

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59238; File No. SR-NSCC-2006-17)

January 13, 2009

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving Proposed Rule Change to Reorganize Membership Rules and Procedures

I. Introduction

On December 13, 2006, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on January 31, 2008, amended proposed rule change SR-NSCC-2006-17 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on July 10, 2008.² On August 4, 2008, NSCC again amended the proposed rule change.³ The Commission received no comment letters. For the reasons discussed below, the Commission is approving the proposed rule change, as amended.

II. Description

NSCC is reorganizing its Rules and Procedures (“Rules”) related to membership standards and membership requirements to conform them to its current practices and to harmonize them with similar rules of NSCC’s affiliate, the Fixed Income Clearing Corporation (“FICC”).⁴

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 58100 (July 3, 2008), 73 FR 39759.

³ The August 4, 2008, amendment was technical in nature and did not require the proposed rule change to be noticed, again.

⁴ Both NSCC and FICC’s Government Securities Division (“GSD”) share a number of common members, and both act as central counterparties with respect to certain transactions submitted by members. Harmonization of NSCC and FICC Rules is an ongoing process, and additional NSCC and FICC “harmonizing” rule filings will follow.

Over the years, NSCC has created a variety of membership classes, each with different initial and continuing membership requirements. These requirements are currently scattered throughout NSCC's Rules. With the objective of promoting greater transparency, NSCC is reorganizing and restructuring its Rules related to member types, the membership application process, and the ongoing requirements of NSCC members in a form that it believes will make them more readily located and understood by applicants and members alike.

To accomplish this, NSCC is restructuring Rule 2 (previously, "Members") into a revised Rule 2 ("Members and Limited Members") and is creating a new Rule 2A ("Initial Membership Requirements") and a new Rule 2B ("Ongoing Membership Requirements and Monitoring"). Current provisions and rule text will be moved from existing rules and addenda and will be relocated within these newly structured rules. Certain provisions will be modified where necessary and, where possible, harmonized with analogous provisions of GSD's rules. Additionally, NSCC proposes to add descriptive text to its Rules with regard to the membership application process and with regard to the voluntary membership retirement process (i.e., text which codifies NSCC's current process of evaluating applicants and the current process by which an existing member may voluntarily retire from membership in NSCC).

1. Membership Types – Members and Limited Members

NSCC's previous Rule 2 (currently titled "Members") provided that an applicant may apply to become a member that uses all of NSCC's services or to become a member that uses certain limited services.

In restructuring and revising Rule 2, NSCC seeks to clearly, concisely, and in one location, set forth each membership type differentiating between member types that may

generally, unless otherwise limited by NSCC access all services made available by NSCC, (often referred to as “full service Members”) and those member types that may utilize NSCC’s systems and services only on a limited basis (“Limited Members”). Limited Members will include the following: Fund Members, Insurance Carrier/Retirement Services Members, Municipal Comparison Only Members, Mutual Fund/Insurance Services Members, Data Services Only Members, Commission Billing Members (previously “Non-Clearing Members”), Settling Bank Only Members, and Third Party Administrator Members. This change is cosmetic only, logically grouping member types, and will not alter in any way each member’s existing rights and obligations.

Additionally, NSCC is adding text to Rule 2 making it clear that no full service Member or Limited Member may submit or confirm any transaction, charge, request, instruction, or transmission through NSCC’s services, or otherwise utilize NSCC’s services, in contravention of any law, rule, regulation, or statute.

