



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69894; File No. SR-NSCC-2013-805)

June 28, 2013

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of No Objection to Advance Notice Filing to Require that All Locked-in Trade Data Submitted to It for Trade Recording be Submitted in Real-time

I. Introduction

On April 30, 2013, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-NSCC-2013-805 (“Advance Notice”) pursuant to Section 806(e) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”),¹ entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act” or “Title VIII”) and Rule 19b-4(n) of the Securities Exchange Act of 1934 (“Exchange Act”). On May 14, 2013, NSCC filed with the Commission Amendment No. 1 to the Advance Notice.² The Advance Notice was published in the Federal Register on June 11, 2013.³ The Commission received one comment letter to the proposed rule change.⁴ This publication serves as notice of no objection to the

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

² In Amendment No. 1, NSCC corrected a typographical error in the text of its Rules & Procedures (“Rules”) related to the Advance Notice.

³ Release No. 34-69699 (June 5, 2013), 78 FR 35076 (June 11, 2013). NSCC also filed a proposed rule change pursuant to Section 19(b)(1) of the Exchange Act on April 30, 2013 seeking Commission approval to permit NSCC to change its rules to reflect the proposed change described herein. The Commission, through delegated authority, published notice of the proposed rule change on May 14, 2013. Release No. 34-69571 (May 14, 2013), 78 FR 29408 (May 20, 2013).

⁴ Comment letter from Kermit Kubitz (“Kubitz”) dated June 10, 2013, <http://www.sec.gov/comments/sr-nscc-2013-05/nscc201305.shtml>. Kubitz supports the proposed rule change’s requirement “to submit trades without any pre-processing . . .”

Advance Notice.

II. Analysis

NSCC filed the Advance Notice to require that all locked-in trade data submitted to NSCC for trade recording be submitted in real-time,⁵ and to prohibit pre-netting⁶ and other practices that prevent real-time trade submission, as discussed below.

Proposal Overview

According to NSCC, the majority of all transactions processed at NSCC are submitted on a locked-in basis by self-regulatory organizations (“SRO”) (including national and regional exchanges and marketplaces), and Qualified Special Representatives (“QSR”).⁷ Currently,

and believes that, “any cost associated with submitting higher volumes of data from limiting pre-netting is small compared to the risks and costs of inaccurate data which might result from submission of other than accurate trade data.” The Commission considers all public comments received on the proposed rule change as comments to the Advance Notice.

⁵ The term “real-time,” when used with respect to trade submission, will be defined in Procedure XIII (Definitions) of NSCC’s Rules as the submission of such data on a trade-by-trade basis promptly after trade execution, in any format and by any communication method acceptable to NSCC.

⁶ According to NSCC, any pre-netting practices include: (i) “summarization” (i.e., a technique in which the clearing broker nets all trades in a single CUSIP by the same correspondent broker into fewer submitted trades); (ii) “compression” (i.e., 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); (iii) netting; and (iv) any other practice that combines two or more trades prior to their submission to NSCC (collectively, “Pre-netting”).

⁷ QSRs are NSCC members (“Members”) that 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.

NSCC data reveals that almost all exchanges⁸ and some QSRs submit trades executed on their respective markets in real-time, representing approximately 91% of the locked-in trades submitted to NSCC today. The rule change will require that all locked-in trades submitted for trade recording by SROs and QSRs be submitted to NSCC in real-time.⁹

NSCC will also prohibit Pre-netting practices that preclude real-time trade submission. NSCC states that typically, Pre-netting is done on a bilateral basis between a QSR and its customer, both NSCC Members. According to NSCC, Pre-netting practices disrupt NSCC's ability to accurately monitor market and credit risks as they evolve during the trading day. Therefore, NSCC will prohibit Pre-netting activity on the part of entities submitting original trade data on a locked-in basis.¹⁰ The rules of NSCC's affiliate Fixed Income Clearing Corporation ("FICC") currently prohibit such activity, and this rule change will align NSCC's trade submission rules with those of FICC.¹¹

⁸ One executing market with very low trade volume does not yet submit trades in real-time.

⁹ Files submitted to NSCC by The Options Clearing Corporation ("OCC") relating to option exercises and assignments (Procedure III, Section D – Settlement of Option Exercises and Assignments) will not be required to be submitted in real-time. OCC's process of assigning option assignments is and will continue to be an end-of-day process.

¹⁰ Trades executed in the normal course of business between a Member that clears for other broker-dealers, and its correspondent, or between correspondents of the Member, which correspondent(s) is not itself a Member and settles such obligations through such clearing Member (i.e., "internalized trades") are not required to be submitted to NSCC and shall not be considered to violate the Pre-netting prohibition.

