

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50797; File No. SR-NSCC-2003-22)

December 6, 2004

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Amend the Standards of Financial Responsibility Required of Mutual Fund and Insurance Services Applicants and Members that Are Banks, Trust Companies, or Broker-Dealers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ notice is hereby given that on November 10, 2003, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on November 29, 2004, amended the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The purpose of the proposed rule change is to amend the standards of financial responsibility required of applicants and members that are banks, trust companies, or broker-dealers using or applying to use NSCC’s non-guaranteed services as Mutual Fund/Insurance Services Members under Rule 2 and Fund Members under Rule 51.

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

¹ 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 these statements.²

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

The proposed rule change amends Addendum B, "Standards of Financial Responsibility and Operational Capability," and Addendum I, "Standards of Financial Responsibility and Operational Capability For Fund Members," of NSCC's Rules and Procedures to enhance the standards of financial responsibility required of applicants and members that are banks, trust companies, and broker-dealers using or applying to use NSCC's non-guaranteed services as Mutual Fund/Insurance Services Members under Rule 2 and Fund Members under Rule 51.³ Addendum B establishes financial criteria applicable to Mutual Fund/Insurance Services Members and applicants admitted or seeking admission under Rule 2. Addendum I establishes the financial criteria applicable to Fund Members and applicants admitted or seeking admission under Rule 51.⁴

² The Commission has modified the text of the summaries prepared by NSCC.

³ Mutual Fund Services and Insurance Processing Services are non-guaranteed services.

⁴ NSCC has revised Addendum B (Version 1) as set forth in Appendix 1 to NSCC's Rules (Version 2 of Addendum B). Version 1 uses allocation and liquidation components to determine participant clearing fund and Version 2 uses risk-based margining to determine participant clearing fund. NSCC is informing members on a rolling basis when Version 2 is applicable to them. The provisions of Addendum B, which are the subject of this proposed rule change, are identical in Version 1 and Version 2. This proposed rule change would amend both the text of Addendum B (Version 1) and Appendix 1 (Version 2 of Addendum B). Securities Exchange Act Release No. 44431 (June 15, 2001), 66 FR 33280.

The proposed rule change (i) raises the minimum excess net capital requirement applicable to such broker-dealer applicants and members from \$25,000 in excess net capital to \$50,000 in excess net capital and (ii) changes the standards of financial responsibility required of banks and trust companies by reference to different types of criteria than currently used for this purpose. The effective date for the proposed rule change as applied to current members will be one year from the date of Commission approval. The one year period, arrived at after consultations with the affected members, is necessary to allow members that do not meet the increased or changed capital requirements sufficient time to evaluate their options and implement any necessary changes without undue disruption to their customers. The proposed rule change also seeks to amend Addendum I to require an established business history of six months instead of three years which is consistent with the required established business history for applicants for other types of membership in NSCC.

1. Increase of Minimum Excess Net Capital Required of Broker-Dealers Using Mutual Fund and Insurance Services

NSCC's current minimum excess net capital requirement applicable to broker-dealer applicants and members using non-guaranteed services was implemented in 1993.⁵ In 1998, NSCC increased its minimum excess net capital requirements under Rule 2 for broker-dealer applicants and members using NSCC guaranteed services from \$50,000 to \$500,000 subject to certain limited exceptions.⁶ At that time, no change was made to the financial requirements

⁵ Securities Exchange Act Release No. 33525 (January 26, 1994), 59 FR 9805.

⁶ Securities Exchange Act Release No. 40081 (June 10, 1998), 63 FR 32905. A municipal securities broker under Rule 15c3-1(a)(8) of the Act is required to maintain \$100,000 in excess net capital, and a clearing broker is required to maintain \$1,000,000 in excess net

applicable to the use of non-guaranteed services. NSCC now believes it is appropriate to do so because of increased transaction volumes and settlement obligations.

