Members;

provided however, in the event insolvency proceedings have commenced against such Member, the actions contemplated by subparagraphs (ii) and (iii) may be taken to the extent permitted by the applicable rules of the relevant insolvency regime. In the event the Corporation declines to take the actions permitted by the foregoing subparagraphs, the open positions of such Member shall be closed out as provided in paragraph (a) of Section 6.

SEC. 6. (a) Promptly after the Corporation has given notice that it has declined or ceased to act for the Member, and in a manner consistent with the provisions of Section 3, the Net Close Out Position with respect to each CNS Security shall be closed out (whether it be by buying in, selling out or otherwise liquidating the position) by the Corporation; provided however, if, in the opinion of the Corporation, the close out of a position in a specific security would create a disorderly market in that security, then the completion of such close-out shall be in the discretion of the Corporation.

If, in the aggregate, the closing out of CNS securities deliverable to or deliverable by such Member results in a profit, said profit shall be credited to the account of such Member with the Corporation. If, in the aggregate, the selling out and buying in of CNS securities deliverable to or deliverable by such Member results in a loss, said loss shall be debited to the account of such Member with the Corporation.

- (b) Except as otherwise may be determined by the Board of Directors:

(i) securities deliverable to or by the Member for whom the Corporation has declined or ceased to act pursuant to security balance orders (except such securities as shall at the time the Corporation so declined or ceased to act have been delivered pursuant to such orders) relating to Balance Order transactions not excluded pursuant to paragraph (a) of Section 2 shall be sold out or bought in by the Members named in such security balance orders without unnecessary delay in the best available market, subject to such terms and conditions as the Corporation may require, and the delivery of and payment for securities deliverable pursuant to such balance orders shall be governed by the provisions of this paragraph (b);

(ii) Separate accountings as to each business day, as hereinafter provided, shall be had with respect to the profits and losses of other Members (computed on the basis of the Settlement Prices shown on the security balance orders) resulting from the buying in or selling out of Balance Order Securities deliverable to or by the Member for whom the Corporation has declined or ceased to act under security balance orders calling for such delivery on such day; provided, however, in the event that the Corporation instructs a Member that the buy in or sell out of an open Balance Order position must be for cash or guaranteed delivery, as the case may be, then any loss relating to such a buy in or sell out shall only be included in such accountings if such Member complied with such instructions.

(iii) With respect to each separate accounting for the close outs of Balance Order transactions directed by the Corporation:

(A) If a profit results from the selling out or the buying in of Balance Order Securities deliverable to or deliverable by the Member for whom the Corporation has declined or ceased to act under a security balance order, the Member realizing such profit shall at once send a statement of the transaction to the Corporation and shall pay over such profit to it. Such profit shall be applied by the Corporation to the payment of losses incurred by such Member or by other Members in selling out or buying in Balance Order Securities deliverable to or deliverable by the Member, for whom the Corporation has declined or ceased to act, under other security balance orders calling for delivery on the same day.

(B) If a loss results from the selling out or buying in of Balance Order Securities deliverable by the Member for whom the Corporation has declined or ceased to act, under a security balance order the Member sustaining such loss shall at once send a statement of the transaction to the Corporation, which shall pay him the amount of the loss in the manner and to the extent hereinafter provided.

- (C)(i) If, in the aggregate, the selling out and buying in of Balance Order Securities deliverable to or deliverable by the Member for whom the Corporation has declined or ceased to act under security balance orders calling for delivery on the same day results in a profit, said profit shall be credited to the account with the Corporation of the Member for whom the Corporation has declined or ceased to act.
- (ii) If, in the aggregate, the selling out and buying in of Balance Order Securities deliverable to or deliverable by the Member for whom the Corporation has declined or ceased to act under security balance orders calling for delivery on the same day results in a loss, the Corporation shall pay the same to the Members sustaining such losses, and debit the net amount to the account with the Corporation of the Member for whom the Corporation has declined or ceased to act.

**SEC 7. After the Corporation has declined or ceased to act for a Member, the Corporation shall exclude any OW Obligations of that Member from further processing in the OW service.**

SEC. 7-8. (a) After the Corporation has declined or ceased to act for a participant either in respect to a particular transaction or transactions generally, the Corporation shall nevertheless have the same rights and remedies in respect to any debit balance due from such participant or any liability incurred on his behalf as though it had not ceased to act for him.

(b) As security for any and all liabilities now existing, or hereafter arising, of a Member, Mutual Fund/Insurance Services Member or Commission Billing Member to the Corporation, the Corporation shall maintain a lien on all property placed by such participant in its possession, including but not limited to, securities and cash in the process of clearance or on deposit with, or pledged to, the Corporation in satisfaction and/or in excess of such participant's Clearing Fund deposit pursuant to Rule 4, Section 1, and Rule 12, Section 1; provided, however, that in no event shall the Corporation have any lien on securities carried by a Member, Mutual Fund/Insurance Services Member or Commission Billing Member for the account of its customers where such lien would be prohibited under Commission Rules 8c-1 and 15c2-1.

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## RULE 50. AUTOMATED CUSTOMER ACCOUNT TRANSFER SERVICE

SEC. 1. The Corporation may provide a service to enable Members and Qualified Securities Depositories, on behalf of their participants (hereinafter referred to as the "QSD"), to transfer accounts of their customers between themselves on an automated basis. Such automated transfer of customer accounts will be known as the Automated Customer Account Transfer Service (hereinafter referred to as the "ACAT Service") and will be processed in accordance with the provisions of this Rule.

SEC. 2. A Member or QSD to whom a customer's full account is to be transferred (hereinafter referred to as the "Receiving Member") may initiate the procedure by submitting to the Corporation, within such time frame as established by the Corporation from time to time, a transfer initiation request in such automated format as the Corporation may establish from time to time.

SEC. 3. The Corporation will review the transfer initiation request received for such data which the Corporation determines from time to time to be necessary. Notwithstanding the foregoing, the Corporation will not be responsible for the completeness or accuracy of any information contained in the transfer initiation request. If the request does not contain the required data, the Corporation will reject the request. If the Corporation rejects the request, the Receiving Member must reinitiate the request as if it had never been previously submitted. The Receiving Member may submit, through the facilities of the Corporation, such documentation as the Member or QSD who currently has the account (hereinafter referred to as the "Delivering Member") requires to transfer the account, and any such delivery shall be made pursuant to the procedures of the Corporation as the Corporation may provide from time to time. The Corporation assumes no responsibility for the completeness or accuracy of any such form or documentation submitted through the facilities of the Corporation or otherwise.