2. Consolidation of Membership Standards and Requirements Within the Rules

The membership qualifications, financial standards, and operational requirements for each member type previously were set forth in separate rules and addenda, which were spread throughout NSCC’s Rules.⁴

⁴ “Members” qualifications, standards, and requirements were located in Rule 2 and in Addendum B. “Mutual Fund/Insurance Services Members,” also defined to be “Members,” qualifications, standards, and requirements were located in Rule 2 and in Addendum B. “Fund Members” qualifications, standards, and requirements were located in Rule 51 and Addendum I. “Insurance Carrier/Retirement Services Members” qualifications, standards, and requirements are located in Rule 56 and in Addendum Q. “Third Party Administrator Members” qualifications, standards, and requirements were located in Rule 60 and in Addendum R. “Data Services Only Members” qualifications, standards, and requirements were located in Rule 31. “Municipal Comparison Only

To consolidate this information, NSCC is creating two new rules, Rule 2A and Rule 2B, which will contain the content moved from membership Rules 3, 31, 51, 54, 56, and 60. Rule 2A (“Initial Membership Requirements”) provides information regarding initial membership eligibility requirements for all member types and addresses the membership application and evaluation process. Rule 2B (“Ongoing Membership Requirements and Monitoring”) contains provisions regarding the continuing requirements of members. For ease of reference, NSCC is also relocating and consolidating the detailed membership qualifications, financial standards, and operational requirements for all member types into Addendum B (renamed “Qualifications and Standards of Financial Responsibility, Operational Capability and Business History”). The content NSCC is reorganizing into Addendum B is currently spread throughout Addenda B, I, Q, and R.

Accordingly, NSCC is deleting current membership related Rules 3 (specifically, Sections 2, 5, and 6), 31, 51, 54, 56, and 60. In addition, NSCC will delete Addenda I, Q, and R.

3. Use of the Terms “Members” and “Settling Members” Throughout the Rules

Currently, an applicant that agrees to limit its use of NSCC’s services to those specified by NSCC (i.e., Mutual Fund Services and/or Insurance and Retirement Services) is called a “Mutual Fund/Insurance Services Member.” Thus when the term “Member” is used within NSCC’s Rules, it may apply to a full service Member (which may generally use all NSCC

(..continued)

Members” qualifications, standards, and requirements were located in Rule 3, Section 2. “Non-Clearing Members” qualifications, standards, and requirements were located in Rule 3, Section 2. “Settling Bank Only Members” qualifications, standards, and requirements were located in Rule 54.

services), a Mutual Fund/Insurance Services Member (which may only utilize the Mutual Fund and Insurance and Retirement Processing Services), or to both depending upon the context.

Additionally, NSCC's Rules make reference to "Settling Members," which may apply to a full service Member, a Mutual Fund/Insurance Services Member, a Non-Clearing Member, or all three member types. It is only in further understanding the Rules or in the context of a term's use that one may determine to which member type a Rule may apply.⁵ Accordingly, NSCC proposes to modify all references to "Settling Member" and to "Member" within each NSCC Rule to clearly indicate which member type a rule is applicable. Definitions associated with these terms (contained in Rule 1) will be modified, and the term "Settling Member" will be deleted from NSCC's Rules.

4. Rule 15 ("Financial Responsibility and Operational Capability")

Rule 15 contains, among other things, the requirements of members with regard to reports to be filed on an ongoing basis (e.g., annual audited financial statements, Financial and Operational Combined Uniform Single ("FOCUS") Reports, etc.) and notifications that members are required to make to NSCC regarding any failure to maintain their membership qualifications and standards, including notifications of certain material changes in business, ownership, or

⁵ For example, as a Mutual Fund/Insurance Services Member may not participate in the Continuous Net Settlement Service ("CNS"), any reference to "Members" within Rule 11 ("CNS") will not apply to Mutual Fund/Insurance Services Members. Any reference to "Settling Member" within Rule 17 ("Fine Payments") will apply to all full service Members, Mutual Fund/Insurance Services Members, and Non-Clearing Members (which NSCC is renaming "Commission Billing Members").

control. NSCC proposes to move these ongoing reporting requirements into new Rule 2B. Rule 15 will then be renamed “Assurances of Financial Responsibility and Operational Capability.”

In Section 2.A. (“Reports and Information”) of new Rule 2B, NSCC is adding text that clarifies that unless specifically set forth within the Rule, the time periods established for submitting reports and data to NSCC are set forth in the form of notices posted on NSCC’s Web site and that each member is required to retrieve all notices from NSCC’s Web site daily.

