

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57813; File No. SR-NSCC-2007-12]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Order Granting Approval of a Proposed Rule Change To Provide a New Alternative Investments Products Service

May 12, 2008.

#### I. Introduction

On July 17, 2007, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on February 19, 2008, amended proposed rule change SR-NSCC-2007-12 pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>1</sup> Notice of the proposal was published in the **Federal Register** on March 17, 2008.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### II. Description

NSCC is establishing a new Alternative Investment Products service (“AIP Service”), a processing platform for alternative investment products such as hedge funds, funds of hedge funds, commodities pools, managed futures, and real estate investment trusts (“REITs”).

##### (1) Summary of AIP Service

The AIP Service will provide for processing of information relating to transactions in alternative investment products and for settlement of related payments (“AIP Payments”). It will facilitate, among other things, processing activities such as subscriptions and redemptions, distributions, position reporting, and account maintenance. Activities that will be supported by the AIP Service are more fully described below in the section titled “Scope of AIP Service.”

Settlement of AIP Payments through NSCC will be done on a prefunded basis. NSCC will simply pass-through AIP Payments from AIP members to the contraside AIP members without netting or without guaranteeing payment in the event of contraside default. NSCC will not be liable to make payment to an AIP member in the event of a default in payment by the contraside AIP member. Settlement of AIP Payments (“AIP

Settlement”) will be segregated from all other money settlements at NSCC. NSCC will have no exposure to credit risk as a result of the operation of the AIP Settlement. AIP Settlement is more fully described below in the section titled “AIP Settlement.”

Participation in the AIP Service will be governed by NSCC’s Rules and procedures applicable to the AIP Service. Each user of the AIP Service (“AIP Member”) will be required to enter into an AIP membership agreement with NSCC that will govern its use of the AIP Service. Entities eligible for membership will include entities subject to regulation under U.S. federal or state laws such as registered broker-dealers, investment advisers, banks, and insurance companies. Because of the unique processing and distribution features of alternative investment products and because NSCC will have no exposure to the credit risk of AIP Members and will have no liability to make payments in the event of an AIP Member’s AIP Settlement default, entities that are not required to register under applicable U.S. federal or state law and entities organized under applicable law outside of the U.S. will also be eligible to become AIP Members. Membership in the AIP Service is more fully described below in the section titled “AIP Members.”

NSCC developed the concept and functionality for the AIP Service at the request of and in consultation with industry participants, many of which were NSCC members using other NSCC services. Some of these interested parties committed to become pilot subscribers to the proposed AIP Service and committed to assist NSCC in funding the launch of the AIP Service. These parties are more fully described below in the section titled “AIP Pilot Group.”

##### (2) Alternative Investment Products

Alternative investment products are typically illiquid, pooled investment products that are exempt from registration under the Security Act of 1933 and the Investment Company Act of 1940 and that are offered through private placements to high net worth individuals and institutional investors such as pension funds.

Alternative investment products may be placed and held by an end investor through a direct relationship with the issuer or manufacturer of an alternative investment product (called the “AIP Manufacturer” for purposes of NSCC Rules) or through an entity acting on behalf of an issuer or manufacturer. They may also be placed and held through a distribution channel such as

a registered broker-dealer that facilitates transactions as a processing counterparty to the AIP Manufacturer (called the “AIP Distributor” for purposes of NSCC Rules). Alternative investment products are not generally traded in the secondary market. In this respect, the distribution for alternative investment products is similar to the distribution of mutual funds on NSCC’s Fund/SERV system. Alternative investment products have processing characteristics and risk profiles that differ from those of mutual funds, and those differences have been taken into account and reflected in the functionality of the AIP Service and in NSCC Rules and procedures.

Increasingly, investors and their advisers are including alternative investment products as part of their portfolios. The alternative investment products market currently represents over \$1 trillion in assets and continues to grow. Despite the large asset base, processing remains extremely manual using methods such as delivery of hard-copy documents, transmission of information by fax, e-mail messages and spreadsheets, and telephone calls. The lack of automation and standardized, centralized processing is inefficient, prolongs transaction processing time, results in high costs per transaction, and increases the likelihood of errors—factors that increase in importance as the volume of transactions in alternative investment products continues to increase as it has in recent years.

##### (3) AIP Pilot Group

Accordingly, several industry participants (many of which were members of NSCC) approached NSCC to explore whether NSCC could bring automation and standardization to the alternative investment product market analogous to that which NSCC’s Mutual Fund Services has provided to the mutual fund market. Mutual funds and alternative investment products frequently share similar distribution channels and are frequently both included in an investor’s portfolio for which a financial intermediary consolidates asset reporting and servicing.