SEC. 4. Each day the Corporation will produce a report, in such form as determined by the Corporation from time to time, indicating all customer account transfer requests received by the Corporation that day. On a daily basis, Members and QSDs must compare the list of customer account transfer requests as reported by the Corporation that were initiated throughout that day with any transfer initiation requests delivered to or received from the Corporation or from another Member or QSD. Any discrepancies between the report and the transfer initiation requests received or delivered must be immediately reported to the Corporation. To the extent necessary or appropriate, the Corporation will cause an adjustment to be made to such report within such time as the Corporation determines to be necessary.

SEC. 5. Within the time frame established by the Corporation or, to the extent applicable, the Delivering Member's Designated Examining Authority ("DEA"), and, to the extent applicable, pursuant to reasons permitted by the

Delivering Member's DEA, the Delivering Member must either reject a customer account transfer request by submitting a rejection to the Corporation in such form as determined by the Corporation from time to time, or submit to the Corporation detailed customer account asset data in such format as established by the Corporation from time to time; provided, however, that if Fund/Serv Eligible Fund assets are to be transferred through Mutual Fund Services, the Delivering Member must specify the quantity of each Fund/Serv Eligible Fund asset to be processed and indicate whether each such transfer shall be a full or a partial transfer<sup>3</sup>. A Delivering Member who rejects a transfer request must indicate the reason for the rejection. Any transfer request that is not responded to by a Delivering Member within such time frame as established by the Corporation from time to time will be deleted from the ACAT Service by the Corporation and the Receiving and Delivering Member's will be notified accordingly. A Receiving Member who desires to resubmit a transfer request that is deleted will be required to reinitiate the request as if one had never been previously submitted.

SEC. 6. The Corporation will notify a Receiving Member, in such manner as determined by the Corporation from time to time, of customer account transfer requests that have been rejected by the Delivering Member and the Corporation will cause such requests to be deleted from the ACAT Service unless a correction is submitted by the Receiving Member as set forth below. To the extent the rejection is for enumerated categories, as specified by the Corporation from time to time, within one (1) business day after notification of a Delivering Member's rejection, a Receiving Member may adjust a customer account transfer request by submitting corrections to the Corporation in such manner as determined by the Corporation from time to time. A Delivering Member must either reject the adjusted transfer request by submitting a rejection to the Corporation or submit to the Corporation detailed customer account asset data, in such manner and by such time as determined by the Corporation from time to time. If the Delivering Member fails to respond to the adjusted transfer request within such time frame as established by the Corporation from time to time, the Corporation will delete such request from the ACAT Service and the Receiving and Delivering Members will be notified accordingly. A Receiving Member who desires to resubmit a transfer request that is deleted will be required to reinitiate the request as if one had never been previously submitted.

SEC. 7. Upon receipt by the Corporation from the Delivering Member of customer account asset data, the Corporation will use its best efforts to validate the data for edit errors. However, the Corporation will not assume the responsibility for such validation process. If no edit errors or format errors are discovered by the Corporation in the asset data, details of the account will be reported to both the Delivering Member and the Receiving Member in such manner and by such time as established by the Corporation from time to time. If

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<sup>3</sup> A full transfer will cause all Fund/Serv Eligible Fund account assets, whether greater or lesser than the quantity specified, to be transferred. A partial transfer will cause only the Fund/Serv Eligible Fund account asset quantity specified or such lesser amount to be transferred.

the Corporation discovers that customer account asset data contains one or more edit errors or, format errors, the Corporation will notify the Receiving Member in such manner and by such time as determined by the Corporation from time to time that customer account asset data has been received from the Delivering Member but that it contains edit errors or format errors. The Corporation will notify the Delivering Member in such manner and by such time as determined by the Corporation from time to time of all customer account asset data reported, indicating that which contains errors. The Delivering Member will be required to correct those items that contain edit errors or format errors in order to permit delivery of the customer's account to occur within the time frame as established by the Delivering Member's DEA. If the Delivering Member fails to correct edit errors or format errors within such time frame established by the Corporation, the Corporation will delete the transfer request from the ACAT Service. A Receiving Member who desires to resubmit a transfer request that is deleted will be required to reinitiate the request as if one had never been previously submitted.

SEC. 8 . A Receiving Member will have one (1) business day after receipt from the Corporation of the report detailing the customer account asset data to review the account and accept all assets, or, to the extent permitted by the Member's DEA, if applicable, reject one or more assets within a DEA determined asset category, request the Delivering Member to make adjustments to it or, as permitted by the Corporation or, to the extent applicable, the Receiving Member's DEA, reject the account. No action is required by the Receiving Member if it determines to accept all assets in an account. During the one (1) business day time period, only the Delivering Member will be able to add, delete or change an item by delivering to the Corporation such information in such form and by such time as established by the Corporation from time to time, other than with respect to MF/IPS Products (as defined below), which can also be deleted by the Receiving Member. Each business day that a Delivering Member causes an adjustment to be made to an account will give the Receiving Member an additional one (1) business day to review the account. If Fund/Serv Eligible Fund assets and/or IPS Eligible Products ("MF/IPS Products") are to be transferred the Receiving Member shall also, within one (1) business day after receipt from the Corporation of the report detailing the MF/IPS Products data or simultaneous with the submission of an acceleration instruction, submit to the Corporation detailed transfer instructions in such format as established by the Corporation from time to time, which instructions shall be processed through Mutual Fund Services in accordance with Section 16 of Subsection A of Rule 52 or through IPS in accordance with Section 6 of Rule 57, as applicable. If a Receiving Member submits instructions and determines that a modification must be made to such instruction, such modifications must be submitted within the same deadline. Each business day that the Delivering Member causes an adjustment to be made to an account will give the Receiving Member an additional one (1) business day to submit such transfer information. With respect to Fund/Serv Eligible Fund assets, if the Receiving Member fails to properly submit such transfer information within the required time period, the Corporation shall transmit

through Mutual Fund Services such standing transfer information as the Corporation shall determine. Each day the Corporation will produce a report indicating the transfer instructions that have been received by the Corporation, if any, and, with respect to Fund/Serv Eligible Fund assets, if no instructions have been received, the standing instructions which will be submitted to the Mutual Fund Processor or Fund Member. Each day the Corporation will produce a report to the Receiving and Delivering Member, indicating the Fund/Serv Eligible Fund customer account asset transfers which have been confirmed or rejected by the Mutual Fund Processor or Fund Member in accordance with Section 16 of Subsection A of Rule 52. Such report will also indicate those transfers which the Mutual Fund Processor or Fund Member has not confirmed or rejected or which have been deleted. Each day the Corporation will produce a report to the Receiving and Delivering Member, indicating the IPS Eligible Products transfers which have been confirmed or rejected by the Insurance Carrier/Retirement Services Member in accordance with Section 6 of Rule 57, or which have been deleted.

