

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87023; File No. SR-NSCC-2019-002)

September 19, 2019

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Partial Amendment No. 1, to Amend Procedure VII with Respect to the Receipt of CNS Securities and Make Other Changes

I. Introduction

On July 22, 2019, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NSCC-2019-002, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on August 8, 2019.³ On September 16, 2019, NSCC filed Partial Amendment No. 1 to the proposed rule change to postpone the implementation date of the proposed rule change.⁴ The Commission did not receive any comment letters on the proposed rule change. The Commission is publishing this notice to solicit comment on Partial Amendment No. 1 from interested persons and to approve the proposed rule change, as modified by Partial Amendment No. 1 (hereinafter,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 86556 (August 2, 2019), 84 FR 39037 (August 8, 2019) (SR-NSCC-2019-002) (“Notice”).

⁴ NSCC submitted a courtesy copy of Partial Amendment No. 1 to the proposed rule change through the Commission’s electronic public comment letter mechanism. Accordingly, Partial Amendment No. 1 to the proposed rule change has been publicly available on the Commission’s website since September 16, 2019: <https://www.sec.gov/comments/sr-nsc-2019-002/srnsc2019002-6132116-192236.pdf>

“Proposed Rule Change”), on an accelerated basis.

II. Description of the Proposed Rule Change

The proposed rule change would amend Procedure VII (CNS Accounting Operation) of NSCC’s Rules & Procedures (“Rules”)⁵ with respect to the receipt of securities from NSCC’s Continuous Net Settlement (“CNS”) System.⁶ Specifically, these amendments would reflect a change in the allocation algorithm used during the night cycle used by NSCC’s CNS System. The proposed rule change would also make technical changes to the Rules.

A. Background

NSCC’s CNS System is an automated accounting and securities settlement system that centralizes and nets the settlement of compared and recorded securities transactions and maintains an orderly flow of security and money balances. The settlement processing cycle spans two business days, with a night cycle that begins at approximately 8:30 p.m. Eastern Time (“ET”) on the day prior to settlement date and runs until approximately 10 p.m. ET, and a day cycle that begins at approximately 6:30 a.m. ET on settlement date and runs until approximately 3:10 p.m. ET. The night cycle and day cycle settlement processes are essentially the same, except that the night cycle settlement process runs in batches and the day cycle settlement process runs continuously. Transactions that do not get processed for settlement during the night cycle are carried into the following day cycle for settlement processing.

⁵ Capitalized terms not defined herein are defined in the Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsccl_rules.pdf.

⁶ The CNS System and its operation are described in Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the Rules. Id.

CNS relies on an interface with the Depository Trust Company (“DTC”), an affiliate of NSCC, for the book-entry movement of securities. Procedure VII (CNS Accounting Operation) describes the receipt and delivery of CNS Securities. CNS long (buy) positions are allocated to Members as the securities are received by NSCC (i.e., CNS long positions are transferred from the NSCC account at DTC to the accounts of NSCC Members at DTC) in accordance with the CNS System algorithm.

Currently, NSCC employs an algorithm to determine the order in which Members with long allocations receive positions from CNS; however, Members can submit priority requests that override NSCC’s algorithm when they have special needs to receive securities owed to them (e.g., the security is undergoing a corporate action or the Member has an urgent customer delivery).⁷ The priority requests can be submitted for the night cycle, the day cycle, or both. The current priority groups are as follows –

First, long positions in a CNS Reorganization Sub-Account established pursuant to paragraph H.4 of Procedure VII of the Rules;⁸

Second, long positions against which Buy-In Intent⁹ notices are due to expire that day but which were not filled the previous day;

⁷ Specifically, under Procedure VII, subsection E (Influencing Receipts from CNS), Members can request that they receive priority for some or all issues on a standing or override basis.

⁸ Supra note 5.

⁹ Section 7 of Rule 11 (CNS System) and subsection J of Procedure VII (CNS Accounting Operation) of the Rules provide that in the event a Member has a Long Position in a CNS Security, the Member may demand immediate delivery thereof by submitting to NSCC a Buy-In Intent notice in such form and within such times as determined by NSCC. Supra note 5.

