

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-55095; File No. SR-NSCC-2006-11)

January 12, 2007

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Amend its Rules and Procedures with Respect to Clearing Fund Collateral

I. Introduction

On October 3, 2006, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on October 25, 2006, amended<sup>1</sup> proposed rule change SR-NSCC-2006-11 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>2</sup> Notice of the proposal was published in the Federal Register on December 6, 2006.<sup>3</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change as amended.

II. Description

NSCC is modifying its rules regarding Clearing Fund collateral requirements in order to improve liquidity and minimize risk for NSCC and its members. NSCC is also making certain technical corrections to the text of Rule 4 to conform the rule to actual practice.<sup>4</sup>

---

<sup>1</sup> The amendment was not substantive.

<sup>2</sup> 15 U.S.C. 78s(b)(1).

<sup>3</sup> Securities Exchange Act Release No. 54822 (November 28, 2006), 71 FR 70820.

<sup>4</sup> For example, the reference in Rule 4, Section 1 to the “market value” of Qualifying Bonds has been corrected to accurately reference the “collateral value” of Eligible Clearing Fund Securities.

Under NSCC's Rules,<sup>5</sup> members are required to make deposits to the Clearing Fund. The amount of each member's required deposit ("Required Deposit") is fixed by NSCC in accordance with one or more formulas. Presently, a member's Required Deposit may be satisfied with a cash deposit, and a portion of a member's Required Deposit may be evidenced by an open account indebtedness secured by Qualifying Bonds and/or one or more irrevocable letters of credit issued under certain guidelines established within NSCC's Rules.<sup>6</sup> Currently, NSCC haircuts the value that Qualifying Bonds receive when used to meet a member's Clearing Fund requirement and will not allow a letter of credit to be used if by doing so more than twenty percent of NSCC's total Clearing Fund would consist of letters of credit issued by that approved letter of credit issuing bank. Each member is entitled to any Clearing Fund interest earned or paid on Qualifying Bonds and cash deposits.

NSCC is modifying its rules to: 1) expand the types of instruments which NSCC may accept as Qualifying Bonds ("Eligible Clearing Fund Securities") securing a member's open account Clearing Fund indebtedness and establish concentration requirements with regard to their use; 2) create a correlating range of haircuts to be applied to these expanded types of Eligible Clearing Fund Securities; and 3) eliminate letters of credit as a generally acceptable form of collateral securing the member's open account Clearing Fund indebtedness.

---

<sup>5</sup> Rule 4 (Clearing Fund), Procedure XV (Clearing Fund Formula and Other Matters), and Appendix 1 (Version 2 of Procedure XV – Limited Applicability).

<sup>6</sup> Mutual Fund/Insurance Service Members are not permitted to use Qualifying Bonds or irrevocable letters of credit to satisfy their Required Deposits.

A. Revised Clearing Fund Components

(1) Cash

The current Clearing Fund minimum cash deposit requirement will remain unchanged: each member must contribute a minimum of \$10,000 with the first forty percent but no less than \$10,000 of a member's Required Deposit being in cash.<sup>7</sup>

(2) Securities

NSCC is replacing the term Qualifying Bonds<sup>8</sup> with a new set of definitions for Eligible Clearing Fund Securities. These securities will be unmatured bonds which are either an Eligible Clearing Fund Agency Security, Eligible Clearing Fund Mortgage-Backed Security, or Eligible Clearing Fund Treasury Security.<sup>9</sup> An Eligible Clearing Fund Agency Security will be defined as a direct obligation of those U.S. agencies or government sponsored enterprises as NSCC may designate from time to time that satisfies such criteria set forth in notices issued by NSCC from time to time. An Eligible Clearing Fund Mortgage-Backed Security will be defined as a mortgage-backed pass through obligation issued by those U.S. agencies or government sponsored enterprises as NSCC may designate from time to time that satisfies such criteria set forth in notices issued by NSCC from time to time. An Eligible Clearing Fund Treasury

---

<sup>7</sup> See supra note 6.