SEC. 9. Once a customer account has been accepted by the Receiving Member:

(i) To the extent a transfer is between a Member and another Member:

(1) Unless the customer account asset data input to the Corporation indicates that a CNS eligible item is to be delivered ex-CNS or an asset is being tracked through DTC's IPO Tracking System, the Corporation will cause all CNS eligible items to enter the CNS accounting operation as provided in the Procedures as of T+1 and such items shall be subject to Rule 11 and other provisions of the Rules; provided, however, that subject to any rights the Corporation may have as provided in these Rules generally, the Corporation will guarantee the settlement of any such ACAT CNS item only to the extent that the Member who has a payment obligation to the Corporation arising out of the ACAT CNS item, pays the Corporation his entire settlement obligation (including any mark-to-market obligation) for the day the ACAT payment obligation arose. To the extent that such Member fails to complete such settlement obligation, in the sole discretion of the Corporation, open CNS ACAT deliver obligations may, in whole or in part, be eliminated from the CNS accounting operation. If the Corporation eliminates an item, any credits received by a Member arising from the corresponding payment obligation shall be reversed and settlement of the item shall be effected between the Receiving and Delivering Member and not through the Corporation.

(2) The Corporation will issue an instruction file to DTC specifying the assets to be delivered/received for all non-CNS eligible items and

CNS-eligible items designated to be delivered ex-CNS, that are otherwise eligible at DTC, in each case pursuant to the standing instructions filed with the Corporation by the Delivering Member;

- (3) The Corporation will produce ACAT Receive and Deliver Instructions for all non-CNS eligible items (for the purpose of this Rule, all ACAT items subject to a voluntary reorganization as specified in the Procedures Section VII.H.4. shall be deemed non-CNS eligible items) and CNS-eligible items designated to be delivered ex-CNS.

**(4) The Corporation may enter ACAT Receive and Deliver Instructions for all non-CNS eligible items,<sup>4</sup> as well as CNS-eligible items designated to be delivered X-CNS, into the Obligation Warehouse service in accordance with timeframes as determined by the Corporation from time to time.**

To the extent that a value is specified on an ACAT Receive and Deliver Instruction, other than for those asset types or asset settling locations designated by the Corporation from time to time, the value for settlement purposes pursuant to Section 10 will be in U.S. dollars and will be based upon (A) in the case of CNS eligible items, the price in the CNS system, or (B) in the case of non-CNS eligible items, (i) the price obtained from a pricing source, if available or, if not available, (ii) the price in U.S. dollars assigned by the Delivering Member or ascribed to such item pursuant to a default matrix as established from time to time by the Corporation, whichever is greater, and will also specify such other information as the Corporation may determine from time to time and shall otherwise, to the extent applicable, be subject to the rules of the Members' DEAs, including, but not limited to, their close-out provisions and shall not be subject to the Rules of the Corporation.

(ii) To the extent a transfer is between QSD participants or between a QSD participant and a Member:

- (1) For all DTC eligible assets, other than (a) U.S. dollar cash balances ("Cash"), (b) assets covered by a standing instruction filed by the Delivering Member with the Corporation, and (c) assets for which a special receive/deliver instruction request was received from the Delivering Member at the time asset details were submitted, the Corporation will issue an instruction file to DTC specifying the quantity of each asset to be delivered with a deliver value of zero.<sup>5</sup>

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<sup>4</sup> **The Corporation may determine from time to time, and shall announce by Important Notice, which items are eligible for the Obligation Warehouse service.**

<sup>5</sup> The special receive/deliver instruction referenced in this Section has the same legal effect as an ACAT Receive and Deliver instruction.

(2) The Corporation will produce ACAT Receive and Deliver Instructions for all assets to be transferred and, upon request, will also produce special receive/deliver instructions naming the Receiving Member and Delivering Member. All such special receive/deliver instructions will specify no value.

(3) For all Cash assets, the Corporation will issue payment instructions to DTC naming the paying/receiving entity.

All assets to be transferred through DTC shall be subject to the rules and procedures of DTC.

SEC. 10. To the extent a transfer is between a Member and another Member:

(i) On Settlement Date as indicated on the ACAT Receive and Deliver Instructions, the Corporation will debit and credit the appropriate Member's settlement account for the value of the applicable items. The actual delivery and corresponding money settlement of the underlying assets, regardless of whether a Member's account has been debited pursuant to this subsection, shall be the responsibility of the appropriate Member and, to the extent applicable, shall be pursuant to the rules of the Member's DEA. If a Member fails to make a delivery, such failure, to the extent applicable, shall be subject to the rules of the Member's DEA and not the Rules of the Corporation.

(ii) The actual delivery and corresponding money settlement, if any, of Fund/Serv Eligible Fund assets which have been rejected or deleted in accordance with Section 16 of Subsection A of Rule 52 for which ACAT Receive and Deliver Instructions have been issued shall be the responsibility of the appropriate Member and, to the extent applicable, shall be pursuant to the rules of the Member's DEA. If a Member fails to make a delivery, such failure shall be, to the extent applicable, subject to the rules of the Member's DEA and not the Rules of the Corporation.

(iii) On Settlement Date, as indicated on the ACAT Settlement Report, the Corporation will debit and credit the Member's settlement account for the value of the Fund/Serv Eligible Fund assets which were specified by the Delivering Member to be processed through Mutual Fund Services in accordance with Section 16 of Subsection A of Rule 52. The Corporation will credit the settlement account of the Member whose settlement account was debited and debit the settlement account of the Member whose settlement account was credited, for the value of the Fund/Serv Eligible Fund assets within such time frame as specified by the Corporation from time to time following receipt from the Mutual Fund Processor or Fund Member of the transfer data confirmation.

SEC. 11. On each business day, the Corporation will issue to each Member and QSD such reports, in such forms and containing such information as established by the Corporation from time to time, indicating the status and details of requested customer account transfers. On each business day, Members and QSDs must compare the reports received against their records and any discrepancies between the two must be immediately reported to the Corporation. To the extent necessary or appropriate, the Corporation will cause an adjustment to be made to the report.

In addition to the foregoing, to the extent that a Receiving Member determines that information as reported on the transfer initiation request is inaccurate, he may cause an adjustment to be made by submitting corrected data to the Corporation. If a Delivering Member determines that the account number of his customer as reported on the transfer initiation request is inaccurate, he may cause an adjustment to be made by submitting corrected data to the Corporation. In both such cases, corrected data must be submitted to the Corporation within such time as established by the Corporation from time to time.

SEC. 12. The Corporation may also provide services to enable Delivering Members to initiate the transfer of:

- (i) residual credit positions, which are received for the benefit of a customer's account by the Delivering Member after the ACAT process is completed or which, due to a restriction, were not included in the original asset transfer (hereinafter collectively referred to as "Residual Credits");
- (ii) a partial account held by a Delivering Member (in the form of cash or securities), (hereinafter collectively referred to as "Partial Accounts");
- (iii) cash in respect of fail positions for which delivery is unable to be completed, provided, however, that this transfer may only be initiated to the extent that the fail is between a Member and another Member (hereinafter collectively referred to as "Fail Reversals"); and
- (iv) cash or securities mistakenly delivered as part of the ACAT Service, other than Fund/Serv Eligible Fund assets and positions eligible for processing at a Registered Clearing Agency with whom the Corporation has entered into an agreement relating to the ACAT Service (hereinafter referred to as an "ACAT RCA") provided, however, that this transfer may only be initiated to the extent that the delivery is between a Member and another Member (hereinafter collectively referred to as "Reclaims").

