

NASD Notice to Members 98-40

Nasdaq To Incorporate Trade Acceptance And Reconciliation Service Into Automated Confirmation Transaction Service

Suggested Routing

- ☒ Senior Management
- ☐ Advertising
- ☐ Continuing Education
- ☐ Corporate Finance
- ☐ Executive Representatives
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- ☐ Institutional
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Executive Summary

In the third quarter of 1998, The Nasdaq Stock MarketSM (Nasdaq[®]) will discontinue the Trade Acceptance and Reconciliation ServiceSM (TARSSM) and will incorporate its functionality into the Automated Confirmation Transaction ServiceSM (ACTSM). ACT will be significantly enhanced as part of this ACT/TARS migration project. The key features are as follows:

- ACT will electronically capture all As-Of paper Form T entries for a period of up to one year.
- ACT will provide a new Step-Out transaction indicator to allow members to flag Step-Out clearing entries that are submitted into ACT for comparison, clearance, and settlement through the National Securities Clearing Corporation (NSCC).
- ACT will allow for a new Give-Up Lock-In feature to reduce the number of entries required to automatically compare trades between executing and/or introducing brokers and their Give-Up correspondents.

Questions regarding this *Notice* should be directed to Benjamin Sang, Assistant Director, Nasdaq Product Development, at (212) 858-4313, or Peter Forte, Manager, Nasdaq ACT Operations, at (203) 385-6244.

Background

TARS began in June 1989 as a system for all reconciliation activity involving the OTC equity comparison process. In the current TARS system, each participant can view all NSCC trade contracts through TARS. Participants can submit As-Of trades for settlement or can withhold settlement on existing trades for a period of up to three years. If a participant submits a transaction on a demand basis, the contra must

respond with a confirmation; otherwise, the transaction will be automatically locked-in by NSCC. However, since there had been comparatively low reconciliation activity in TARS, Nasdaq worked in conjunction with NSCC to optimize the trade comparison and reconciliation process. As a result, certain outdated functionality was eliminated, and by rolling the other functionality into ACT, Nasdaq is able to reduce the cost associated with supporting TARS as a separate and distinct system.

TARS Replacement

As part of Nasdaq's cost-savings effort, TARS will be discontinued as an independent service, and will be incorporated as a part of ACT. All of the functionality of TARS will be present in the revised ACT service, with these alterations:

- Participants will be able to enter As-Of Trades and As-Of Trade Reversals (T-1 to T-N) for a period of up to one year.
- NSCC will be the sole source of contract sheet information since this TARS functionality will not be available in ACT.
- In order for clearing firms to reconcile trades on behalf of their correspondents, they must execute an Attachment II (Give-Up) for each executing correspondent.

ACT As-Of Trades

The As-Of trade entry function will allow the subscriber to enter the trade date for an As-Of trade for a period of up to one calendar year. All As-Of trades that are entered for clearing are subject to matching/comparison with the contra. These trades will be eligible for nightly M2 matching via the ACT batch cycle.

The ACTII entry time window will be extended from 1:30 p.m. to 5:15 p.m. ACT will no longer perform an on-line M2 match in the afternoon of the second day; instead, the M2 match will only be performed at the end of the entry day. All As-Of trades that remain open on the afternoon (2:30 p.m.) of the second day after the trade was entered will be automatically locked-in by ACT. As-Of trades that are submitted against non-ACT participants will be submitted to NSCC as one-sided entries at the end of the entry day.

As-Of trades will be included in ACT's risk management calculations and will be subject to Blockbuster and Sizable Trade processing.

New System Feature: ACT As-Of Trade Reversals

The revised ACT will introduce a new reversal function to allow participants to cancel the effects of a prior trade submission to NSCC. This function will replace the current TARS "withhold" and "demand withhold" functions.

The As-Of trade reversal will be subject to the same rules as the previously described As-Of trade-entry function. The participant will need to reverse the side of the trade when submitting an As-Of trade reversal into ACT. For example, if the subscriber wishes to cancel a previously submitted sell trade, the subscriber must submit an As-Of reversal trade as a buy.