<sup>8</sup> "Qualifying Bonds" is currently defined in Rule 4 as unmatured bonds that are either direct obligations of or obligations guaranteed as to principal and interest by the United States or its agencies.

<sup>9</sup> Initial eligibility criteria for each type of Eligible Clearing Fund Security will be announced to members in an Important Notice prior to the effective date of these proposed rule changes. Any future changes to the eligibility criteria will also be announced to members in Important Notices in advance of such changes becoming effective.

Security will be defined as a direct obligation of the U.S. government that satisfies the criteria set forth in notices issued by NSCC from time to time.

(3) Security Concentration Provisions

NSCC is also establishing security concentration provisions for Clearing Fund deposits. As is currently required, each member must contribute a minimum of \$10,000 with the first forty percent but no less than \$10,000 of a member's Required Deposit being in cash.<sup>10</sup> The remainder of a member's deposit may be secured by the pledge of Eligible Clearing Fund Securities in any combination of Eligible Clearing Fund Treasury Securities, Eligible Clearing Fund Agency Securities, and/or Eligible Clearing Fund Mortgage-Backed Securities, subject to the following two limitations. First, any deposits of Eligible Clearing Fund Agency Securities or Eligible Clearing Fund Mortgage-Backed Securities in excess of twenty-five percent of the member's Required Deposit will be subject to an additional haircut equal to twice the percentage noted in the haircut schedule. Second, no more than twenty percent of a member's Required Deposit secured by pledged Eligible Clearing Fund Agency Securities may be of a single issuer.<sup>11</sup>

(4) Letters of Credit and Other Adequate Assurances

The provisions in NSCC's Rules that pertain to Letter of Credit Issuers are being modified to reflect that letters of credit are no longer a generally accepted form of Clearing Fund

---

<sup>10</sup> See supra note 6.

<sup>11</sup> No member may post as collateral Eligible Clearing Fund Agency Securities for which it is the issuer. However, a member may pledge Eligible Clearing Fund Mortgage-Backed Securities for which it is the issuer subject to a premium haircut. That haircut shall be fourteen percent as an initial matter, and if the member also exceeds the twenty-five percent concentration limit, the haircut shall be twenty-one percent.

collateral.<sup>12</sup> Effective April 1, 2007 (the regular expiration date of letters of credit), members that have letters of credit posted as collateral (other than members, if any, that have been required to post letters of credit for legal risk) will be required to replace the portion of the Clearing Fund collateralized by letters of credit with either cash or Eligible Clearing Fund Securities.

(5) Implementation Timeframes

The foregoing rule changes will become effective thirty days after an Important Notice is issued to members informing them that NSCC's systems are ready to accommodate such changes. The corresponding changes to NSCC's rules will be made at that time. On April 1, 2007, changes pertaining to letters of credit will be made to NSCC's rules.

III. Discussion

Section 19(b) of the Act 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 the rules and regulations thereunder applicable to such organization.<sup>13</sup> Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.<sup>14</sup> The Commission finds that NSCC's rule change is consistent with this requirement because by revising its rules governing the acceptable

---

<sup>12</sup> NSCC has found that in practice letters of credit are not as liquid as cash and securities, and therefore potentially pose more risk to NSCC and its members when accepted by NSCC as Clearing Fund collateral. NSCC will, however, reserve the right to require letters of credit from members in those instances where a particular member has been found, by NSCC in its discretion, to present legal risk.

<sup>13</sup> 15 U.S.C. 78s(b).

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

forms of Clearing Fund collateral deposits to increase the liquidity of its Clearing Fund and to minimize risk to NSCC and its members, the proposed rule change should better enable NSCC to assure the safeguarding of securities and funds in its custody or control or for which it is responsible.<sup>15</sup>

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (File No. SR-NSCC-2006-11) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Florence E. Harmon  
Deputy Secretary

---

<sup>15</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>16</sup> 15 U.S.C. 78s(b)(2).

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