Such transfers shall be processed as follows:

1. Transfers may be initiated by a Delivering Member by submitting to the Corporation such details as required by the Corporation from time to time within such time frame as established by the Corporation from time to time. The Corporation will reject a transfer if the details contain an edit or

format error. The Corporation will notify the Delivering Member if a transfer is rejected and the Delivering Member must reinitiate the transfer as if it had never been previously submitted. If no edit errors or format errors are discovered by the Corporation in the asset data, details of the account will be reported to both the Delivering Member and the Receiving Member in such manner and by such time as established by the Corporation from time to time.

2. A Receiving Member may reject the transfer by submitting such information as determined by the Corporation by the time and in the manner specified by the Corporation on the same day as the transfer request is received or, in respect of Reclaim transfers, no later than two business days following the day the Reclaim transfer request is received. No action is required by the Receiving Member if it determines to accept the transfer. A Receiving Member may not submit corrections and a Delivering Member may not make adjustments to such transfer request.

3. Settlement Date for all transfers covered by this section shall be one business day following the day the Corporation receives the transfer request unless the request is Reclaim transfer, in which case Settlement Date shall be one business day following the day the Receiving Member accepts the request or the Corporation deems the request accepted, or the request includes options assets which are eligible for processing an ACAT RCA, in which case the settlement date for all assets shall be two business days following the day the Corporation receives the transfer request.

SEC. 13. A Receiving Member may submit a request to a Delivering Member to initiate the transfer of a partial customer account, in such form as determined by the Corporation from time to time. Such request shall be delivered by the Corporation to the Delivering Member on the same day as received by the Corporation. Each day for a period not to exceed two days, the Corporation will produce a report, in such form as determined by the Corporation from time to time, indicating all such requests received by the Corporation. A Delivering Member must either reject a customer account transfer request by submitting a rejection to the Corporation in such form as determined by the Corporation from time to time, or submit to the Corporation detailed customer account asset data in such format as established by the Corporation from time to time. If a request is rejected, the Delivering Member must indicate the reason for the rejection.

SEC. 14. Notwithstanding the forgoing, to the extent a transfer involves an asset position eligible for delivery at an ACAT RCA (other than the DTC), and both the Receiving Member and the Delivering Member have an account at the ACAT RCA, the Corporation will either: issue an instruction file to the applicable ACAT RCA indicating the quantity of assets to be delivered and received and the delivering/receiving participant, or produce ACAT Receive and Deliver Instructions if requested by the Delivering Member at the time the asset details

are submitted or pursuant to a standing instruction filed by the Delivering Member with the Corporation. Such ACAT Receive and Deliver Instructions and instruction files shall not specify a value, unless the transfer is between two Members and the assets to be transferred are government securities (where a nominal value shall be specified) and mortgage-backed securities. In the case of mortgage-backed securities, the ACAT Receive and Deliver Instructions and instruction files shall specify a value for each item (in accordance with the pricing provisions of Section 9 of this Rule for non-CNS eligible items) and, on Settlement Date as indicated on the ACAT Receive and Deliver Instructions and instruction files, the Corporation will debit and credit the appropriate Members' settlement accounts for the specified value of such items.

SEC. 15. The Corporation may report to the Delivering and Receiving Members' DEA, to the extent applicable, such information regarding customer account transfers as may be requested of the Corporation from time to time by the DEA.

SEC. 16. Settlement of money payments between Members arising out of account transfers covered by this Rule shall be made in accordance with Rule 12 and other provisions of these Rules.

SEC. 17. Each Member or participant of a QSD that requests a transfer through the ACAT Service (the "Requesting Firm") agrees to (i) indemnify and hold harmless the Member or participant of a QSD that accepts such transfer request (the "Accepting Firm") from and against any and all losses, claims, damages or liabilities (or actions in respect thereof) to which the Accepting Firm may become subject, under any provision of law, to the Accepting Firm's customer or to any other person, insofar as such losses, claims, damages or liabilities arise out of or are based upon an unauthorized or allegedly unauthorized transfer request or any inaccurate or allegedly inaccurate documentation or information, in any format, transmitted by the Requesting Firm through NSCC or the ACAT Service and (ii) reimburse the Accepting Firm for any legal or other expenses reasonably incurred by the Accepting Firm in connection with defending any such action or claim as such expenses are incurred. Each Requesting Firm agrees that an Accepting Firm accepting its transfer request through the ACAT Service shall be a third-party beneficiary of the above indemnification and reimbursement obligations in respect of such request, and that such an Accepting Firm may assert any claim under these indemnification and reimbursement obligations as a third-party beneficiary directly against such Requesting Firm.

Each Accepting Firm agrees, promptly after receipt of written notice from any customer of the Accepting Firm or any other person, or after any action is brought against the Accepting Firm by such a customer or other person in respect of a loss, claim, damage or liability that may give rise to the indemnification obligations under the preceding paragraph, to notify the Requesting Firm in writing of the receipt of such notice or action. The

Requesting Firm agrees that any failure by the Accepting Firm to give such notice does not relieve the Requesting Firm of any liability to the Accepting Firm under the preceding paragraph. If any action shall be brought against the Accepting Firm that may give rise to the indemnification provisions of the preceding paragraph, the Accepting Firm further agrees that the Requesting Firm shall be entitled to participate therein and/or assume the defense thereof (with counsel satisfactory to the Accepting Firm), without the prejudice to the continuing rights of the Accepting Firm. Each Requesting Firm and Accepting Firm agrees that any Requesting Firm or Accepting Firm benefiting from the notification and participation obligations in this paragraph is intended to be a third-party beneficiary of such obligations and may enforce such obligations as a third-party beneficiary against the promisor thereof.

Each Requesting Firm and Accepting Firm agrees that any dispute between them arising under this section shall be resolved directly between them, and that the Corporation shall not be made a party to any such dispute and shall have no responsibility with respect to the enforcement or satisfaction of any indemnification, reimbursement, notification and participation obligations contained in this section.

