

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 19705 / April 26, 1983

NATIONAL SECURITIES CLEARING CORPORATION ("NSCC")  
File No. SR-NSCC-82-28

ORDER APPROVING PROPOSED RULE CHANGE

On November 29, 1982, NSCC filed with the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §78s(b)(1), (the "Act") and Rule 19b-4 thereunder, a proposed rule change that would permit NSCC to consolidate into a single processing stream the clearance and settlement of exchange-listed and over-the-counter ("OTC") securities transactions in New York City. NSCC currently processes these transactions separately. As discussed in detail below, by approving this proposal, the Commission would allow NSCC to enter "Phase II" of its operations. Notice of the proposed rule change, together with its terms of substance, was given by publication in Securities Exchange Act Release No. 19361 (December 21, 1982), 47 FR 58419 (December 30, 1982). No letters of comment were received.

I. Summary of Events 1/

A. Procedural History

In 1976, NSCC applied for temporary registration as a clearing agency pursuant to Sections 17A(b) and 19(a)(1) of the Act and Rule 17Ab2-1 (17 CFR §240.17Ab2-1) thereunder, and requested that the Commission exempt NSCC from one or more of the determinations that the Commission is directed to make pursuant to Section 17A(b)(3)(A)-(I) of the Act. 2/ NSCC's

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1/ This Order merely highlights certain events concerning NSCC's registration and does not represent a complete record.

2/ Section 17A(b)(1) of the Act requires each clearing agency to be registered with the Commission. Section 17A(b)(3) of the Act states that a clearing agency may not be registered unless the Commission determines that the clearing agency satisfies the requirements of Section 17A(b)(3)(A)-(I)

(Footnote continued on next page)

application for registration proposed the merger of three clearing corporations, The American Stock Exchange Clearing Corporation ("ASECC"), The National Clearing Corporation ("NCC"), and Stock Clearing Corporation ("SCC"). <sup>3/</sup> NSCC suggested that the merger occur in two phases. In Phase I, which was intended to last approximately 120 days, NSCC would operate the three clearing agencies separately and would develop a plan to merge the systems. Once the Commission approved the merger plan, SIAC would become NSCC's facilities manager to process all transactions. "Phase II" was to begin when the merger plan was approved. In accordance with Section 19(a)(1) of the Act, the Commission

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(Continued footnote)

(the "Requirements"). The Commission, however, has the authority under Section 17A(b)(1) of the Act to grant a registered clearing agency an exemption from one or more of the Requirements. Pursuant to this authority, the Commission has adopted Rule 17Ab2-1(c)(1) (17 CFR §240.17Ab2-1(c)(1)), Securities Exchange Act Release No. 11787 (November 3, 1975), 40 FR 52356 (November 10, 1975)), which provides that a clearing agency may request the Commission to grant it registration but to exempt it from one or more of the Requirements. Registration granted in that form is effective only for eighteen months, or such longer period as the Commission may order ("temporary registration"). Following NSCC's application for temporary registration under Rule 17Ab2-1(c)(1), the Commission determined that NSCC satisfied, or was exempt from satisfying, a number of the Requirements and, as discussed in more detail below, granted NSCC temporary registration. See 42 FR at 3922, discussed at note 7, infra. The Commission has extended by order NSCC's and other applicant clearing agencies' temporary registrations until September 30, 1983, (see Securities Exchange Act Release No. 18584 (March 22, 1982), 47 FR 13266 (March 29, 1982)) and is currently concluding proceedings to determine whether all applicant clearing agencies should be fully registered. See also note 11, infra.

<sup>3/</sup> In general, ASECC was owned by, and cleared transactions executed on, the American Stock Exchange, Inc. ("Amex"); NCC was owned by the National Association of Securities Dealers ("NASD") and cleared OTC transactions; and SCC was owned by, and cleared transactions executed on, the New York Stock Exchange, Inc. ("NYSE"). Under the merger plan, NSCC was to be owned equally by the Amex, NASD, and NYSE. The facilities manager for ASECC and SCC was the Securities Industry Automation Corporation ("SIAC"), owned 2/3 by the NYSE and 1/3 by the Amex. The facilities manager for NCC was Bradford National Clearing Corporation ("BNCC"), a subsidiary of Bradford National Corporation ("Bradford").

published notice of the application in the Federal Register, requesting that interested persons submit pertinent written data, views, and arguments. 4/