Third, long positions against which Buy-In Intent notices are due to expire the following day;

Fourth, (i) long positions in a receiving ID Net Subscriber's agency account established at a Qualified Securities Depository,¹⁰ and (ii) long positions against the component securities of index receipts;

Fifth, in descending sequence, priority levels as specified by Standing Priority Requests and as modified by Priority Overrides.

Currently, when more than one long position in a given CNS Security exists within the same priority group, the positions are allocated based on their age (i.e., the "oldest" position is allocated first). In addition, when more than one long position in a given CNS Security exists within the same priority group and all of those have been long the same number of consecutive days (i.e., within the same age group), the allocation rank is determined by a computer generated random number. The allocation algorithm currently used for the night and day cycles is the same but is computed separately.

B. Proposed Changes to Allocation Algorithm

Under the current algorithm, approximately 50 percent of the CNS transactions are processed for settlement during the night cycle. In order to improve processing efficiency and maximize the number of CNS transactions that would get processed for settlement during the night cycle, NSCC is proposing a modification to the allocation algorithm used during the night cycle.¹¹ NSCC anticipates that the proposal would

¹⁰ ID Net Service and its operation are described in Rule 65 (ID Net Service) and Procedure XVI (ID Net Service) of the Rules. Supra note 5.

¹¹ See Notice, supra note 3, at 39038-39.

increase the percentage of CNS transactions processed for settlement during the night cycle to approximately 65 percent.¹² NSCC is not proposing changes to the allocation algorithm used during the day cycle.

As described above, the current allocation sequence for day cycle and night cycle is as follows: priority groups, age of positions, and random number within an age group. Under the proposal, NSCC would change the allocation algorithm so that age of positions and random number within an age group would no longer be considered as factors when allocating CNS long positions within the same priority group during the night cycle. Instead, allocation of CNS long positions within the same priority group during the night cycle would be determined by the DTC settlement optimization algorithm.¹³

NSCC represents that eliminating the age of positions and random number within an age group from being considered as factors when allocating CNS long positions within the same priority group during the night cycle would help maximize the number of transactions processed for settlement during the night cycle.¹⁴ Specifically, according to NSCC, removing the requirement to process transactions for settlement during the night cycle in an order based on the age of positions and random number within an age group would help the DTC settlement optimization algorithm perform more effectively in

¹² Id.

¹³ On July 22, 2019, DTC submitted a proposed rule change to implement a new algorithm to optimize its settlement processing of transactions during the night cycle (“DTC settlement optimization algorithm”). The proposal is designed to maximize the number of transactions processed for settlement during the night cycle. See Securities Exchange Act Release No. 86554 (August 2, 2019), 84 FR 39025 (August 8, 2019) (SR-DTC-2019-005).

¹⁴ See Notice, supra note 3, at 39038-39.

identifying the optimal order by which transactions are processed for settlement, which, in turn, would help maximize the number of transactions processed for settlement during the night cycle.¹⁵

NSCC is proposing to add a clause to subsection C.4 of Procedure VII (CNS Accounting Operation) to make it clear that there would be differences in the allocation algorithm used for receipts from CNS between the day cycle and the night cycle processes. NSCC is also proposing to add a parenthetical regarding subsection E of Procedure VII for ease of reference. To reflect the proposed elimination of random number within an age group as a factor when allocating CNS long positions within the same priority group during the night cycle, NSCC is proposing to modify the first paragraph of subsection E of Procedure VII by deleting the references to an algorithm which changes daily.

NSCC is also proposing to revise subsection E.4 of Procedure VII to reflect the proposed changes to the allocation algorithm used during the night cycle by adding (i) “and, for the day cycle only,” to the first paragraph in subsection E.4 and (ii) “For the day cycle only,” to the third and fourth paragraphs of subsection E.4. According to NSCC, these changes are being proposed to state that age of positions and random number within an age group would only be considered as factors when allocating CNS long positions during the day cycle.¹⁶

In addition, NSCC is proposing to modify the last paragraph of subsection E.4 of Procedure VII to clarify that the allocation algorithm used for the night and day cycles is

¹⁵ Id.