**RULE 51. (~~RULE NUMBER RESERVED FOR FUTURE USE~~) OBLIGATION WAREHOUSE**

**SEC. 1. General**

**The Corporation may offer a service to Members for: (i) the comparison of securities transactions that are not otherwise submitted by or on behalf of Members for trade comparison or recording through other NSCC systems or services, (ii) tracking, storage and maintenance of obligations either compared through the service, or forwarded to it from other NSCC accounting operations or services in accordance with the Rules and Procedures through the time of settlement of such obligations (such obligations shall collectively be referred to as “OW Obligations”), and (iii) the repricing and updating of fail obligations. As regards to tracking and maintenance, the Corporation will cause CNS-eligible OW Obligations to be entered into the CNS Accounting Operation on a regular basis.<sup>6</sup> This service shall be known as the “Obligation Warehouse” service. In addition, in accordance with this Rule and the Obligation Warehouse Procedure, a Member shall submit to the Obligation Warehouse for repricing, netting and allotting, fail data with respect to transactions already compared through the facilities of the Corporation or other facilities.**

**SEC. 2. Eligible Obligations**

**The Obligation Warehouse shall be available for use by Members for the tracking, records storage and maintenance of transactions in such securities or classes of securities as the Corporation shall determine from time to time.**

**SEC. 3. Non-Guaranteed Service and Settlement**

**The Obligation Warehouse shall not be a guaranteed service of the Corporation. Except with respect to: (i) OW Obligations that have been forwarded to the CNS Accounting Operation in accordance with Procedure II A. and Procedure VII, and (ii) any cash adjustment forwarded to the settlement system of the Corporation in accordance with the Obligation Warehouse Procedure, the settlement of OW Obligations shall occur between the parties themselves. Any obligations (settlement or otherwise) arising from OW Obligations shall be the sole responsibility of the Members that are parties to the obligation. In the event of the default of a Member, the Corporation within such time frames as determined from time to time and whether before or after settlement on any business day, may: (i) exit all OW Obligations of such Member, (ii) reverse all credits and debits for the Member relating to OW Obligations that have entered the CNS**

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<sup>6</sup> **This functionality will be made available to Members at a date no less than 10 business days following announcement of its implementation by Important Notice.**

**Accounting Operation, and (iii) reverse any cash adjustment of the Member forwarded to settlement pursuant to the Obligation Warehouse Procedures.**

**SEC. 4. 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 users of the Obligation Warehouse service, 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.**
- (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 II. TRADE COMPARISON AND RECORDING SERVICE

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### ~~[E. Reconfirmation and Pricing Service]~~

~~[The Reconfirmation and Pricing Service ("RECAPS") is a fail clearance system run by the Corporation. The system will be run from time-to-time as established by the Corporation for such securities as the Corporation shall determine. The system provides an opportunity to reconfirm and reprice transactions that already have been compared.~~

~~Members shall submit to the Corporation, on a day specified by the Corporation, at the time and in the manner established by the Corporation, RECAPS fail information. The day such information is submitted to the Corporation is referred to as "R." RECAPS fail information submitted on R shall be hereinafter referred to as "RECAPS Input." On a day specified by the Corporation, at the time and in the manner established by the Corporation, the Corporation will produce RECAPS Contracts containing standard contract categories (i.e., compared, uncomparing and advisory columns). On the next business day after R, at the time and in the manner established by the Corporation, Members: (1) may submit an As-of-trade if the Member failed to timely submit a transaction to RECAPS and (2) must respond to a transaction submitted by a contra side that has not been reconfirmed after processing of RECAPS Input (hereinafter referred to as an "Unreconfirmed RECAP") by submitting in such form as determined by the Corporation an advisory, a DK or a reject and, in the case of a reject, indicating the reason(s) for the rejection and such other information as the Corporation may require. Failure to respond to an Unreconfirmed RECAP shall result in the transaction being deemed DK'ed. A DK'ed transaction extinguishes the rights, if any, of the DK'ing Member in respect of the transaction. Transactions of a Member that have been DK'ed shall be subject to the rules of the appropriate marketplace. As-Of trades will be compared only if there is an exact match; no trade resolution process will be available.~~

~~On a day specified by the Corporation, at the time and in the manner established by the Corporation, the Corporation will issue a second set of RECAPS Contracts, reflecting the RECAPS supplemental input received. Settlement information will be distributed to Members depending on the system in which the reconfirmed transaction will settle and settlement will occur, as follows:~~

- ~~(a) CNS – Reconfirmed fails in Securities eligible for CNS at the time of the RECAPS cycle will be forwarded to CNS for settlement on a day specified by the Corporation. A RECAPS CNS Compared~~

~~Trade Summary will be issued concurrent with the production of the first or second RECAPS Contracts, whichever is appropriate.~~

~~(b) Balance Orders - Reconfirmed fails in Balance Order Securities will be netted and allotted, and a RECAPS Non-CNS Compared Trade Summary will be issued, concurrent with the production of the first or second RECAPS Contracts, whichever is appropriate, that will indicate such RECAP Balance Orders and the settlement dates specified by the Corporation.~~

~~(c) Trade-for-Trade - The RECAPS Non-CNS Compared Trade Summary will also include receive and deliver information for reconfirmed fails in securities not eligible for the CNS or Balance Order Systems, which will settle on a trade-for-trade basis on a day specified by the Corporation.~~

~~In the event that the current market price for a security is not available, or if the original fail price was less than one penny per share, the trade will settle on a trade-for-trade basis as a "Special Trade," with the value on the RECAPS Non-CNS Compared Trade Summary being the amount at which the trade previously was compared. For reconfirmed fails in debt securities, the current market price will include accrued interest from the previous interest payment date to the new Settlement Date. If a fail was open over an interest payment date, the two parties to the trade will be required to settle that interest payment outside RECAPS, although the parties could use the Corporation's Dividend Settlement Service.~~

~~The RECAPS CNS Compared Trade Summary and the RECAPS Non-CNS Compared Trade Summary also will include the aggregate value of the original fails. In addition, the RECAPS Non-CNS Compared Trade Summary also includes the aggregate value of the Repriced RECAPS positions (i.e., the current market price of the reconfirmed trades) and the difference between the two, or the net cash adjustment. The net cash adjustment will settle the day the underlying RECAPS contract settles and will be included as part of the Member's daily money settlement with the Corporation. RECAPS, however, will not be a guaranteed service of the Corporation, so that if the Corporation fails to receive payment from a Member, the Corporation, in its discretion, may reverse in whole or part any credit previously given to any Member who is the contra side to a trade reconfirmed and repriced through RECAPS.~~

~~For the purposes of the Corporation's Buy-In Rules and Procedures, the Original Settlement Date for transactions reconfirmed through RECAPS, except for transactions in Municipal Securities, shall be considered to be the RECAPS Settlement Date for the reconfirmed transaction. For Municipal Securities, the Settlement Date shall continue to be the original~~

~~date of the fail unless provided otherwise by the rules of the Municipal Securities Rulemaking Board, and the buy-in rules of the MSRB shall apply.~~

~~At the end of the RECAPS cycle, the Corporation will make available to Members a RECAPS Activity Report, in such form and by such time as determined by the Corporation, containing such information as determined by the Corporation regarding the Member's activity for the RECAPS cycle.]~~