Because of the importance of NSCC's registration to the Commission's efforts to foster the development of a national market system 5/ and a national system for the safe and efficient clearance and settlement of securities transactions (the "National System"), 6/ and because of the extensive written data, views, and arguments submitted in response to the Commission's request for comments, the Commission instituted proceedings to explore further the issues raised by NSCC's application. Toward that end, the Commission provided an opportunity for oral presentation of data, views, and arguments regarding NSCC's application on June 16-18, 1976. At the conclusion of those hearings and in accordance with the requirements of the Act, the Commission temporarily registered NSCC, subject to several terms, conditions, and directives. 7/

#### B. The Registration Order

The Registration Order reviewed NSCC's application in light of the requirements of the Securities Acts Amendments of 1975 ("1975 Amendments"), in which Congress directed the Commis-

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4/ Securities Exchange Act Release No. 12274 (March 29, 1976), 41 FR 14455 (April 5, 1976).

5/ Section 11A(a)(2) of the Act.

6/ Section 17A(a) of the Act.

7/ Securities Exchange Act Release No. 13163 (January 13, 1977), 42 FR 3916 (January 21, 1977), National Securities Clearing Corporation, Order Granting Registration and Statement of Reasons, File No. 600-15 (the "Registration Order"). Two subsidiaries of Bradford subsequently petitioned the United States Court of Appeals for the District of Columbia Circuit for a review of the Commission's decision granting temporary registration to NSCC. The court affirmed the Commission's decision, but remanded certain issues for fuller explanation by the Commission. Bradford National Clearing Corporation et al. v. Securities and Exchange Commission et al., 590 F.2d 1085, 1111 (D.C. Cir, 1978). In response to the remand, the Commission issued a final order addressing the issues remanded by the court. Securities Exchange Act Release No. 17562 (February 20, 1981), 22 SEC Docket 129 (1981), as referenced by 46 FR 14244 (February 26, 1981) ("Remand Order").

sion to foster the development of a National System. 8/ The Commission determined that granting NSCC's application for temporary registration was critical to the establishment of the National System and accordingly approved NSCC's application, including the two phase merger proposal. In accordance with Section 17A(b)(3) and Rule 17Ab2-1(c)(1), the Commission determined that (i) NSCC was so organized and had the capacity to safeguard securities and funds in its control or for which it was responsible; (ii) NSCC's rules did not impose any schedule of prices or fix rates for services rendered by participants; and (iii) NSCC's rules assure the safeguarding of securities and funds which were in its custody or control or for which it was responsible. 9/ The Commission stated its intention, however,

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8/ See supra, note 6.

9/ The Registration Order provides at 42 FR 3927 that the Commission would review these determinations with respect to the consolidated system before permitting NSCC to begin Phase II. As discussed infra, the Commission has carefully monitored NSCC and expressly reaffirms its findings that NSCC and its rules insure the safeguarding of securities and funds, and that NSCC does not fix participants' prices. See note 19 infra for discussions of NSCC's price schedule and choice of facilities manager. See also File No. SR-NSCC-82-5, Securities Exchange Act Release No. 18744 (May 17, 1982), 47 FR 22265 (May 21, 1982) (financial protections and applicant and participant standards for broker-dealers) modified by File No. SR-NSCC-82-16, Securities Exchange Act Release No. 18417 (August 23, 1982), 47 FR 37990 (September 16, 1982); File No. SR-NSCC-82-13, Securities Exchange Act Release No. 19191 (October 29, 1982), 47 FR 50597 (November 8, 1982) (applicant and participant standards for banks); File No. SR-NSCC-81-7, Securities Exchange Act Release No. 19230 (November 10, 1982), 47 FR 51969 (November 18, 1982) (clearing fund requirements for bank participants).

As discussed supra at note 2, the Commission currently is determining whether NSCC satisfies all of the Act's Requirements and should be granted full registration in accordance with Rule 17Ab2-1(c)(2) (17 CFR §240.17Ab2-1(c)(2)).

to monitor carefully the effect of NSCC's registration on the National System and the securities industry and reserved the right during Phase I to reverse or to modify substantially its decision to register NSCC temporarily. Furthermore, the Registration Order provided that NSCC could not begin Phase II until NSCC met certain substantial conditions summarized below: 10/