NSCC solicited its members to assess industry interest. A pilot group of interested broker-dealers, alternative product manufacturers, and fund administrators was formed to determine the feasibility of NSCC providing such a service and if feasible to assist in the development of the business requirements and functional specifications for such a service. Some members of the pilot group committed to assist in the costs of development of such a service through payment of a

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

<sup>2</sup> Securities Exchange Act Release No. 57461 (March 10, 2008), 73 FR 14294.

fixed amount that would be applied to their respective usage fees when the service was in production. Consistent with this commitment to support the costs developing and implementing the service, NSCC agreed to consult with the members of the pilot group in refining and enhancing the necessary functionality for the service. The functionality for the initial scope of the AIP Service is described below in the section titled "Scope of AIP Service."

#### (4) Eligible AIP Products

Alternative investment products that can be processed through NSCC's AIP Service ("Eligible AIP Products") will initially include the types of products referenced above (*i.e.*, hedge funds, funds of hedge funds, commodities pools, managed futures, and REITs). Additional products could be added in the initial phase or from time to time as requested by industry participants and as approved by NSCC.<sup>3</sup> Eligible AIP Products may include those registered with the Commission and those not required to be registered. When an AIP Manufacturer submits an alternative investment product for processing through the AIP Service, pursuant to NSCC rules and procedures, it represents and warrants to NSCC that the offer and sale of the investment product complies with applicable law.

#### (5) AIP Members

The following types of entities will be eligible to become AIP Manufacturers or AIP Distributors:

(i) A broker-dealer registered under the Exchange Act or a non-US broker-dealer subject to regulation by the appropriate financial services regulator in its home jurisdiction;

(ii) A bank or trust company under supervision of federal or state banking authorities or a non-US bank subject to regulation in its home jurisdiction;

(iii) An investment company registered under the Investment Company Act or an issuer (structured as a fund or other pooled investment vehicle) that is not required to register thereunder;

(iv) An investment adviser as defined under the Investment Advisers Act of 1940 regardless of whether it is registered under the Investment Advisers Act or is exempt from registration;

(v) A commodity pool operator or commodity trading advisor as defined in the Commodity Exchange Act regardless of whether the commodity pool operator or commodity trading advisor is registered pursuant to the Commodity Exchange Act or is exempt from registration thereunder;

(vi) An insurance company regulated under state insurance law or a non-US insurance company subject to regulation by the appropriate insurance regulator in its home jurisdiction;

(vii) An AIP Manufacturer that is an entity engaged under contract to provide administrative services to one or more Eligible AIP Products; or

(viii) An entity that does not qualify as one of the above entities but that has demonstrated to the Board of Directors of NSCC that its business and capabilities are such that it could reasonably expect material benefit from direct access to the AIP Service.

Because AIP Settlement will be prefunded and because NSCC will be insulated from exposure to the credit risk of AIP Members and will have no liability to make payments in the event of an AIP Member's AIP Settlement default, there are no financial requirements for participation in the AIP Service. Members will be required to meet NSCC's operational requirements and general standards applicable to competency for membership and to meet such other requirements as NSCC may establish from time to time.<sup>4</sup>

#### (6) Scope of AIP Services

The AIP Service will support communication of information and settlement of AIP Payments between AIP Manufacturers and the AIP Distributors in order to facilitate the processing of subscriptions and purchases, tenders and redemptions, dividends and distributions, commissions and fees, position reporting, product information, account maintenance, automated transmission of imaged documents, and such other actions as NSCC may determine from time to time. The AIP Service will provide AIP Members with the ability to transmit data in connection with transactions whether the payments are made outside of NSCC or through the AIP Service.

As with all NSCC services, NSCC will not be responsible for the completeness or accuracy of data transmitted through the AIP Services or for any errors,

omissions, or delays which may occur in the absence of gross negligence on the part of NSCC.

Fees for the use of the AIP Service have not yet been established and will be the subject of a subsequent proposed rule change filed under section 19(b)(3)(A) of the Act if this proposed rule filing is approved.

#### (7) AIP Settlement

AIP Settlement will be in same day funds over fedwire and will be segregated from all other settlement payments at NSCC. Unless otherwise provided by NSCC, AIP Members will be required to appoint a settling bank ("AIP Settling Bank") for purposes of settlement similar to NSCC settlement procedures for its other money settlements.

NSCC will maintain credit balances and debit balances for each AIP Member to which NSCC will post gross credits and gross debits for settlement on the date designated for settlement by the AIP Member ("Settlement Date"). AIP Settlement will be on a gross basis meaning that the credit balance of an AIP Member will not be netted against its debit balance. If NSCC does not receive funds from an AIP Member in the amount of the debit balance by the requisite time on the Settlement Date, NSCC will reduce the corresponding settlement credit balances of the AIP Members that are the contrasides to the AIP Member that did not pay its gross debit balance. Nonpayment of a debit balance will not be deemed a payment default under NSCC Rules, but NSCC may establish fees for late payment or nonpayment and may establish a threshold number of instances of late payment or nonpayment which would result in other sanctions, including NSCC's ceasing to act for such an AIP Member.

