

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-76462; File No. SR-NSCC-2015-004)

November 17, 2015

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Require Real-Time Trade Submission and to Prohibit Pre-Netting Practices Through NSCC's Correspondent Clearing Service

On September 30, 2015, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-NSCC-2015-004 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to require correspondent clearing trades to be submitted in real-time. The proposed rule change was published for comment in the Federal Register on October 14, 2015.<sup>3</sup> The Commission did not receive comment letters regarding the proposed change. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

I. Description of the Proposed Rule Change

The following is a description of the proposed rule change, as provided by NSCC:

The proposed rule change consists of amendments to NSCC's Rules & Procedures ("Rules") in order to require that trade data submitted to NSCC through its Correspondent Clearing service, other than position movements between NSCC Members that are Affiliates and Client Custody Movements, as described further below, be

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 76099 (October 7, 2015), 80 FR 61860 (October 14, 2015) (SR-NSCC-2015-004).

submitted in real-time, and to prohibit pre-netting and other practices that prevent real-time trade submission.<sup>4</sup>

### Background

Requiring trades to be submitted in real-time facilitates efficient risk management for both NSCC and its Members, enables same-day bookkeeping and reconciliation, and, therefore, significantly reduces risk to the industry. Receipt of trade data on a real-time basis permits NSCC's risk management processes to monitor trades closer to trade execution on an intra-day basis, and to identify and risk manage any issues relating to exposures earlier in the day. Contract information is currently reported out to submitting firms by NSCC's Universal Trade Capture ("UTC") system upon trade comparison and validation, and receipt of trade data in real-time enables NSCC to report to Members trade data as it is received, thereby promoting intra-day reconciliation of transactions at the Member level. The majority of trades submitted to NSCC for clearing are currently being submitted in real-time on a trade-by-trade basis, and NSCC is operationally capable of managing trade volumes that are multiple times larger than the historical peak volumes.

NSCC will require that trade data submitted through its Correspondent Clearing service, as described below, be submitted in real-time and to prohibit pre-netting and other practices that prevent real-time trade submission ("pre-netting practices"). NSCC will exclude from this requirement position movements between NSCC Members that are Affiliates and Client Custody Movements, as described below. The term "real-time," when used with respect to trade submission, is defined in Procedure XIII (Definitions) of

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<sup>4</sup> Terms not defined herein are defined in the Rules, available at [http://dtcc.com/~media/Files/Downloads/legal/rules/nsccl\\_rules.pdf](http://dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf).

the Rules as the submission of trade data on a trade-by-trade basis promptly after trade execution, in any format and by any communication method acceptable to NSCC.

NSCC's UTC system receives and validates transactions that are submitted to it, reports trade details back out to the submitting firm, and prepares those transactions for netting and settlement by routing transactions to netting and settlement systems, such as Continuous Net Settlement Accounting Operation, the Balance Order Accounting Operation, or the Foreign Security Accounting Operation, as applicable. Transactions are submitted to UTC either on a locked-in basis by self-regulatory organizations (including national and regional exchanges and marketplaces) ("SROs") and Qualified Special Representatives ("QSRs"),<sup>5</sup> or are submitted to UTC as a part of NSCC's Correspondent Clearing service, which allows for post-execution position movements between two clearing firms. Currently all transactions submitted to NSCC on a locked-in basis by SROs and QSRs, which constitute approximately 95% of all transactions processed at NSCC,<sup>6</sup> are required to be submitted in real-time and may not be pre-netted or batched

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<sup>5</sup> QSRs are defined in Section 3 of Rule 7 as NSCC Members that have applied to NSCC to be a Special Representative, and either (i) operate an automated execution system where they are always the contra side of every trade, (ii) are the parent or affiliate of an entity operating such an automated system, where they are the contra side of every trade, or (iii) clear for a broker/dealer that operates such a system and the subscribers to the system acknowledge the clearing Member's role in the clearance and settlement of these trades. Rules, supra note 4.