In Section 2.B. (“Notification of Changes in Condition”) of new Rule 2B, NSCC is changing the reporting requirements of certain member types with respect to providing NSCC with written notice of events that will effect a change in control of the member or that could have a material impact on the member’s business and/or financial condition. Historically, this provision applied to full service Members (i.e., those Members for which certain activity is guaranteed at a fixed point in the clearance and settlement process) as well as Mutual Fund/Insurance Services Members, Fund Members, and Insurance Carrier/Retirement Services Members (i.e., those member types whose activity is limited to use of non-guaranteed services). NSCC has determined that this notification provision should apply solely to full service Members.

Additionally, NSCC seeks to delete the current requirement that a Commission Billing Member (previously called a “Non-Clearing Member”) provide NSCC with written and oral notice if it is no longer in compliance with any of the relevant qualifications and standards for membership. Commission Billing Members participate in NSCC solely for the purpose of paying and receiving broker commissions and file transmissions that are sent to NSCC directly from either the New York Stock Exchange or the American Stock Exchange. As there are no

NSCC financial or operational requirements applicable to this member type and the participation of the member is coordinated between NSCC and the member's Exchange, the current requirement is not necessary.

5. Rule 1 ("Definitions and Descriptions")

NSCC proposes the following with respect to terms defined within Rule 1:

Board of Directors

The current definition is modified to make clear that the term "Board of Directors" means the Board of Directors of NSCC or a committee thereof acting on delegated authority.

Commission Billing Member

NSCC is renaming Non-Clearing Members "Commission Billing Members" to better reflect the nature of their participation in NSCC's services. Non-Clearing Members utilize NSCC's Commission Settlement Service solely for the payment and collection of commissions.

Limited Member

The term "Limited Member" will mean a Person whose use of NSCC's services is limited to those services specified by NSCC.

Person

The proposed term "Person" will mean a partnership, corporation, limited liability corporation, or other organization, entity, or individual.

Registered Broker-Dealer

The term "Registered Broker-Dealer" (currently defined in Rule 2 as "a broker or dealer registered under the Securities Exchange Act of 1934, as amended") is being moved to Rule 1.

Settling Member

The term “Settling Member” is being deleted from NSCC’s Rules. Each member type encompassed by this term is being specifically named within NSCC’s Rules.

Other conforming technical changes to Rule 1 are being made to accommodate the restructuring of the Rules.

6. Rule 2A (“Initial Membership Requirements”)

Applicant Operational Testing Requirements

Under NSCC’s Rules, certain applicants as determined by NSCC must demonstrate that they will be able to satisfactorily communicate with NSCC. These applicants conduct system/operational tests with NSCC. NSCC is adding new text to its rules (Rule 2A, Section 1.C. [“Application Documents”]) to make clear NSCC’s current requirement with regard to applicant testing.

Member’s Agreement

NSCC’s Rules currently provide that members sign and deliver to NSCC a member’s agreement. The applicable provisions of each type of member’s agreement have historically been set forth in the Rule that applies to that member type (e.g., a Fund Member’s agreement provisions are contained in Rule 51, a full service Member’s provisions are contained in Rule 2, a Third Party Administrator Member’s provisions are contained in Rule 60).

Regardless of member type, each member agreement has certain standard provisions that generally apply to all members (e.g., the only services the member may use are those that are permitted by NSCC, that the member will abide by NSCC’s Rules and be bound by all

provisions of the Rules, etc.) and certain other provisions that are unique to particular member types (e.g., Fund Members have a unique provision with regard to NSCC’s inspection of their books and records).

NSCC new Rule 2A, Section 1.E. (“Membership and Other Agreements”) contains the main member agreement provisions for all member types, as well as address the requirements with regard to any other agreements.