¹¹ See, e.g., GSD Rule 11 (Netting System), Section 3 ("All trade data required to be submitted to the Corporation under this Section must be submitted on a trade-by-trade basis with the original terms of the trades unaltered. A Member or any of its Affiliates may not engage in the Pre-Netting of Trades prior to their submission to the Corporation in contravention of this section. In addition, a Member or any of its Affiliates may not engage in any practice designed to contravene the prohibition against the Pre-Netting of Trades."), http://dtcc.com/legal/rules_proc/FICC-Government_Security_Division_Rulebook.pdf. See also Order Granting Approval of a

Further, NSCC does not expect the rule changes to impact trade volumes significantly. According to NSCC, the majority of trades are currently being submitted to NSCC 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.

In the wake of recent industry disruptions, industry participants have been focused on developing controls to address the risks that arise from technology issues. A comment letter submitted to the Commission in advance of its Technology and Trading Roundtable, held in October 2012, and signed by a number of industry participants including SROs, broker-dealers, and buy-side firms, supported this rule change as a crucial component of the industry controls that could increase market transparency and ultimately mitigate risks associated with high-frequency trading and related technology.¹²

Implementation Timeframe

NSCC will advise Members of the implementation date of the rule change through issuance of an NSCC Important Notice. The rule change will not be implemented earlier than seven (7) months from the date of Commission approval.

III. Discussion

Although Title VIII does not specify a standard of review for an Advance Notice, the stated purpose of Title VIII is instructive.¹³ The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability by, among other things,

Proposed Rule Change Relating to Trade Submission Requirements and Pre-Netting, Release No. 34-51908 (June 22, 2005), 70 FR 37450 (June 29, 2005).

¹² See Market Technology Roundtable Comment Letter dated Sept. 28, 2012, available at <http://www.sec.gov/comments/4-652/4652-17.pdf>.

¹³ 12 U.S.C. 5461(b).

promoting uniform risk management standards for systemically-important financial market utilities (“FMU”) and providing an enhanced role for the Board of Governors of the Federal Reserve System (“Federal Reserve”) in the supervision of risk management standards for systemically-important FMUs.¹⁴

Section 805(a)(2) of the Clearing Supervision Act¹⁵ authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the supervisory agency or the appropriate financial regulator. Section 805(b) of the Clearing Supervision Act¹⁶ states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support the stability of the broader financial system.

The Commission adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act on October 22, 2012 (“Clearing Agency Standards”).¹⁷ The Clearing Agency Standards became effective on January 2, 2013 and require clearing agencies that perform central counterparty (“CCP”) services to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum

¹⁴ Id.

¹⁵ 12 U.S.C. 5464(a)(2).

¹⁶ 12 U.S.C. 5464(b).

¹⁷ Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (Nov. 2, 2012).

requirements for their operations and risk management practices on an ongoing basis.¹⁸ As such, it is appropriate for the Commission to review Advance Notices against these risk management standards that the Commission promulgated under Section 805(a) and the objectives and principles of these risk management standards as described in Section 805(b).

Consistent with Section 805(a), the Commission believes NSCC's proposal promotes robust risk management, as well as the safety and soundness of NSCC's operations, while reducing systemic risks and supporting the stability of the broader financial system. As discussed above, the rule change will allow NSCC to mitigate the operational risk that results from locked-in trade data not being submitted to NSCC in real-time.

Commission Rule 17Ad-22(d)(4) regarding identification and mitigation of operational risk,¹⁹ adopted as part of the Clearing Agency Standards,²⁰ requires clearing agencies 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, controls, and procedures”²¹ The Commission believes that the receipt of locked-in trade data on a real-time basis will permit NSCC's risk management processes to monitor trades closer to trade execution on an intra-day basis and identify and manage any issues

¹⁸ The Clearing Agency Standards are substantially similar to the risk management standards established by the Board of Governors governing the operations of designated FMUs that are not clearing entities and financial institutions engaged in designated activities for which the Commission or the Commodity Futures Trading Commission is the Supervisory Agency. See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012).

¹⁹ 17 CFR 240.17Ad-22(d)(4).

²⁰ Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (Nov. 2, 2012).

²¹ 17 CFR 240.17Ad-22(d)(4).

relating to excessive risk exposure earlier on a closer to real-time basis, thereby potentially minimizing a source of operational risk.

IV. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,²² that the Commission DOES NOT OBJECT to the proposed rule change described in the Advance Notice (File No. SR-NSCC-2013-805) and that NSCC be and hereby is AUTHORIZED to implement the proposed rule change as of the date of this notice or the date of the “Order Approving Proposed Rule Change to Require that All Locked-in Trade Data Submitted to It for Trade Recording be Submitted in Real-time,”²³ whichever is later.

By the Commission.

Kevin M. O’Neill
Deputy Secretary

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²² 12 U.S.C. 5465(e)(1)(I).

²³ Release No. 34-69890 (June 28, 2013).