

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-67850; File No. SR-NSCC-2012-07]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Which: (i) Eliminates the Practice of Netting of Creations and Redemptions of Index Receipts Prior to Their Entering NSCC's Accounting Operation, and (ii) Effects Certain Other Technical Changes

September 13, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on September 4, 2012, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared primarily by NSCC. NSCC filed the proposal pursuant to Section 19(b)(3)(A)(iii) of the Act,<sup>2</sup> and Rule 19b-4(f)(4)<sup>3</sup> thereunder so that the proposal was effective upon filing with the Commission. 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: (i) Eliminates the practice of netting of creations and redemptions of index receipts prior to their entering NSCC's Accounting Operation, and (ii) effects certain other technical changes. Details are set forth in Exhibit 5 to NSCC's rule filing, which can be found on NSCC's Web site ([http://www.dtcc.com/downloads/legal/rule\\_filings/2012/nscs/SR-NSCC-2012-07.pdf](http://www.dtcc.com/downloads/legal/rule_filings/2012/nscs/SR-NSCC-2012-07.pdf)).

#### 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 in Item IV below. NSCC has prepared summaries, set forth in sections (A), (B)

and (C) below, of the most significant aspects of such statements.

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

NSCC reports on, clears and settles domestic index receipts (i.e. shares in exchange-traded funds ("ETFs")) and their underlying component securities through a creation/redemption process, which is initiated by a Member. As more fully described below, the purposes of the proposed rule change are to: (a) Discontinue the current practice of netting of ETF transactions prior to entering the Corporation's Accounting Operation in order to: (1) Harmonize ETF processing with that for other transaction types and (2) better facilitate Members' internal reconciliation processes, and (b) make certain technical corrections and clarifications to the Rules text with respect to current ETF processing.

NSCC's index receipt processing supports: (a) The establishment of index receipt units (creation), whereby a Member will deliver the underlying component securities or cash to the index receipt agent and receive index receipts, and (b) the redemption of index receipt units whereby a Member will deliver the index receipts and receive the underlying components or cash. NSCC facilitates the processing of these transactions as set forth below.<sup>4</sup>

NSCC's process for handling of index receipt transactions is set forth in Procedure II, Section G. On the day before trade date (T-1), an index receipt agent transmits files to NSCC which contain information regarding the underlying composition of index receipts for creates and redeems occurring the next business day. That evening, NSCC compiles the information and provides the respective Members with a portfolio composition report/file that lists the composition of index receipts eligible for processing. The file displays the proportionate amount of underlying components or cash<sup>5</sup> that comprise each index receipt.

<sup>4</sup> For the NSCC rule filing which implemented ETF processing, see Securities Exchange Act Release No. 31601 (December 16, 1992), [File No. SR-NSCC-92-08].

<sup>5</sup> In 2008, NSCC expanded its index receipt processing to allow for creates and redeems using cash as the sole underlying component. This allows Members and their agent banks to create and redeem index receipts whose underlying components are not currently eligible for processing at NSCC (for example, commodity index receipts). The index receipt agent would use the cash to purchase the components, the settlement of which would occur outside of NSCC. See Securities Exchange Act Release No. 58694 (September 30, 2008), [File No. SR-NSCC-2008-07].

This file also contains a cash balancing component, which is an estimation of accrued dividends, cash-in-lieu of securities and any necessary balancing amount.<sup>6</sup> The portfolio information contained in this file is used for creation/redemption processing the next day, or Trade Date (T). On T, by such time as established by NSCC, the index receipt agent, on behalf of each Member placing an index receipt order, will report to NSCC the number of index receipts created and redeemed that day. Such transactions constitute locked-in transactions between the index receipt agent and the relevant Members. The index receipt agent also will report the final cash amount and a transaction amount which represents the transaction fee. On the night of T, NSCC transmits an index receipt instruction detail report to Members who had activity on T. The report serves as the contract for the creation/redemption activity and lists the number of component shares, on a netted basis, associated with particular creations and redemptions executed on T. Prior to entering the Corporation's Accounting Operation, each index share instruction is separated into its underlying stock components, and incorporated into the normal equity clearance and settlement process. Unsettled positions in index receipts and their component securities are risk managed as ordinary activity and guaranteed pursuant to the provisions of Addendum K.