Third Party Administrator (“TPA”) ACH Agreements

NSCC’s Rules currently state that TPA Members (non-settling members) must provide NSCC with an agreement for preauthorized payments (an “ACH” agreement) so that NSCC may collect monthly charges pursuant to Rule 26 (“Bills Rendered”). To accommodate payment methods other than ACH (i.e., “e-payment” using a credit card or bank account), NSCC is replacing the specific TPA ACH requirement within its Rules with more generic text.

7. Rule 2B (“Ongoing Membership Requirements and Monitoring”) Reports and Information

Annual Audited Financial Statements

NSCC’s Rules currently state that a member whose membership is contingent upon a guarantee of a third party must provide a copy of the annual audited financial statements of the guarantor. If such statements for the member or its guarantor are not available, NSCC may accept at its sole discretion consolidated financial statements prepared at the level of the parent of the member or guarantor. NSCC is modifying this text to make clear that it may accept

consolidated financial statements or financial information prepared at the level of the parent of such entity.⁶

Call Reports

New Rule 2B, Section 2.A.(c) applies to Call Reports filed with NSCC by members that are banks or trust companies. To the extent that such information is not contained within the Call Report or the member is a bank or trust company that is not required to file a Call Report, such member will be required to provide NSCC with information containing each of its capital levels and ratios.

Supplemental and Quarterly Financial Statements Filed With The National Association of Insurance Commissioners (“NAIC”)

NSCC is deleting the current Rule 15 requirement that Insurance Companies provide NSCC with copies of their supplemental and quarterly financial statements filed with the NAIC or the Insurance Company’s regulatory authority. Currently, NSCC receives annual audited financial statements and annual regulatory reports from these members in order to monitor adherence to membership requirements. The revised rule language will conform the Rules to current practice.

Securities Exchange Act Rule 15c3-1 Notification

NSCC is adding Rule 2B, Section 2.A.(g) to its Rules to require that a member that has provided notice to the Commission pursuant to paragraph (e) of Securities Exchange Act Rule 15c3-1 (“Notice Provisions Relating to Limitations on the Withdrawal of Equity Capital”) shall

⁶ NSCC is also correcting a typographical error in Rule 2B, Section 2.A.(a) in that “each” guarantor should read “such” guarantor.

notify NSCC and shall provide NSCC with a copy of such notice by close of business on the day such notice is provided to the Commission.

Operational Testing

NSCC requires that certain “top tier” members participate in periodic connectivity testing with NSCC for business recovery purposes. NSCC is adding Rule 2B, Section 3 (“Operational Testing”) to its Rules to specifically set forth NSCC’s operational testing requirements.

Ongoing Monitoring – Surveillance Status

Currently NSCC’s “credit risk matrix,” (i.e., the provision relating to NSCC’s ongoing monitoring of full service Members) appears in Addendum B. NSCC is moving its current risk matrix into new Rule 2B. NSCC is also replacing the term “Settling Member” with “Member” as the credit risk matrix only applies to full service “Members.”

Voluntary Retirement

NSCC is adding Rule 2B, Section 5 (“Voluntary Retirement”) to its Rules, which is the current process by which an active participant may voluntarily retire as an NSCC member.

8. Addendum B (“Qualifications and Standards of Financial Responsibility, Operational Capability and Business History”)

Immediate Placement on Surveillance by NSCC

Currently, NSCC’s Rules provide that applicants to become a Member, Mutual Fund/Insurance Services Member, Fund Member, or Insurance Carrier/Retirement Services Member may not be known to be subject to any other action or condition the existence of which will require it to be placed on surveillance by NSCC. In addition, the financial requirements for certain members (full service Members and Mutual Fund/Insurance Services Members) state that the member must have a capital ratio or percentage that will not require the applicant to be

placed on immediate surveillance by NSCC. All applicants must meet their minimum financial requirements, as applicable to their member type. NSCC is deleting these provisions.

When the NSCC membership standards were developed, the NSCC credit risk matrix was not in place. As a result of the implementation of the credit risk matrix, it is possible that once an applicant is approved for membership, it may be placed directly on NSCC's Watch List (i.e., surveillance status). As sufficient discretion to deny membership based on financial, operational, or character issues exists in other sections of NSCC's rules, elimination of these provisions will not diminish NSCC's authority under its Rules to deny an applicant membership.

