

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49079; File No. SR-SCCP-2001-09]

### Self-Regulatory Organizations; Stock Clearing Corporation of Philadelphia; Notice of Filing of Proposed Rule Change Relating to Establishing Risk Management Procedures for Short Settlement Transactions

January 14, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 30, 2001, the Stock Clearing Corporation of Philadelphia ("SCCP") filed with the Securities and Exchange Commission ("Commission") and on October 9, 2001<sup>2</sup> and September 20, 2002,<sup>3</sup> amended the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by SCCP. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change would require SCCP specialists and alternate specialists ("SCCP margin members") to comply with certain procedures when engaging in short settlement transactions. These procedures would require the review of short settlement transactions by the SCCP Board of Directors or Operations Committee to determine whether additional margin will be required prior to settlement date from SCCP specialists and alternate specialists engaging in these transactions.

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

In its filing with the Commission, SCCP 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 in Item IV below. SCCP has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.<sup>4</sup>

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

The purpose of the proposed rule change is to implement risk management procedures to protect SCCP from undue credit risk and short settlement risk when a SCCP margin member engages in a short settlement transaction.<sup>5</sup> In the absence of explicit risk management procedures, SCCP may face unlimited credit risk with its lending institutions and short settlement risk in connection with its clearance and settlement of transactions with the National Securities Clearing Corporation ("NSCC") through its omnibus clearing and settlement account.

SCCP provides margin services to SCCP margin members in accordance with Rule 9 of SCCP's by-laws and procedures and Regulation T of the Board of Governors of the Federal Reserve System. Pursuant to current-Rule 9, SCCP guarantees the cash settlement obligations of the omnibus clearance and settlement account to NSCC.

If a SCCP margin member executes a short settlement transaction, SCCP is obliged by NSCC's rules and procedures to finance the covering transaction until settlement on T+2 or T+3 because the SCCP margin member has already received the proceeds from the opening transaction on T+1 or T+2, respectively.<sup>6</sup> This creates an additional cash settlement obligation from SCCP to NSCC which, for example in the case of large basket transactions, could be larger than the executing margin member's capital deposit with SCCP, and imposes additional market risk on SCCP should the securities decline in value prior to settlement. If SCCP does not have access to sufficient available funds through its existing credit facilities with its lending

institutions, a short settlement transaction thereby exposes SCCP to credit risk that may result from the lack of available funds to cover the transaction. Additionally, if a SCCP margin member executes a short settlement transaction and SCCP cannot meet the cash settlement obligation to NSCC, under NSCC's rules and procedures NSCC is authorized to cease to act on SCCP's behalf and/or buy-in the open positions in the omnibus clearance and settlement account.<sup>7</sup> Such a risk to SCCP is called "short settlement risk" and includes exposure to market risk from a decrease in value of the securities during the financing period.

Currently, Rule 9 provides, in part, that SCCP will provide margin accounts for SCCP margin members that clear and settle their transactions through SCCP's omnibus clearance and settlement account. Pursuant to Rule 9, SCCP may issue margin calls to any SCCP margin member when the margin requirement exceeds the account equity. In addition, Rule 9 provides that SCCP may require adequate assurances or additional margin (in addition to minimum margin thresholds) payable in Federal funds in order to protect SCCP in issues deemed by SCCP to warrant additional protection.

Rule 9 also currently provides that any failure by a SCCP margin member to meet a margin call shall subject such delinquent SCCP margin member to the late margin call payment schedule contained in Rule 9 and to SCCP's Rule 22, which governs disciplinary proceedings and penalties. Moreover, pursuant to SCCP's Rules 9 and 15, SCCP may cease to act for the account of such delinquent SCCP margin member, and SCCP will retain a lien on all such SCCP margin member's accounts and securities therein to satisfy any capital deficiency of such margin member.

SCCP proposes to amend Rule 9 to expressly shift the credit risk and the short settlement risk from short settlement transactions from SCCP to the SCCP margin member. The proposed rule change sets forth procedures that would require a SCCP margin member to notify SCCP on trade date (T) whenever the SCCP margin member executes a short settlement transaction. The purpose of this notification is to put SCCP on notice that a short settlement transaction has been executed, to allow SCCP to verify the SCCP margin member's net capital and net settlement cap, and to allow SCCP to calculate any net settlement obligations to NSCC. The

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

<sup>2</sup> In October 2001, SCCP filed Amendment No. 1 to its original filing in order to replace its request for immediate effectiveness under Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) with a request for approval pursuant to Section 19(b)(2). Amendment No. 1 also revised Rule 9 to reflect the addition of the schedule for late margin call payments which had previously been approved by the Commission in another SCCP rule filing. Securities Exchange Act Release No. 44722 (Aug. 20, 2001), 66 FR 44661 (Aug. 24, 2001) [SR-SCCP-2001-04].