**[G.] F. Special Trades**

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**[H.] G. Index Receipts**

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**[I.] H. Reports and Output**

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**[J.] I. Consolidated Trade Summaries**

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[Remainder of Procedure II Unchanged]

## PROCEDURE II A. OBLIGATION WAREHOUSE

### A. Introduction

The Obligation Warehouse (the “OW”) is a service available to Members for (i) comparison of transactions that are not otherwise submitted by Members, Self-Regulatory Organizations, or Qualified Special Representatives on behalf of Members for trade comparison or recording through other services of the Corporation, (ii) tracking, storage and maintenance of obligations either compared through the service or forwarded to it from other services of the Corporation in accordance with the Rules and Procedures, and (iii) the repricing and updating of fail obligations.<sup>7</sup>

Other than Balance Order Contracts and obligations that have been forwarded to CNS from the OW, which shall continue to be subject to the Rules, all Buy-Ins; deliveries, receives and reclamations; adjustments for corporate actions, whether mandatory or voluntary; and transactions of a Member that have been DK’ed, shall be remain subject to the rules of the appropriate marketplace.

Members may submit to the Corporation trade data relating to securities eligible for OW processing as provided in this Procedure. Obligations eligible for submission must have a valid CUSIP or ISIN and be denominated in U.S. Dollars or such other currencies as the Corporation determines from time to time. NSCC will designate certain security or transaction types as eligible for the OW process from time to time.<sup>8</sup> Comparison of items submitted directly by Members to the OW shall occur daily on a real-time basis in accordance with the OW Comparison process set forth below. Each OW Obligation shall be assigned a unique “OW Control Number” to facilitate tracking the obligation through its settlement, cancellation or closure. OW Obligations (as defined in Rule 51) will be tracked, stored, and maintained until settled or otherwise cancelled by Members or otherwise removed by the Corporation in accordance with the Rules and Procedures. In addition, for those Members participating in the OW Service, transactions exited from CNS, ACATS Receive and Deliver transactions (e.g., ACATs deliveries that settle outside of CNS) Balance Orders, and Special Trades shall automatically be entered by the Corporation into the OW for storage and for Reconfirmation and Pricing

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<sup>7</sup> Members should note that in accordance with MSRB rules, NSCC reports transactions in municipal securities matched through its Real-Time Trade Matching (“RTTM”) service to the MSRB on behalf of Members. Transactions submitted through the OW will not be reported to the MSRB. In order to remain compliant with MSRB reporting requirements, transactions subject to MSRB rules should continue to be submitted by Members to NSCC’s RTTM service.

<sup>8</sup> The Corporation may determine from time to time, and shall announce by Important Notice, which items are eligible for the Operation Warehouse service.

**Service (“RECAPS”) processing, as set forth below. In addition, the Corporation will cause CNS-eligible OW Obligations to be entered into the CNS Accounting Operation on a regular basis.<sup>9</sup>**

**B. OW Comparison**

**The following steps will apply with respect to transactions submitted to the Obligation Warehouse for comparison:**

1. **Transaction data as submitted by Members for processing in the Obligation Warehouse is compared by the Corporation to ensure that the matching criteria of each obligation are in agreement between the purchaser and the seller.**
2. **Data may be submitted during the timeframes and in such form as may be specified by the Corporation from time to time. Data required for a valid submission will include quantity, which party is deliverer or receiver, security identification, contra-broker, deliverer’s final money, settlement date, unique reference number (“x-ref”), market participant identification (MPID), where applicable, whether a transaction should be excluded from CNS processing and other identifying details as NSCC may require or permit, and shall be in such formats as specified by the Corporation relative to the method utilized for submission. Criteria which must match between contra-parties to effect a comparison of transaction details includes quantity, an indication as to which party is deliverer or receiver, security identification, contra-broker, deliverer’s final money, settlement date, whether a transaction should be excluded from CNS processing and other identifying details as NSCC may require or permit (collectively referred to herein as the “Required Matching Fields”).**
3. **Upon receipt and validation by the Corporation of obligation information from the initiating party, the contra side will receive an Advisory, to which they must respond by submitting like details to facilitate a compared obligation or they can DK the obligation entry. Any submission of a DK must include the applicable reason code pertaining to the Member’s disagreement with the transaction.**

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<sup>9</sup> **This functionality will be made available to Members at a date no less than 10 business days following announcement of its implementation by Important Notice.**

4. A Member against which a DK is submitted may respond with modifying details of the applicable transaction within the timeframes specified by the Corporation from time to time, otherwise the item will be deleted from processing in accordance with timeframes specified by the Corporation from time to time. If a Member submits modifying details in response to a DK from a contraparty, the item will be treated as a new submission pursuant to Section B(1) of this Procedure.
5. A Member may modify trade details of, or cancel, a transaction, that it has submitted and is designated by the Corporation as uncomparing by forwarding the appropriate instruction to the Operation Warehouse by the time specified by the Corporation from time to time, so long as notification of settlement of the uncomparing transaction has not been received by the Operation Warehouse prior thereto. If a Member submits modifying details, the item will be treated as a new submission pursuant to Section B(1) of this Procedure.
6. If the deliverer and receiver submit trade data that matches in all required respects, the trades will be deemed compared if it meets money tolerances as announced by the Corporation from time to time, and deemed an OW Obligation.
7. The Corporation may delete trade input which is not matched by such timeframes as determined by the Corporation from time to time.
8. The Corporation shall have no responsibility for determining whether any trade submission is duplicative of an earlier trade submission. Any such input shall be treated as a separate submission for all purposes of these Rules and Procedures.

**C. Obligation Warehouse Storage, Tracking, Maintenance and Settlement**

1. The Corporation will track, store and maintain each OW Obligation until settled or otherwise cancelled by the Members party to the obligation or otherwise closed by the Corporation.
2. The Corporation may adjust compared OW Obligations with respect to the following mandatory reorganization events:

forward stock splits, name changes, redemptions, mergers (both cash and stock) and full calls with respect to bonds.<sup>10</sup> In the case of such an event, at such time on or after the effective date of the event as the Corporation shall determine it has all relevant information, the affected OW Obligation will be adjusted in accordance with the terms of the reorganization event.<sup>11</sup> With respect to name changes and forward stock splits, OW positions in the subject security shall be converted into the equivalent positions of the new securities and/or cash and a new obligation will be created automatically as part of the processing for OW. Any cash adjustment associated with a mandatory reorganization will be included as part of the Member's daily money settlement with the Corporation and will appear on reports generated in the OW.