Fund Member Applicants Subject to Securities Exchange Act Rule 17a-11 Reporting

NSCC is deleting Addendum I ("Standards of Financial Responsibility and Operational Capability for Fund Members"), which includes a requirement that a broker-dealer Fund Member applicant not be subject to reporting under Securities Exchange Act Rule 17a-11 ("Notification Provisions for Broker and Dealers"). As a Fund Member, an applicant must meet NSCC's minimum financial requirements for membership (and, as stated above, NSCC retains sufficient discretion to deny membership based on financial, operational, or character issues in other sections of NSCC's Rules). Thus, NSCC has determined that this requirement is duplicative and that its elimination will not diminish NSCC's authority under its Rules to deny an applicant membership if it does not meet the applicable financial standards.

Financial Responsibility – Entities That Qualify for Membership Under the Category of "Other" Entity Types

In certain instances in NSCC's membership Rules, an applicant that does not qualify for membership under one of the specifically defined qualification criteria established for its membership type, may apply for membership if it has demonstrated to NSCC that its business and capabilities are such that it could reasonably expect material benefit from direct access to NSCC's services. NSCC's financial requirements for such an applicant required that it meet financial stability standards as were applied to the industry in which the applicant was associated.

Because industry standards have not always been well-defined and as there has not always been consensus among market participants as to what those industry standards should be, in new Section 1 of Addendum B, NSCC is modifying the financial requirements for "other" applicants by requiring that such applicants satisfy such minimum standards of financial responsibility deemed appropriate by NSCC.

Business History

NSCC's Rules currently provide that Insurance Carrier/Retirement Services applicants and Third Party Administrator applicants (both non-guaranteed service members) must have an established business history of a minimum of three years or personnel with sufficient operational background and experience to ensure the ability of the applicant to conduct such a business. The business history requirement for full service Members, as well as Mutual Fund/Insurance Services Members and Fund Members (both non-guaranteed service members) is six months, or the member must have personnel with sufficient operational background and experience to ensure the ability of the applicant to conduct such a business.

NSCC has determined that the business history requirement of Insurance Carrier/Retirement Services and Third Party Administrator applicants need not be any more stringent than those applied to Fund Members and Mutual Fund/Insurance Services Members. Therefore, NSCC is changing the three year requirement to six months.

Fund Members that are Insurance Companies

Under NSCC's Rules, an Insurance Company may apply to become a Fund Member; however, the financial requirements for Insurance Companies is not specifically set forth in Addendum I. Addendum I states that all "other" applicants shall be required to meet financial stability and operational capability standards as are applicable to the industry in which the applicant is associated. Historically, NSCC looked to its Insurance Carrier/Retirement Services Member financial standards set forth in Rule 57. NSCC is clearly stating Insurance Company financial standards under its Fund Member financial requirements in Addendum B, Section 3.

9. Rule 3 ("Lists to be Maintained")

In consolidating NSCC's membership standards, NSCC is moving to Rule 2 the portions of Rule 3 (specifically, Sections 2, 5, and 6) that pertain to Municipal Comparison Only Members, Non-Clearing Members, and/or Data Services Only Members. For purposes of clarity, the remaining information within Rule 3 is being reorganized and reordered.

10. Addendum D ("Statement of Policy Envelope Settlement Service")

To more accurately reflect the scope of the information contained within Addendum D, NSCC is renaming it "Statement of Policy Envelope Settlement Service, Mutual Fund Services, Insurance and Retirement Processing Service and Other Services Offered by the Corporation."

11. Rule 38 (“Captions”)

Mirroring FICC’s Rules, NSCC is adding language to Rule 38 to make clear that NSCC’s Rules are governed by New York substantive law. This language currently exists in NSCC’s membership agreements only. Rule 38 will be renamed “Governing Law and Captions.”