1. NSCC was required to establish full interfaces with the Midwest Clearing Corporation ("MCC"), the Pacific Clearing Corporation ("PCC"), and the Stock Clearing Corporation of Philadelphia ("SCCP") without charging a fee to those clearing corporations, their participants, or to NSCC's participants for using the interfaces (the "Free Interface Condition"); 11/
2. NSCC was required to provide, at cost, efficient facilities through which a broker or dealer located outside of New York City, either directly or through an agent, including a registered clearing corporation, could compare Amex, NYSE, and OTC transactions eligible for comparison at NSCC (the "Remote Comparison Condition");
3. NSCC was required to permit competing clearing corporations to use NSCC's branch network, provided they agreed to pay a proportionate share of the network's operating costs (the "Common Branch Facility Condition"); and
4. NSCC was required to furnish to any requesting clearing corporation, without charge, computer programs for OTC trade comparison. In addition, the comparison of all OTC transactions between participants in two different clearing agencies was required to be performed by one clearing agency at no charge to the other clearing agency. If no other clearing agency was willing to operate the "national" OTC comparison service, NSCC was required to compare all OTC transactions between participants in different clear-

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10/ 42 FR 3929-3935 and 3938. A number of minor conditions contained in the Registration Order have been omitted from this summary.

11/ NSCC also was directed to establish appropriate free links with the Boston Stock Exchange Clearing Corporation ("BSECC") and the now-deregistered TAD Depository Corporation ("TAD"). BSECC is now linked with, and is a participant in, NSCC. TAD's deregistration was ordered by the Commission in Securities Exchange Act Release No. 18583 (March 22, 1982), 47 FR 13262 (March 29, 1982).

ing agencies without separate charge to participating clearing agencies (the "OTC Comparison Condition"). 12/

C. Modifications of the Registration Order

After the Commission issued the Registration Order, NSCC began its Phase I operations and developed plans for Phase II. The Commission, pursuant to its general oversight authority under the Act and in accordance with the specific directives of the Registration Order, monitored NSCC's operations and services, as well as NSCC's effects on other clearing agencies and on the securities industry as a whole. This oversight was accomplished, among other things, through the Commission's review of numerous proposed rule changes filed by NSCC and other clearing agencies, pursuant to Section 19(b) of the Act and Rule 19b-4 (17 CFR §240.19b-4) thereunder, the review of notices sent by the clearing agencies to their participants and filed with the Commission according to Rule 17a-22 (17 CFR §240.17a-22), and the inspection of NSCC's activities.

In September 1978, then Chairman Williams told NSCC in a letter that NSCC could terminate its contract with BNCC for facilities management of the OTC processing stream, and instead, could process OTC trades through SIAC. The letter stipulated, however, that exchange-traded and OTC processing streams would have to remain separate. 13/ The letter further stated that, based on the Commission's monitoring of NSCC, other clearing agencies and the securities industry, the Commission concluded

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12/ The OTC Comparison Condition further provided that a clearing agency that did not wish to compare OTC transactions executed between its participants could contract with another clearing agency for those services to be performed for a fee. Registration Order at note 175. SIAC, as NSCC's facilities manager, now performs all OTC trade comparison services for MCC, PCC, and SCCP. Securities Exchange Act Release No. 18277 (November 20, 1981), 45 FR 58239 (November 30, 1981), approving File Nos. SR-MCC-81-7, SR-PCC-81-2, and SR-SCCP-81-6. We understand that, in connection with operating NSCC's national OTC comparison system, NSCC does not charge a fee beyond the facilities management costs it incurs for operating that program for the participating clearing agencies. Those arrangements, negotiated by the participating clearing agencies, appear to be consistent with the Registration Order.

13/ Letter from the Honorable Harold M. Williams, former Chairman, Securities and Exchange Commission, to Mr. Jack Nelson, President, NSCC, September 13, 1978, at 1.

that NSCC "ha[d] satisfied all of the conditions to its registration except for the installation of listed clearing in its branch offices, which ha[d] been delayed by request of the staff." 14/ The letter also cautioned NSCC not to proceed further toward Phase II pending a resolution of Bradford National Clearing Corporation et al. v. Securities and Exchange Commission et al., supra.

Six days after the Chairman's letter was sent, the Court of Appeals for the District of Columbia affirmed the Registration Order. 15/ The court, however, criticized the Commission's reasoning on two issues and remanded both "for further study and explication." 16/ To assist the Commission's study, the Commission issued a release requesting public comment on a list of questions and published a letter to NSCC, asking NSCC to comment on the questions. The letter also provided that NSCC had to observe the conditions in the Registration Order but was released from any other conditions, such as those included in the Chairman's letter of September 13, 1978. Because of this release, NSCC developed and offered to its participants through the branch network merged exchange-listed and OTC clearance and settlement services. The letter, however, also imposed several additional restrictions on NSCC, including a provision that precluded NSCC from offering exchange-listed and OTC processing through a single account in New York City. 17/

The Commission issued the Remand Order when it finished its study. 18/ The Remand Order reaffirmed NSCC's temporary

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14/ Id., at 4.