¹⁶ Id.

computed separately to allow for the use of different allocation factors in those respective cycles.¹⁷

NSCC is proposing technical changes by replacing references to “evening cycle” with “night cycle” in subsections A, C.3, E.1, E.2, E.4, E.5, and H.5 of Procedure VII. Similarly, NSCC is proposing to replace references to (i) “evening allocation” with “night allocation” in subsections C.3, C.4, and J.1 of Procedure VII, (ii) “evening and day delivery cycles” with “night and day delivery cycles” in subsection E.4 of Procedure VII and (iii) “evening allocation cycle” with “night cycle” in Section I of Addendum G. These changes are being proposed to ensure consistency in terminology usage in the Rules.¹⁸ NSCC is also proposing technical changes to correct cross references in subsections E.3 and E.4(a) of Procedure VII.

C. Description of Partial Amendment No. 1

In Partial Amendment No. 1, NSCC proposes to amend the implementation timeframe of the proposal.¹⁹ In its original filing with the Commission, NSCC previously stated that the proposed rule change would be effective by September 26, 2019. Pursuant to Partial Amendment No. 1, the Proposed Rule Change would be effective by December 6, 2019.

¹⁷ Id.

¹⁸ Id.

¹⁹ Partial Amendment No. 1, supra note 4.

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act²⁰ 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. After carefully considering the Proposed Rule Change, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to DTC. In particular, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act.²¹

Section 17A(b)(3)(F) of the Act requires, in part, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.²² The Commission believes that the proposed changes to the allocation algorithm used during the night cycle are designed to promote prompt and accurate clearance and settlement of securities transactions. Removing the requirement to process transactions for settlement during the night cycle in an order based on the age of positions and random number within an age group should enhance the effectiveness of the DTC settlement optimization algorithm in identifying the optimal order to process transactions for settlement. Being able to effectively identify the optimal order to process transactions for settlement should help maximize the number of transactions processed for settlement during the night cycle. Therefore, the Commission believes that the

²⁰ 15 U.S.C. 78s(b)(2)(C).

²¹ 15 U.S.C. 78q-1(b)(3)(F).

²² Id.

proposed changes to the allocation algorithm used during the night cycle are designed to promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.²³

The Commission also believes that the proposal to make technical changes is designed to promote prompt and accurate clearance and settlement of securities transactions. The proposed technical changes would help ensure consistency in terminology usage and correct cross references in the Rules, both of which would ensure the Rules are clear and accurate. The Commission believes that using consistent terminology and correct cross references would avoid any confusion by Members and allow Members to accurately understand NSCC's clearance and settlement services. In turn, the Commission believes that the proposal is designed to promote prompt and accurate clearance and settlement of securities transactions by NSCC. As such, the Commission believes the proposal to make technical changes is consistent with Section 17A(b)(3)(F) of the Act.²⁴

IV. Solicitation of Comments on Partial Amendment No. 1 to the Proposed Rule Change

Interested persons are invited to submit written data, views and arguments concerning whether Partial Amendment No. 1 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

²³ Id.

²⁴ Id.

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NSCC-2019-002 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NSCC-2019-002. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make

available publicly. All submissions should refer to File Number SR-NSCC-2019-002 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of the Proposed Rule Change, as Modified as Partial Amendment No. 1

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,²⁵ to approve the proposed rule change prior to the 30th day after the date of publication of Partial Amendment No. 1 in the Federal Register. As noted above, Partial Amendment No. 1 delays the implementation timeframe of the proposal from September 26, 2019 to December 6, 2019.²⁶ The Commission believes that the Partial Amendment is consistent with the Act because it does not raise any regulatory issues and would provide more time before the proposal would go into effect.

For the reasons discussed above, the Commission finds that Partial Amendment No. 1 is reasonably designed to protect investors and the public interest, and consistent with the requirements of the Act. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,²⁷ to approve the proposed rule change, as modified by Partial Amendment No. 1, on an accelerated basis.

VI. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change, as modified by Partial Amendment No. 1, is consistent with the requirements of

²⁵ 15 U.S.C. §78s(b)(2).

²⁶ Partial Amendment No. 1, supra note 4.

²⁷ 15 U.S.C. §78s(b)(2).

the Act and, in particular, with the requirements of Section 17A of the Act²⁸ and the rules and regulations promulgated thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act²⁹ that proposed rule change SR-NSCC-2019-002, as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.³⁰

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³¹

Jill M. Peterson
Assistant Secretary

²⁸ 15 U.S.C. 78q-1.

²⁹ 15 U.S.C. 78s(b)(2).

³⁰ In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³¹ 17 CFR 200.30-3(a)(12).