12. Technical Corrections

In 2006, NSCC submitted for immediate effectiveness proposed rule change SR-NSCC-2006-07 which made clarifying and technical changes to NSCC’s Rules related to funds which are eligible for processing on Fund/Serv.⁷ At that time, the membership qualifications contained within Section 1(viii) of Rule 31 (“Data Services Only Member”) should have been modified to reflect the definitional change made within Rule 1 with respect to “TPA.” Accordingly, NSCC is correcting the text within its rules to eliminate the reference to “defined contribution plans as defined in Section 414(i) of the Internal Revenue Code of 1986, as amended,” and to refer instead to “a retirement or other benefit plan.”

In 2006, NSCC submitted for immediate effectiveness proposed rule change SR-NSCC-2006-14 which, among other things, deleted references to the Product Repository service as NSCC had determined not to offer the service.⁸ At that time, all references within NSCC’s Rules to “Repository Data” should have been deleted. Accordingly, NSCC is seeking to delete such references.

⁷ Securities Exchange Act Release No. 54366 (August 25, 2006), 71 FR 52199.

⁸ Securities Exchange Act Release No. 54921 (December 12, 2006), 71 FR 76415.

In 2005, the Commission approved NSCC proposed rule change SR-NSCC-2005-01 which clarified that the operational capability that is ordinarily focused upon by NSCC during the application process is the ability of an applicant to appropriately communicate with NSCC—that is the ability to input to NSCC and to receive output from NSCC on a timely and accurate basis.⁹ The rule change removed certain provisions that might be interpreted to impose upon NSCC an obligation to make determinations with respect to particular aspects of operational capability. Instead, NSCC relies upon the requirement that the applicant in fact be able to satisfactorily communicate with NSCC as generally stated in the operational capability requirements currently set forth for members in NSCC’s Rules. At the time of the filing, the provision within Rule 60 with respect to approval of TPA Member applicants based upon an alternative operational standard should have been deleted. Accordingly, NSCC now seeks to delete this provision from its Rules. NSCC will continue to retain the right to examine any aspect of an applicant’s or member’s business pursuant to the provisions of Rule 15.

In 2005, the Commission approved NSCC proposed rule change SR-NSCC-2005-14 which added Rule 64 (“DTCC Shareholders Agreement”) requiring that full service Members of NSCC purchase shares of the common stock of The Depository Trust & Clearing Corporation (“DTCC”), NSCC’s parent corporation, and that certain Limited Member types could voluntarily purchase such shares.¹⁰ Section 5 of Rule 64 made incorrect references to “Members” and

⁹ Securities Exchange Act Release No. 51600 (April 22, 2005), 70 FR 22167.

¹⁰ Securities Exchange Act Release No. 52922 (December 7, 2005), 70 FR 74070.

should have referenced all member types specified in Section 2 (“Members”) and Section 3 (“Fund Members, Insurance Carrier/Retirement Services Members, Municipal Comparison Only Members, and Mutual Fund/Insurance Services Members”) of Rule 64. Accordingly, NSCC now correcting such references.

In 2004, the Commission approved NSCC proposed rule change SR-NSCC-2003-05 which modified NSCC’s Rules to provide that notices to members posted by NSCC via electronic format (i.e., posted on NSCC’s Web site) meet NSCC’s notification obligations.¹¹ At that time, Section 7 of Rule 45 (“Notices”) was added to NSCC’s Rules with an incorrect reference to Section 3. NSCC is seeking to remove this incorrect reference.

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. Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.¹² The Commission believes that NSCC’s rule change is consistent with this Section because it should perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions by assisting NSCC applicants and

¹¹ Securities Exchange Act Release No. 50085 (July 26, 2004), 69 FR 45872.

¹² 15 U.S.C. 78q-1(b)(3)(F).

members in understanding, and thereby complying with, NSCC's membership standards and requirements.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder. In approving the proposed rule change, as amended, the Commission considered the proposal's impact on efficiency, competition, and capital formation.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NSCC-2006-17), as amended, be and hereby is approved.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹³

Florence E. Harmon
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).