<sup>6</sup> Based on data from the second quarter of 2015, which show an approximate daily average of 41 million transactions processed at NSCC, with an approximate total daily value of an average of \$455 billion; and an approximate average of 1.1 million submissions through Correspondent Clearing, with an approximate total daily value of an average of \$57 billion. The average daily volume of submissions through Correspondent Clearing is less than 5% of NSCC's overall daily volume.

prior to submission.<sup>7</sup>

NSCC's Correspondent Clearing service is designed to provide an automated method by which a Member, acting as a Special Representative, may move a position that has been submitted to NSCC for clearing to the account of another Member (the submitting Member's correspondent) on whose behalf the original trade was executed.<sup>8</sup> Members participating in the Correspondent Clearing service for post-execution position movements and those participating as a QSR for submission of original, locked-in trades are required to apply for status as a Special Representative or as a QSR, and to establish relationships with other NSCC Members that will be designated as their correspondents. While NSCC encourages Special Representatives to submit Correspondent Clearing submissions to NSCC as soon as possible following execution, currently these position movements may be sent to NSCC either in real-time, intraday, or at the end of the day.

NSCC has continued to engage widely with its Members about the benefits of expanding the requirements to submit transactions in real-time and, as a result of these continuing discussions, will modify its Rules to require that trade data submitted through its Correspondent Clearing service also be submitted in real-time. The proposed rule

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<sup>7</sup> Securities Exchange Act Release No. 69890 (June 28, 2013), 78 FR 40538 (July 5, 2013) (File No. SR-NSCC-2013-05). See also Rule 7 (Comparison and Trade Recording Operation), Procedure II (Trade Comparison and Recording Service), and Procedure IV (Special Representative Service), supra note 4.

<sup>8</sup> The term "original trade" is used within the Rules describing the Correspondent Clearing service solely to distinguish between trades executed in the marketplace by the Special Representative, and transactions booked for accounting purposes to accommodate the movement of positions between Members as provided for in Section C of Procedure IV. Original trades may not be submitted through NSCC's Correspondent Clearing service. Rules, supra note 4.

change will also prohibit pre-netting practices that prevent real-time trade submission through Correspondent Clearing.

NSCC's Rules currently prohibit pre-netting practices that preclude real-time submission with respect to submissions by QSRs and SROs. Pre-netting practices that are currently prohibited include "summarization" (a technique in which the clearing broker nets all trades in a single CUSIP by the same correspondent broker into fewer submitted trades), "compression" (a technique to combine submissions of data for multiple trades to the point where the identity of the party actually responsible for the trades is masked), netting, or any other practice that combines two or more trades prior to their submission to NSCC.

NSCC will extend the prohibition against pre-netting practices to submissions through Correspondent Clearing because pre-netting practices prevent the submission to NSCC of transactions on a trade-by-trade basis, and cause Special Representatives to delay submission of their trades, thereby undermining the risk mitigation benefits of real-time trade submission. Pre-netting practices disrupt NSCC's ability to accurately monitor market and credit risks as they evolve during the trading day.

NSCC will exclude from the requirements of this proposal any position movements between Members that are Affiliates, as identified within NSCC's membership management records. As defined in Rule 4A, "Affiliate" means a person that controls or is controlled by or is under common control with another person.<sup>9</sup>

Position movements between Affiliates do not introduce the risk management concerns

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<sup>9</sup> Control of a person means the direct or indirect ownership or power to vote more than 50% of any class of the voting securities or other voting interests of any person. Rule 4A, supra note 4.

that are mitigated by real-time trade submission. As such, Members will not be required to submit these position movements in real-time, but will continue to be encouraged to do so. Positions movements between Affiliates represent fewer than 5% of trade data submitted through Correspondent Clearing to NSCC.<sup>10</sup>

In order to submit trade data through Correspondent Clearing outside of the real-time trade submission requirements, Special Representatives will need to identify a transaction as an Affiliate position movement. NSCC will validate the Affiliates' relationship between the counterparties by a check against the information within NSCC's membership management records as of the time of the trade submission. Members continue to be required to provide NSCC with current information regarding their corporate ownership structure. If an Affiliate relationship is not reflected on NSCC's records at the time of the trade submission, the transaction will be rejected.