<sup>3</sup> In September 2002, SCCP filed Amendment No. 2 to its original filing whereby SCCP added the requirement that the SCCP Operations Committee or Board of Directors shall determine whether additional margin will be required prior to the settlement date for short settlement transactions.

<sup>4</sup> The Commission has modified text of the summaries prepared by SCCP.

<sup>5</sup> As defined in SCCP's proposed rule, "a short settlement transaction occurs when, for example, the buy (or sell) side of the trade ("opening transaction") settles on T+1 or T+2 and the sell (or buy) side of the trade ("covering transaction") settles on T+2 or T+3.

<sup>6</sup> NSCC Rule 10, Section 4 and Rule 12, Section 1.

<sup>7</sup> NSCC's Rules 18 and 46.

proposed rule change would establish that there shall be a cap on net settlement obligations undertaken by any SCCP margin member of two times net capital. On the day following trade date (T+1), SCCP shall notify the SCCP margin member of any settlement obligations to NSCC exceeding the net settlement cap and whether the SCCP Board of Directors or Operations Committee has decided, in its sole discretion, that SCCP shall finance the increased settlement obligations on behalf of the SCCP margin member.

Under the proposed rule change, a SCCP margin member must obtain approval from the SCCP Board of Directors or Operations Committee to continue carrying any transactions having an aggregate value above the net settlement cap. The SCCP Board of Directors or Operations Committee has the sole discretion to approve whether a margin member may continue to carry any transactions that exceed the net settlement cap. A SCCP margin member may only carry a short settlement transaction with an aggregate value above the net settlement cap until the clearance and settlement of such transaction with NSCC. The SCCP Board of Directors or Operations Committee shall determine, in its sole discretion, whether SCCP will finance the short settlement transaction in excess of the margin member's net settlement cap. If the SCCP Board of Directors or Operations Committee, as the case may be, determines that SCCP will not finance such short settlement transaction, the SCCP margin member shall be required to pay 100 percent of its settlement obligations to SCCP above the net settlement cap. In this manner, SCCP will satisfy its obligations to NSCC for the additional clearing funds caused by a net settlement transaction.

The SCCP margin member shall have until 3 p.m. eastern time on the date following the initial notification (T+2) to provide sufficient funds to cover 100 percent of the settlement obligations above the SCCP margin member's net settlement cap. The net settlement cap related provisions are intended to require any SCCP margin member who executes a short settlement transaction to bear the credit risk from such transaction and to decrease associated risks to SCCP. Finally, the proposed rule change reminds SCCP margin members that SCCP has the authority to initiate a disciplinary proceeding or to cease to act on behalf of such SCCP margin member if sufficient funds are not provided by the T+2 deadline. These provisions currently appear in SCCP Rules 9 and 15.

No other aspect of Rule 9 is being modified. Rule 9 is being specifically interpreted to (i) Require notification of SCCP by the SCCP margin member in the event the SCCP margin member executes a short settlement transaction; (ii) require the SCCP margin member to finance 100 percent of the net settlement obligation in the event SCCP's Board of Directors or Operations Committee, as the case may be, elects not to finance the opening transaction; and (iii) clarify that SCCP is authorized to bring a disciplinary proceeding against the SCCP margin member and to cease to act on behalf of such SCCP margin member if the firm continues to carry the short settlement transaction without providing sufficient capital to cover the margin member's net settlement obligation.

SCCP believes that the proposed rule change should facilitate compliance with SCCP's rules regarding the carrying of securities in margin accounts and Regulation T and is, therefore, consistent with Section 17A(b)(3)(A) of the Act. In particular, SCCP believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>8</sup> which requires that the rules of a clearing agency be designed to promote the prompt and accurate settlement of securities transactions, to remove impediments to and perfect the mechanism of a national system, and to protect SCCP, its members, investors, and the public interest.

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

SCCP does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or received.

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

Within thirty-five 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 ninety 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 SCCP consents, the Commission will:

(a) By order approve the 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-SCCP-2001-09. 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at SCCP's principal office and on SCCP's Web site at [http://www.phlx.com/exchange/memos/SCCP/memindex\\_sccpproposals.html](http://www.phlx.com/exchange/memos/SCCP/memindex_sccpproposals.html). All submissions should refer to File No. SR-SCCP-2001-09 and should be submitted by February 17, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>9</sup> 17 CFR 200.30-3(a)(12).