

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50652; File No. SR-NSCC-2004-04)

November 10, 2004

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Order Granting Accelerated Approval on a Temporary Basis of a Proposed Rule Change To Establish a Confirmation and Matching Service for Over-The-Counter U.S. Equity Options Transactions

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> notice is hereby given that on August 13, 2004, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on September 15, 2004, and on October 28, 2004, amended the proposed rule change described in Items I and II below, which items have been prepared primarily by NSCC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change through May 31, 2005.

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

NSCC is seeking to add Addendum M to its Rules and Procedures to establish a confirmation and matching service for over-the-counter (“OTC”) U.S. equity options transactions (“NSCC Equity Options Service”).

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

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

below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

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

Currently, confirmation of trade details among dealers and the dealers' buy-side customers in the OTC equity options industry is supported largely by faxes and telephone communication. It is widely acknowledged by the industry that this current operational infrastructure, which depends upon nonstandard and manual processing, results in excessive processing costs, delays, and errors. The industry is seeking to reduce the attendant operational risks associated with OTC equity options processing by automating the trade confirmation process for OTC equity options.

In response to similar conditions prevailing in the credit default swaps industry, the corporate parent of NSCC, The Depository Trust & Clearing Corporation ("DTCC") created a subsidiary, DTCC Deriv/SERV LLC ("Deriv/SERV"), in 2003. Deriv/SERV currently offers a confirmation and matching service for OTC credit default swaps transactions and their associated cash flows. This service is now used by approximately 30 entities including all of the largest OTC credit default swaps dealers.

Deriv/SERV has developed a confirmation and matching service for OTC equity options transactions and their associated cash flows ("Deriv/SERV Equity Options Service"). The Deriv/SERV Equity Options Service will provide for confirmation and matching either between two OTC equity options dealers or between an OTC equity options dealer and its buy-side customer. Where either the buyer or the seller of an equity option is a U.S. person and the equity

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<sup>2</sup> The Commission has modified the text of the summaries prepared by NSCC.

option is issued by a U.S. issuer (“U.S. Equity Option Transaction”), NSCC will provide confirmation and matching services (“NSCC Equity Options Service”) to Deriv/SERV pursuant to the NSCC/DTCC Deriv/SERV Service Agreement (“Service Agreement”).<sup>3</sup> In connection with the NSCC Equity Options Service, Deriv/SERV will become a Data Services Only Member of NSCC.<sup>4</sup>

The Deriv/SERV Equity Options Service will be operated pursuant to the operating procedures of Deriv/SERV (“Deriv/SERV Operating Procedures”). U.S. Equity Option Transactions will also be subject to NSCC’s proposed Addendum M. Therefore, each user of the Deriv/SERV Equity Options Service will enter into an agreement with Deriv/SERV obligating the user to abide by the terms of the Deriv/SERV Operating Procedures and obligating them to abide by Addendum M for any U.S. Equity Option Transactions. Pursuant to the Service Agreement between NSCC/DTCC and Deriv/SERV, NSCC will have the right to require Deriv/SERV to cause Deriv/SERV’s users to abide by the terms of Addendum M. In addition, pursuant to the Service Agreement, NSCC and Deriv/SERV have agreed that should the Commission request that NSCC provide to the Commission any information relating to the NSCC Equity Options Service, Deriv/SERV will provide any such information in its possession to NSCC so that NSCC may provide such information to the Commission.

NSCC will neither be responsible for the content of the messages transmitted through the NSCC Equity Options Service nor be responsible for any errors, omissions, or delays that may

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<sup>3</sup> DTC has represented that the processing of Deriv/SERV’s transactions will not be a strain on the capacity of DTC’s systems. The host computer and other automated facilities associated with the NSCC Equity Options Service will be provided by DTC pursuant to service agreements between NSCC and DTCC and between DTCC and DTC.

<sup>4</sup> NSCC Rules and Procedures, Rule 31.

occur relating to the NSCC Equity Options Service in the absence of gross negligence on NSCC's part. Both the Service Agreement and the Deriv/SERV Operating Procedures will provide that NSCC has no liability in connection with the NSCC Equity Options Service in the absence of gross negligence on NSCC's part. Because the NSCC Equity Options Service does not involve money settlement, securities clearance, or netting through the facilities of NSCC, it will be a nonguaranteed service of NSCC.<sup>5</sup>

Deriv/SERV will charge its users fees in connection with the Deriv/SERV Equity Options Service and pursuant to the Service Agreement will make payments to NSCC for the services that NSCC is providing. NSCC will file proposed rule changes under Section 19(b) of the Act for fees that NSCC charges to Deriv/SERV for the NSCC Equity Options Service and for any changes made by NSCC to the Equity Options Service.

NSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act<sup>6</sup> and the rules and regulations thereunder because the implementation of

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<sup>5</sup> NSCC offers certain "guaranteed" services through its CNS system in which NSCC acts as a central counterparty and provides settlement-related guarantees regarding certain trades cleared and netted at NSCC. NSCC also offers "nonguaranteed" services, such as NSCC's Mutual Fund and Insurance Processing Services, in which members do not receive the protections of the NSCC guarantee. Some of NSCC's nonguaranteed services entail settlement of funds through NSCC on a nonguaranteed basis (*i.e.*, NSCC's FundSERV® service). Other nonguaranteed services involve the communication of information only without settlement of transactions or funds through the facilities of NSCC (*i.e.*, NSCC's Profile service). The NSCC Equity Options Service is a nonguaranteed service limited to the matching and communication of information and does not involve settlement of securities transactions or funds through the facilities of NSCC. In its Matching Release, the Commission concluded that matching constitutes a clearing agency function, specifically the "comparison of data respecting the terms of settlement of securities transactions," within the meaning of Section 3(a)(23)(A) of the Exchange Act. Securities Exchange Act Release No. 39829 (April 6, 1998), 63 FR 17943 [File No. S7-10-98].

<sup>6</sup> 15 U.S.C. 78q-1.

the proposal will provide for the prompt and accurate clearance and settlement of U.S. OTC equity option transactions processed through the NSCC Equity Options Service by facilitating the transmission of standardized information on a centralized communications platform. This will reduce processing errors, delays, and risks that are typically associated with manual processes.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NSCC does not believe that the proposed rule change will impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

NSCC has not solicited or received any written comments on this proposal. NSCC will notify the Commission of any written comments it receives.

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

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>7</sup> The Commission finds that NSCC's proposed rule change is consistent with this obligation under the Act because the NSCC Equity Options Service should reduce manual processing errors, delays, and risks that are typically associated with U.S. OTC equity option transactions by facilitating the transmission of standardized information on a centralized communications platform for all U.S. OTC equity options processed through it.

NSCC has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after publication of the notice of filing. The Commission

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<sup>7</sup> 15 U.S.C. 78q-1(b)(3)(F).

finds good cause for approving prior to the thirtieth day after publication because by so approving NSCC will be able to implement and firms to begin using the NSCC Equity Options Service before the approaching end of year freeze on systems changes.

The Commission is approving the NSCC Equity Options Service on a temporary basis through May 31, 2005, so that NSCC will have time to evaluate the operations of the service and to report its findings to the Commission before the Commission decides on permanent approval.

#### 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 E-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2004-04 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NSCC-2004-04. 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 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 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 the principal office of NSCC and on NSCC's Web site at [www.nsccl.com/legal](http://www.nsccl.com/legal). 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-2004-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (File No. SR-NSCC-2004-04) be and hereby is approved on an accelerated basis through May 31, 2005.

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. 78s(b)(2).

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