15/ 590 F.2d at 1111.

16/ Id. The issues remanded were the Commission's approval of: (i) NSCC's pricing policy under which NSCC charges participants the same basic fees for transactions compared, cleared, and settled through its branch network as for transactions compared, cleared, and settled through its New York City facility ("Geographic Price Mutualization" or "GPM"); and (ii) NSCC's selection, without competitive bidding, of SIAC as facilities manager of NSCC's system.

17/ Securities Exchange Act Release No. 15640 (March 14, 1979), 44 FR 17838 (March 23, 1979), including a letter from the Honorable Philip A. Loomis, Jr., Commissioner, to Mr. Jack P. Nelson, President, NSCC, March 15, 1979. See also File No. SR-NSCC-79-11 approved by Securities Exchange Act Release No. 16213 (September 21, 1979), 44 FR 56082 (September 28, 1979).

18/ See note 7 supra.

registration and explained in greater detail the Commission's approval of NSCC's use of Geographic Price Mutualization and NSCC's choice of SIAC as facilities manager. The Remand Order also imposed two additional requirements on NSCC. 19/

## II. NSCC's Rationale for the Proposed Rule Change

As noted above, the proposed rule change would permit NSCC to consolidate the clearance and settlement of exchange-listed and OTC transactions in New York City and would signify that NSCC's operational consolidation has reached Phase II. In its filing, NSCC states that, for several reasons, the proposal would facilitate the prompt and accurate clearance and settlement of securities transactions and would reduce direct and indirect processing costs for NSCC's participants.

First, under the current scheme, if a New York participant has an open long position in an exchange-listed security issue and an open short position in the same issue that was established by the participant in the third market, the participant is required to (i) arrange for two separate securities movements to settle these trades, one for the exchange-listed obligation and another for the off-board obligation; and (ii) pay two separate fees for those two movements. Under the proposed rule change, these positions would be netted, and, in general, would result in the complete elimination of the positions or in a single smaller net long or short position. Consequently, any net position could be satisfied by a smaller movement of securities for one fee, rather than two larger movements for two fees. Second, the proposal also may reduce the size of NSCC participants' clearing fund contributions because that

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19/ NSCC was required to submit a new fee schedule supporting NSCC's representation that it would operate each branch office only as long as that office produced revenues sufficient to cover operating costs. NSCC submitted such a fee schedule to the Commission pursuant to Section 19(b)(3)(A) of the Act. File No. SR-NSCC-81-16, Securities Exchange Act Release No. 18327 (December 11, 1981), 46 FR 61379 (December 16, 1981).

NSCC also was required to submit a report explaining how NSCC had decided to conduct its clearing operations. NSCC filed this report, as prepared by NSCC's independent public accountants, and the Commission published notice of the report's contents as "Notice of Submission of Report Evaluating Facilities Management Alternatives By NSCC," File No. S7-916, Securities Exchange Act Release No. 18296 (December 1, 1981), 46 FR 60082 (December 8, 1981).



contribution is calculated by reference to each participant's open long and short positions. 20/ Third, whenever the netting process eliminates a participant's short position under the proposed rule change, that participant cannot be subject to any potential buy-in liability. 21/

### III. Discussion

The Commission stated in the Registration Order that the National System, among other things, should provide participants with the ability "to compare, account for, and settle through one entity all trades in securities included in the [National System, regardless of the location of the other party to the trade or the market in which the trade is executed ('one account processing')." 22/ The Commission continues to believe that one account processing, which would be enhanced for NSCC's participants by the proposed rule change, is an important element of the National System. 23/

In addition, the Commission believes that NSCC correctly has identified significant operational reasons for approving this proposal. 24/ Accordingly, we believe the proposed rule change is consistent with, and in furtherance of, the purposes of the Act because it would reduce costs and improve efficiencies for NSCC and its participants.

Approval of the proposal would permit NSCC to enter Phase II of its temporary registration. As discussed above,

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20/ See NSCC Rule 4 and NSCC Procedures, XIV.