3. On a regular basis, the Corporation will review all OW Obligations for CNS eligibility.<sup>12</sup> Unless otherwise excluded by a Member through its submission of an appropriate instruction, the Corporation will cause all CNS-eligible OW Obligations: (i) that have not reached their scheduled settlement date to be reported on the CNS Miscellaneous Activity Report the night prior to Settlement Date (SD-1) and entered into the CNS Accounting Operation for the night cycle on SD (i.e., the evening of SD-1), and (ii) that have reached or passed their scheduled settlement date to be reported on the Miscellaneous Activity Report on the evening of the date they become CNS-eligible and entered into the CNS Accounting Operation for settlement on the next Settlement Day (i.e, the night cycle which runs on the same evening of the Miscellaneous Activity reports covering the obligations is issued). Such items shall be subject to Rule 11 and other provisions of these Rules and Procedures; provided, however, that subject to any rights the Corporation may have as provided in these Rules

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<sup>10</sup> This functionality will be made available to Members at a date no less than 10 business days following announcement of its implementation by Important Notice. Prior to the date of implementation, and at any time if the Corporation determines that corporate actions adjustments will not be offered with respect to a particular security or event, Members may adjust OW Obligations subject to such events by cancelling and resubmitting them as new obligations under the comparison process described above. Please note, however, that the processing of dividends and interest will not be done for OW transactions and remain the responsibility of the parties outside the facilities of the Corporation.

<sup>11</sup> If the Corporation determines that it does not have the relevant information, Members may adjust OW Obligations subject to such events by cancelling and resubmitting them.

<sup>12</sup> This functionality will be made available to Members at a date no less than 10 business days following announcement of its implementation by Important Notice.

generally, the Corporation will guarantee the settlement of any such OW Obligation only to the extent that the Member pays the Corporation its full settlement obligation on the date the obligation is scheduled to settle in the CNS Accounting Operation. To the extent that such Member fails to pay in full its settlement obligation, in the sole discretion of the Corporation, OW Obligations which have been sent to the CNS Accounting Operation may, in whole or in part, be removed from the CNS Accounting Operation by reversing all credits and debits for the Member relating to OW Obligations that have entered the CNS Accounting Operation. Settlement of such item shall be effected between the Receiving and Delivering Member and not through the facilities of the Corporation.

4. The Corporation will update OW Obligations for which deliveries have been made through a Qualified Securities Depository to reflect their status as settled, in accordance with instructions received from the Qualified Securities Depository.<sup>13</sup> The Qualified Securities Depository's instructions shall use the OW Control Number and contain such other information as the Corporation determines from time to time. In the event of a partial delivery through a Qualified Securities Depository, the Corporation, in accordance with proper instructions from the Qualified Securities Depository, will update the records of the respective OW Obligation accordingly.<sup>14</sup>
5. In order to reflect the settlement of a transaction effected otherwise than through a Qualified Securities Depository, one party must submit the relevant obligation details, similar to the data required for OW comparison (including the actual settlement date, quantity and amount settled), as specified by the Corporation. At that point, the counterparty will receive an advisory, to which they must respond by submitting like details, or by notification that it does not accept the submitted settlement details. If the parties submit settlement data that matches in all required respects, the obligation will be updated to reflect the amount so settled, if it meets money tolerances as

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<sup>13</sup> In order to effect such an update, Members must provide the Qualified Securities Depository with instructions in accordance with the Procedures of the Qualified Securities Depository.

<sup>14</sup> Members should note that transactions settled through NSCC's Envelope Settlement Service are not automatically updated. This functionality will be made available to Members at a date no less than 10 business days following announcement of its implementation by Important Notice.

announced by the Corporation from time to time. If the contraparty responds to an advisory that it does not accept the submitted settlement details, however, the initiating party may submit modifying details to the applicable transaction, in which case the item will be treated as a new update of the settlement details.

6. Obligations that have been reflected in the OW as settled in accordance with these Procedures may be re-opened (either partially or fully), as a result of a delivery reclaim message sent by either party to the obligation to OW. Updates to reflect reclaims of settled transactions will be made once one party enters details of the original transaction, and the original transaction's OW Control Number. Once these details are submitted, an advisory of the reclaim will be sent to the contraparty, who must either submit identical transaction details to facilitate the reclaim and re-open the obligation in OW, or submit notification that it does not accept the reclaim details entered by the initiating party. Updates for reclaims may only be submitted to the OW for a period of two business days following the actual settlement date of the relevant obligation. If the reclaim message is not accepted by the contraparty, it will be deleted from the OW, and the parties will need to generate a new reclaim message in OW. If the original obligation has been settled for longer than two business days, any reclaim message will be rejected.

#### D. Reconfirmation and Pricing

##### 1. Introduction

The OW system includes a reconfirmation and pricing service ("RECAPS") which will be run from time-to-time as established by the Corporation for such securities in the OW system as the Corporation shall determine. The system provides an opportunity to reconfirm and reprice transactions that already have been compared.<sup>15</sup> The time on the day that the Corporation determines to commence a cycle of the RECAPS process shall be referred to as "R".

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<sup>15</sup> Obligations initially compared through the OW service, or forwarded to the OW from other NSCC systems or services, will not be reconfirmed; however, pre-existing fail obligations submitted by Members will be reconfirmed upon their submission to the OW subject to the matching process outlined in subsections A, B, and C above.

## 2. RECAPS Processing

### (a) Eligibility

OW Obligations (i.e., items that have either: (i) been matched pursuant to this Procedure, or (ii) forwarded to the OW from other NSCC systems or services as provided in this Procedure) and have a settlement date of at least two days prior to the date of R will be considered for the RECAPS process; however, such OW Obligations can be excluded from the RECAPS process if so designated by the Member or the Corporation. In addition, X-CNS items (i.e. CNS-eligible items that the parties have designated to settle on a trade-for-trade basis) will be excluded from the RECAPS process. Fail items not already in the OW but which are eligible for RECAPS processing must have been submitted to, and matched in, OW prior to R. Any such submission is subject to the eligibility and matching provisions of subsections A and B of this Procedure.

### (b) RECAPS Processing

On R, except as provided below, each eligible OW Obligation will be re-priced, if appropriate, netted and allotted, if appropriate, the settlement date updated to the next business date and opened as a new obligation. Those securities that are not CNS-eligible or are designated to settle on a trade-for-trade basis will not be netted and allotted.

In the event that the current market price for a security is not available, the fail obligation will be priced at the amount at which the obligation previously was compared and assigned a new settlement date; however, such items will not be netted and allotted.

### (c) Cash Adjustment

The difference between the aggregate value of a Member's original fails and the aggregate value of the Repriced RECAPS positions (i.e., the current market price of the reconfirmed trades) is known as the net cash adjustment. The net cash adjustment will settle on the Business Day following the date on which the RECAPS process is run and will be included as part of the Member's daily settlement with the Corporation.<sup>16</sup>

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<sup>16</sup> Such net cash adjustments will be separately identified on Members' money settlement statements.