The subscriber will also have the ability to enter an As-Of Reversal function on a net position basis. If, for example, a subscriber entered a sell trade for 1,000 shares, but the trade should have been for 800 shares, the subscriber may enter an As-Of trade reversal for 200 shares as a buy to net the position to the correct amount. Users may find this

easier than entering an As-Of trade reversal buy for 1,000 shares and an As-Of trade sell for 800 shares.

Form T Trade Reporting

Both the As-Of trade-entry and trade-reversal functions described above can be used to satisfy Nasdaq's "paper" reporting requirements—that is, on Form T. Subscribers that have failed to report a trade into ACT by the end of the day after the trade (T+1) will now be able to electronically submit these trades later, using the expanded As-Of trade-entry function (T+2 to T+N). In addition, the As-Of trade-reversal function can be used to cancel and/or correct trades on an As-Of basis.

ACT Step-Outs

The revised ACT service will also provide a new Step-Out transaction indicator to allow members to uniquely identify Step-Out "clearing-only" entries submitted to ACT for comparison, clearance, and settlement through NSCC. ACT will provide a separate Step-Out selection option on the ACT Trade Scan Window that will allow firms to view all their Step-Out entries at one time. These entries will not be reported to the tape nor disseminated to the media.

A Step-Out allows the executing broker (Broker A) to "step-out," or allocate, all or part of the trade(s) to another broker(s) (Broker B). In other words, a Step-Out functions as a position transfer, rather than a trade. Broker A will submit an ACT market-maker entry that is flagged as a Step-Out against Broker B. Broker B will be required to acknowledge the entry by either accepting it or submitting a matching order-entry firm entry that is also flagged as a Step-Out. Since the Step-Out flag will be a part of the matching criteria, an omission of the flag by either side

will cause the entries not to match. Once matched, it will be submitted to NSCC for clearance and settlement and will include the Step-Out flag for identification purposes.

ACT Give-Up Automatic Lock-In

The ACT Give-Up Automatic Lock-in function allows an introducing broker to enter and lock-in a trade when it is responsible for both sides of the trade. This occurs when two of its "Give-Ups" trade with each other or the introducing broker trades with one of its own Give-Up firms. In the current ACT system, the introducing broker may submit a market-maker entry for one side and either accept the trade or submit an order-entry firm entry to match the trade. In the new system, by specifying the new Give-Up Lock-In feature, the introducing broker avoids the need to accept the trade or submit the order-entry side. In other words, this new lock-in feature will allow the introducing broker to submit just one entry, not two. ACT will submit this trade to NSCC as an M1 Matched Locked-In trade.

No/Was Trades

While in the current ACT system, a trade that is entered incorrectly, or for some other reason is declined by the contra, must be deleted and re-entered by the market-maker side, the enhanced ACT will allow the market-maker side to modify, or No/Was, a trade that was declined by the contra.

".S" Trader Modifier

Currently the ".S" trade modifier cannot be used to indicate a two-day settlement period; the system only recognizes the modifier as indicating four or more days. However, in the new ACT, the allowable entries for the ".S" modifier will be either two

days, or anywhere from four through 60 days.

ACT Second Generation CTCI Specifications

During the ACT/TARS migration, Nasdaq developed ACT Second Generation Computer-to-Computer Interface (CTCI) specifications that are Year 2000 compliant. Although the use of these new specifications is not required to perform the existing ACT functionality, Nasdaq advises members that, in order to participate in the enhancements (*i.e.*, Reversal,

Step-Out, Auto Lock-In Give-Up, and T-2 to T-N As-Of entries), they must implement the ACT Second Generation specifications. Nasdaq expects all ACT CTCI users to migrate to the new specifications by the year 2000.

To obtain a copy of the ACT Second Generation CTCI specifications, please contact Subscriber Services at (800) 777-5606. Questions regarding the specifications should be directed to the CTCI Help Desk at (203) 385-6332.

Equipment Requirements

To use the new ACT/TARS service, firms will need a Nasdaq Workstation II™ (NWII). If you do not currently have NWII service, please contact Subscriber Services at (800) 777-5606.

More information regarding the ACT/TARS Migration will be provided for market participants before implementation in the third quarter of 1998.

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