Pursuant to the proposed Rule change, creation/redemption index receipt activity will no longer be netted prior to the general netting associated with NSCC's Accounting Operation, and thus will not appear on the Index Receipt Detail Report as netted, but will be reported in gross. The discontinuation of this "pre-netting" practice will harmonize NSCC's processing for ETFs with the processing of other transactions that enter the Accounting Operation which are not netted prior to entering the Accounting Operation. In addition, the reporting of the underlying components for creations and redemptions in gross will better facilitate Members' internal

<sup>6</sup> The balancing amount is designed to compensate for any difference between the net asset value of the index receipt and the value of the underlying index. Among other reasons, a difference in value could result from the fact that an index receipt cannot contain fractional shares of a security. Separately, from time to time, an Index Receipt Agent may use cash-in-lieu as part of the cash balancing amount which means it would substitute the cash value of a component security for a security in the portfolio. For instance, such a substitution may be made due to difficulty in obtaining a particular security. The cash-in-lieu designation is not used where cash is the sole underlying component of a creation or redemption.

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

<sup>2</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>3</sup> 17 CFR 240.19b-4(f)(4).

reconciliation processes by providing a comprehensive view of their activity prior to it entering the net. The proposed change will not have a substantive impact on Members or the Corporation, either operationally or from a risk perspective, as a Member's overall positions are mathematically the same, and margined equally, regardless of the whether a Member's create/redeem positions are separately netted prior to processing in the Accounting Operation. (Note: Included in NSCC's fee schedule, as set forth in Addendum A to the Rules, is an "into the net" charge which is volume based in terms of the dollar value of the transactions entering the Corporation's Accounting Operation. In this regard, the proposed change may have an impact on Member billing in that a gross rather than net transaction value for creations and redemptions will be fed into the Accounting Operation.)

In addition, NSCC proposes certain technical corrections and clarifications to the Section G of Procedure II, including to:

(a) Highlight the distinction between cash used as the sole underlying component versus as a partial replacement for underlying components,

(b) Indicate, consistent with the change to eliminate the "pre-net" of index receipts, that the Index Receipt Detail Report will report securities components for a given index receipt transaction in gross,

(c) Make a correction to reflect that the Corporation reports to Members on the Index Receipt Detail Report the details of the creations and redemptions submitted on T rather than T+1,

(d) Clarify that the Index Receipt Detail Report also shows the quantity of index receipt shares associated with the current creation and redemption activity, and

(e) Delete an incorrect reference that the Index Receipt Detail Report provides the total quantity of securities to be delivered and received on Settlement Date.<sup>7</sup>

#### *Implementation timeframe:*

NSCC proposes to implement the changes set forth in this filing in the third quarter of 2012. Members will be advised of the implementation date through the issuance of an NSCC Important Notice.

The proposed rule change facilitates the prompt and accurate clearance and settlement of securities transactions by

<sup>7</sup> Quantities of all securities to be delivered and received by a Member on Settlement Date (not only with respect to index receipts) are reported to Members on the Consolidated Trade Summary.

harmonizing the processing of creates and redeems of index receipts with other NSCC activity and enhancing Members' abilities to reconcile such activity, as described above; and is therefore consistent with the requirements of the Act and the rules and regulations thereunder applicable to NSCC. The proposed rule change is consistent with the Principles for Financial Market Infrastructures as it promotes clarity in the Rules with respect to the reporting of contracts and input into the Corporation's Accounting Operation.

#### *(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, Participants 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**

The foregoing rule change has become effective upon filing pursuant to Section 19(b)(3)(A)(iii)<sup>8</sup> of the Act and Rule 19b-4(f)(4)<sup>9</sup> thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

### **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*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>) or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2012-07 on the subject line.

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>9</sup> 17 CFR 240.19b-4(f)(4).

#### *Paper Comments*

- Send paper comments 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-2012-07. This file number should be included on the subject line if email 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 Web site viewing and printing in the Commission's Public Reference Section, 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 such filings will also be available for inspection and copying at the principal office of NSCC and on NSCC's Web site ([http://www.dtcc.com/downloads/legal/rule\\_filings/2012/nscc/SR-NSCC-2012-07.pdf](http://www.dtcc.com/downloads/legal/rule_filings/2012/nscc/SR-NSCC-2012-07.pdf)).

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 File Number SR-NSCC-2012-07 and should be submitted on or before October 10, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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<sup>10</sup> 17 CFR 200.30-3(a)(12).