21/ Notwithstanding those benefits, the proposal also would permit NSCC to maintain separate exchange-traded and third market processing streams for participants that so desired.

22/ 42 FR at 3920 (footnotes omitted).

23/ The Commission also continues to believe that:

while a participant should be able to obtain one account processing through one clearing entity, the participant should be able also . . . to compare trades through the clearing entity affiliated with the marketplace in which the trade was executed and direct delivery of the compared trade to the clearing entity the participant selects to perform the accounting [i.e., clearing] operation.

Id. at 3921.

24/ See supra at Section II of this Order.

the Commission's continuous and close monitoring of NSCC and its effects on the securities industry has led the Commission to conclude that NSCC has satisfied, or with approval of this proposal, will be in compliance with the conditions precedent to Phase II. 25/ Moreover, the Commission is not aware of any reason for delaying further the beginning of Phase II. The non-New York clearing agencies currently offer their participants the consolidated clearance and settlement processing that NSCC seeks to provide. Thus, this Order will not provide NSCC with a unique service, but merely will permit it to experience the efficiencies already enjoyed by competing non-New York clearing agencies. At the same time, because the proposed rule change is only applicable to consolidated processing at NSCC's New York City office, 26/ it will enable NSCC's New York City participants to realize the economies associated with consolidated secondary trade clearance and settlement processing. Finally, based on the Commission's experience, the Commission believes that the non-New York clearing agencies generally find it uneconomical to compete directly for the secondary trade clearance and settlement business of New York broker-dealers 27/ and that, as a result, clearing agency competition should not be affected by the rule change.

Although the Commission is allowing NSCC to enter Phase II, the Commission emphasizes that, under this Order, the terms, conditions, and directives of the Registration Order, as modified by the Remand Order and other Commission letters, releases, or actions, remain in effect to the extent practicable. 28/

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25/ Pursuant to the Remand Order, NSCC is permitted to operate its branch offices only to the extent that each office produces revenues sufficient to cover the cost of that branch's operation. The Commission continues to monitor, in a proceeding separate from this order, the relationship between branch office costs and branch office revenues, and in that setting will take whatever steps are necessary to ensure the continued fulfillment of that condition to NSCC's registration.

26/ As noted, NSCC has offered merged processing in its branch facilities at Geographically Mutualized Prices for several years. See supra at notes 16 and 17.

27/ See discussion in the Remand Order.

28/ For example, NSCC continues to be required to provide free interfaces to other registered clearing agencies in accordance with the terms of the Registration Order. See

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The Commission continues to believe that these terms, conditions, and directives are beneficial to the development of the National System and intends (i) to continue to monitor NSCC and its impact on broker-dealers, banks, other clearing agencies and the securities markets; and (ii) to amend, modify, or expand the terms, conditions, and directives in NSCC's registration whenever the Commission deems such modifications necessary or appropriate, in accordance with the requirements of the Act.

Accordingly, IT IS THEREFORE ORDERED, pursuant to Section 19(b) of the Act, that the proposed rule change (SR-NSCC-82-28) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation pursuant to delegated authority.

George A. Fitzsimmons  
Secretary

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(Continued footnote)

also Securities Exchange Act Release No. 18823 (June 23, 1982), 47 FR 28512 (June 30, 1982), approving File No. SR-MCC-82-8 and SR-MSTC-82-11, which indicated at note 7 that the "Commission generally has required that the interface costs incurred by each interfacing clearing member . . . be absorbed by that interfacing clearing agency and mutualized across its own participant base." The Registration Order, as supplemented by Release No. 18823, thus contemplated that the free interface requirement for clearing corporations would be a central characteristic of the National System.

Of course, the Commission recognizes that some requirements imposed on NSCC during the course of NSCC's temporary registration have become obsolete. For example, NSCC no longer can establish appropriate links with TAD since TAD has been dissolved and is not registered with the Commission as a clearing agency. See supra at note 11.

SEC NEWS DIGEST  
SELF-REGULATORY ORGANIZATIONS

NOTICE OF APPROVAL OF PROPOSED RULE CHANGE

The Commission has approved a proposed rule change (SR-NSCC-82-28) filed by the National Securities Clearing Corporation ("NSCC") permitting NSCC to consolidate into a single processing stream the clearance and settlement of exchange-listed and over-the-counter securities transactions in New York City. The Commission determined that the proposal is in accordance with the Commission's order granting temporary registration to NSCC. (Release No. 34-19705)