After receipt of an AIP Member's debit balance from the AIP Member's AIP Settling Bank on Settlement Date, NSCC will transfer to the AIP Settling Bank(s) of the contraside AIP Member(s) the settlement credit balance(s). NSCC's payment will include gross credit balances which may have been reduced to reflect the reversal of any credits with respect to debit balance amounts that were not paid by a contraside AIP Member.

Use of NSCC's AIP Service will provide the alternative investment product industry with the ability to process transactions and to settle funds on a centralized, fully redundant platform that will provide more robust business continuity in the event of interruption to processing on a primary system, better audit trails on

<sup>3</sup>Due to the nature of alternative investment products, NSCC retains the right to refuse to process a specific product or type of product through the AIP Service or to require that a product or type of product no longer be processed through the AIP service if NSCC deems it to be in the interests of NSCC and its members to do so.

<sup>4</sup>NSCC's general standards applicable to competency are designed to screen for any action or condition of an applicant or member that could in the judgment of NSCC present undue risk to NSCC or its members.

transactions, lower costs, and fewer errors and delays than is currently the case.

Settlement on the basis of gross debits and gross credits without offsets insulates NSCC from any financial risks associated with Eligible AIP Products and AIP Members. Because NSCC's obligation to pay a credit balance will be conditioned upon receipt by NSCC of the debit balance from the contraside AIP Member, NSCC will not bear the risk that an AIP Member may default at settlement.

#### (8) AIP Document Transmission

The AIP Service will automate the transmission of imaged hard-copy documents ("paper workflow") between AIP Manufacturers and AIP Distributors. The alternative investment industry has a number of investment instruments that are private or are traded outside of the normal processes and that require the exchange of documentation. It is not untypical for the parties to exchange up to forty pages of hard-copy documents. Subaccount documentation is typically sent for both initial and subsequent subscriptions, depending on the requirements of the alternative investment product, and for tender offers. The paper workflow component of the AIP Service will allow parties to scan and to convert documents to a file format such as portable document format ("PDF") file for transmission with or without a pending transaction message.

#### (9) Proposed Changes to NSCC Rules

A new Rule 53, "Alternative Investment Product Services and Members," will be added to NSCC's Rules, and additional confirming changes will be made elsewhere throughout NSCC's Rules as needed to provide consistency with the new Rule 53.

### III. Discussion

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to remove impediments to and to perfect the mechanism of a national system for prompt and accurate clearance and settlement of securities transactions.<sup>5</sup> By facilitating the transmission of standardized information for alternative investment products on a centralized communications platform and by automating money settlements through a centralized facility in the same day funds, the AIP Service will provide increased efficiencies and reduced risks that are typically associated with the

current alternative investment products processing. As such, the proposed changes will help remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.

### 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.<sup>6</sup>

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NSCC-2007-12) be and hereby is approved.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>7</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57806; File No. SR-Phlx-2008-34]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Consolidating Into a Single Rule Certain Requirements for Products Traded on the Exchange Pursuant to Unlisted Trading Privileges

May 9, 2008.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 5, 2008, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been substantially prepared by the Exchange. This order provides notice of the proposed rule change and approves the proposal on an accelerated basis.

<sup>6</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>7</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b-4.

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

The Exchange proposes to amend its rules to consolidate into a single rule certain requirements for products traded on the Exchange pursuant to unlisted trading privileges ("UTP") that have been established in various new products proposals previously approved by the Commission. The text of the proposed rule change is available at the Exchange's principal office, on the Exchange's Web site ([www.phlx.com](http://www.phlx.com)), and at the Commission's Public Reference Room.

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

In its filing with the Commission, Phlx 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 III below. Phlx 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

##### 1. Purpose

The Exchange proposes to amend its rules to consolidate into a single rule certain requirements for products traded on the Exchange pursuant to UTP. Many of these products have been established in various new products proposals previously approved by the Commission. The Exchange proposes to amend Phlx Rule 803 to set forth a new rule, Phlx Rule 803(o), regarding the extension of UTP to an NMS stock that is listed on another national securities exchange. Any such security will be subject to all Exchange trading rules applicable to NMS stocks, unless otherwise noted. The Exchange will file with the Commission a Form 19b-4(e) with respect to any such security that is a "new derivative securities product" ("NDSP") as defined in Rule 19b-4(e) under the Act.<sup>3</sup> In addition, any NDSP traded on the Exchange pursuant to proposed Phlx Rule 803(o) will be subject to the following criteria.

Proposed Phlx Rule 803(o)(2)(A) provides that the Exchange will distribute an information circular prior to the commencement of trading in such

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

<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(F).