**(d) Adjustment of Settlement Date**

**For the purposes of the Corporation's Buy-In Rules and Procedures the RECAPS Settlement Date shall be considered to be the original RECAPS Settlement Date for transactions processed through RECAPS.**

**E. Notifications and Reports**

**Members will be informed in real-time of status changes with respect to obligations submitted to the OW.**

**The Corporation shall make available to each Member a report which reflects the end-of-day status of OW activity which took place for such Member during each Business Day.**

**Activity relating to RECAPS processing will be separately identified on such reports.**

**Each Member participating in the OW service shall have an affirmative obligation to monitor status updates and reports issued by the Corporation with respect to its OW activity, and immediately inform the Corporation of any discrepancies between its OW activity and the contents of such updates and reports.**

**F. Non-Guaranteed Service**

**The Obligation Warehouse shall not be a guaranteed service of the Corporation. If the Corporation Ceases to Act for a Member pursuant to Rule 18 it may: (i) close all open activity relating to that Member from the OW, (ii) reverse all credits and debits for the Member relating to OW Obligations that have entered the CNS Accounting Operation, and (iii) reverse any cash adjustments forwarded to settlement pursuant to this Procedure.**

**G. Applicability of Marketplace Rules**

**It is intended that Buy-In executions, good delivery requirements for physical deliveries, reclamation rights and transactions of a Member that have been DK'ed shall be remain subject to the rules of the appropriate marketplace, notwithstanding that such requirements would not otherwise apply to a transaction processed in the OW, unless the relevant process is otherwise specifically provided for in these Rules & Procedures (e.g., such as the buy-in process for CNS transactions).**

## PROCEDURE V. BALANCE ORDER ACCOUNTING OPERATION

### A. Introduction

The Balance Order Accounting Operation includes transactions in all Balance Order Securities and transactions which have been identified as Special Trades including Special Trades in CNS Securities. The Balance Order Accounting Operation processes trades compared or recorded under the provisions of Section II, trades recorded under the provisions of Section III and transactions entered by Special Representatives under the provisions of Section IV. The Balance Order Accounting Operation produces Balance Orders which identify the receive and deliver obligations of Members. Balance Orders may be issued on a trade-for-trade basis or a net basis. The Corporation will make available to participants information detailing their receive or deliver obligations, on a trade-for-trade or net basis, as applicable, in respect of Balance Order transactions.

### B. Trade-for-Trade Balance Orders

All transactions either: (i) identified as Special Trades, (ii) compared or otherwise entered to the Balance Order Accounting Operation on SD-1 or thereafter, (iii) in securities which are subject to a voluntary corporate reorganization which have a trade date on or before the expiration of the voluntary corporate reorganization and which are compared or received after SD-1 and at least one day prior to the end of the protect period, or (iv) identified as cash, next day or seller's option transactions in Balance Order Securities, or in securities which are subject to any corporate action, whether mandatory or voluntary, are processed on a trade-for-trade basis. Receive and Deliver Orders are produced instructing Members to deliver or receive a quantity of securities to or from the contra-Member involved in that transaction.

### C. Net Balance Orders

Trades in Balance Order Securities ~~executed on the NYSE, NYSE Alternext and OTC~~ (except for Special Trades) which are compared on T and T+1, and transactions entered through the Trade Recording or Special Representative procedures on T and T+1, are netted so that the Member becomes a net purchaser or net seller in each security issue in which it had activity. An allotting procedure matches these net quantities and produces Net Balance Orders. Net Balance Orders are instructions to a Member to deliver or receive a quantity of securities to or from another Member. Net Balance Orders have the same status under the Rules and these Procedures as Balance Orders.

In order to net trades executed at different prices, a uniform Settlement Price is used. The Settlement Price is as follows:

1. If the current per share price of the Balance Order Security is under \$2.00, the Settlement Price will be established to the nearest cent.

2. If the current per share price of the Balance Order Security is between \$2.00 and \$10.00, the Settlement Price will be to the nearest quarter dollar.
3. If the current per share price of the Balance Order Security is over \$10.00, the Settlement Price will be to the nearest whole dollar.

A mechanism is required to adjust the differences between Contract Money (i.e., the price at which the trade was executed) and Settlement Money. To avoid calculating an adjustment for each Balance Order, the Corporation computes a single adjustment amount for each Member. This amount is called the Clearance Cash Adjustment. The Clearance Cash Adjustment amount for all Balance Orders, both bond and equity, plus the net amount of both figures will appear on the Consolidated Trade Summary which is available on T+2.

Since Special Trades produce Balance Orders at the Contract Price, Settlement Money is the same as Contract Money and requires no Clearance Cash Adjustment.

#### D. Balance Order Contracts

Balance Orders issued under subsections B and C above are Balance Order Contracts as defined in Rule 5.

#### E. Consolidated Trade Summaries

On each settlement day, a Consolidated Trade Summary and one or more Supplemental Consolidated Trade Summaries indicating Balance Order transactions settling that day and the next settlement day will be made available to participants.

#### **F. Obligation Warehouse**

**Balance Order transactions will be forwarded to the Obligation Warehouse for processing in accordance with the Obligation Warehouse Procedure.**

\* \* \*

## 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, **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.

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 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 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 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) (i) 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;
- (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.

Following the allocation of securities to a Member pursuant to the Allocation Algorithm described above, deliveries in a particular security processed through CNS, will be deemed by the Corporation to satisfy a Member's ACATS receive obligation prior to the other CNS-related receive obligations for that Member in the same security, and this information shall be provided to that Member's Designated Depository to facilitate processing in accordance with the Designated Depository's procedures.

#### 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, **OW Obligations**, 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 is the responsibility of the parties to the Receive and Deliver Instructions.

**Securities removed from CNS that result in a CNS Receive and Deliver Instruction may be entered into the Obligation Warehouse service in accordance with the Obligation Warehouse Procedure.**

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>17</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

<sup>17</sup> Same input time deadline on the date indicated as for offers with longer protect periods.

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 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 offer 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. **ID Net Service**

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.

## 7. **Obligation Warehouse**

**Pursuant to Rule 51 and the Obligation Warehouse Procedure, the Corporation permits Members to submit OW Obligations for processing through the Obligation Warehouse service and CNS-eligible obligations processed therein may be entered into this accounting operation.<sup>18</sup> Unless otherwise excluded by the Member pursuant to the Obligation Warehouse Procedure, CNS-eligible OW Obligations will be recorded on the Miscellaneous Activity Report on the night before Settlement Date (SD-1) and included in the CNS Accounting Operation in the night cycle on Settlement Date in accordance with the provisions of the Obligation Warehouse Procedure. All OW CNS activity will be reflected on the Miscellaneous Activity Report.**

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[Remainder of Procedure VII Unchanged]

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<sup>18</sup> **This functionality will be made available to Members at a date no less than 10 business days following announcement of its implementation by Important Notice.**