NSCC will also exclude from the requirements of this proposal position movements that occur between two unaffiliated clearing brokers, typically at the end of the day, on behalf of a common customer for custody purposes ("Client Custody Movements"). These movements, which today represent approximately 1% of submissions through Correspondent Clearing, will be exempt from the requirement because they necessarily take place at the end of the day, after the common client has

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<sup>10</sup> Based on data from the second quarter of 2015, which show an approximate daily average of 1.1 million submissions through Correspondent Clearing at NSCC, with an approximate total daily value of an average of \$57 billion; and an approximate average of 52,000 position movements through Correspondent Clearing between Affiliates, with an approximate total daily value of an average of \$13 billion. The average daily volume of position movements through Correspondent Clearing between Affiliates is less than 1% of NSCC's overall daily volume.

reviewed its end of day positions and has instructed the clearing brokers as to which positions it will move for custody purposes.

NSCC will amend Rule 7 (Comparison and Trade Recording Operation), Procedure II (Trade Comparison and Recording Service), and Procedure IV (Special Representative Service) to require that trades submitted by Special Representatives for trade recording through NSCC's Correspondent Clearing service be submitted on a real-time basis and to make clear that trade data submitted to NSCC through Correspondent Clearing service must be submitted on a trade-by-trade basis, in the original form executed, and that pre-netting practices are prohibited. The proposed rule change will also make clear that these requirements will not apply to position movements between NSCC Members that are Affiliates or to Client Custody Movements.

#### Implementation

The effective date of the proposed rule change will be announced via a NSCC Important Notice. The proposed rule change will not be implemented earlier than ten business days from the date of Commission approval.

#### II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>11</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. The Commission believes the proposal is consistent with

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<sup>11</sup> 15 U.S.C. 78s(b)(2)(C).

Section 17A(b)(3)(F) of the Act<sup>12</sup> and Rule 17Ad-22(d)(4)<sup>13</sup> under the Act, as described in detail below.

*Consistency with Section 17A(b)(3)(F) of the Act.* Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, as well as, in general, protect investors and the public interest.<sup>14</sup> The Commission believes that the receipt of locked-in trade data on a real-time basis through NSCC's Correspondent Clearing service will enable NSCC's risk management processes to monitor such trades closer to trade execution and, thus, better identify and manage related risk exposure on an intra-day basis. Further, receiving such transactions in real-time will promote intra-day reconciliation and, in return, more timely reporting of Member transactions back to Members, thereby enabling Members to manage their exposure to certain operational, market, and credit risks, all of which helps facilitate the prompt and accurate clearance and settlement of securities transactions. As such, the Commission believes that the proposal is consistent with Section 17A(b)(3)(F) of the Act.<sup>15</sup>

*Consistency with Rule 17Ad-22(d)(4).* Rule 17Ad-22(d)(4) under the Act requires a central counterparty, such as NSCC, to “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [i]dentify sources of operational risk and minimize them through the development of appropriate systems,

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<sup>12</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>13</sup> 17 CFR 240.17Ad-22(d)(4).

<sup>14</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>15</sup> Id.

controls, and procedures . . . .”<sup>16</sup> As stated above, the Commission believes that the receipt of locked-in trade data on a real-time basis through NSCC’s Correspondent Clearing service will enable NSCC’s risk management processes to monitor such trades closer to trade execution, on an intra-day basis, and, thus, identify and manage related risk exposure earlier, thereby potentially minimizing a source of operational risk. As such, the Commission believes that the proposal is consistent with Rule 17Ad-22(d)(4).<sup>17</sup>

### III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>18</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that

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<sup>16</sup> 17 CFR 240.17Ad-22(d)(4).

<sup>17</sup> Id.

<sup>18</sup> 15 U.S.C. 78q-1.

proposed rule change SR-NSCC-2015-004 be, and hereby is, APPROVED.<sup>19</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

Robert W. Errett  
Deputy Secretary

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<sup>19</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>20</sup> 17 CFR 200.30-3(a)(12).