NSCC currently has 290 broker-dealer members to which the increased excess net capital requirement would apply. Thirteen of the 290 broker-dealer members have been identified as not meeting the increased capital requirement. The purpose of delaying effectiveness of the proposed rule change is to allow these thirteen members time in which to obtain and apply additional excess net capital or make alternate arrangements such as clearing through another NSCC member without disruption to their businesses.

NSCC currently requires a larger clearing fund deposit from broker-dealer members which have a minimum excess net capital of less than \$50,000 (i.e., a minimum of \$10,000 - \$20,000 - \$40,000 as compared to \$5,000 - \$10,000 - \$20,000 depending upon settlement debit history). When the proposed minimum excess net capital requirement is increased to \$50,000, the minimum clearing fund requirements currently imposed would no longer be applicable because \$50,000 in excess net capital would be required of these broker-dealers in all instances.

2. Amendment to Standards of Financial Responsibility Applied to Banks and Trust Companies Using Mutual Fund Services and Insurance Processing Service

Addendum B currently requires that banks and trust companies that are applying to be or are Mutual Fund/Insurance Services Members under Rule 2 have \$100,000 minimum excess net capital over the capital requirement imposed by the applicable state or federal regulatory authority. Addendum I is silent on the criteria applicable to banks and trust companies for purposes of being Fund Members under Rule 51.

(.continued)
capital.

Under the proposed rule change, the standards of financial responsibility applicable to banks and trust company applicants and members applying to use or using Mutual Fund Services and Insurance Processing Services would be applicable both to Mutual Fund/Insurance Services Members under Rule 2 and to Fund Members under Rule 51.

Under the proposed standard, a bank or trust company would be required to have a Tier 1 risk-based capital ratio of at least 6% or greater. A trust company which is not required to calculate a risk-based capital ratio by its regulators will be required to have at least \$2,000,000 in capital.

As applied to banks, the revised criteria will apply the standard adopted by the Federal Deposit Insurance Corporation (“FDIC”) to compute risk-based capital ratios. The proposed standard of a minimum Tier 1 risk-based capital ratio of 6% is currently categorized as “well-capitalized” under the guidelines issued by the Board of Governors of the Federal Reserve System. All current NSCC Mutual Fund/Insurance Services Members and Fund Members that are banks exceed this requirement.

With respect to trust companies, the current standard of \$100,000 in excess capital over the capital required by applicable state or federal regulations would be replaced by a requirement that the trust company have \$2,000,000 in capital. Since state regulations vary in their respective capital requirements and some states do not have a capital requirement, the proposed revised criteria would provide a uniform and consistent standard to all trust companies regardless of whether they are members of the Federal Reserve System or subject to nonuniform state regulatory requirements. The proposed \$2,000,000 capital requirement is the same capital standard required for membership in The Depository Trust Company.

Some trust companies which are not required to calculate a Tier 1 risk-based capital ratio pursuant to FDIC or Federal Reserve Act requirements calculate this ratio for other purposes. NSCC would therefore accept as an alternative to the minimum \$2,000,000 capital requirement the 6% Tier 1 risk-based capital ratio from those trust companies which provide this calculation for regulatory purposes.⁷

NSCC currently has sixty-six bank/trust company members to which the revised capital requirements would apply. Only one trust company has been identified as not meeting the new standard.

NSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act⁸ and the rules and regulations thereunder applicable to NSCC because it will assure the safeguarding of securities and funds which are in the custody or control of NSCC by enhancing the standards of financial responsibility applicable to NSCC members using NSCC's Mutual Fund Services and Insurance Processing Service and thereby should help NSCC protect itself and its participants from undue financial risk.

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

⁷ The proposed rule change seeks to make a technical amendment to Addendum B regarding the capital standards applicable to bank applicants for full membership under NSCC Rule 2. In particular, the proposed rule change amends Section I.B.2.(a)(i) by replacing the listed components of bank capital with a reference to bank capital as it is defined in the Consolidated Report of Condition ("CALL Report").

⁸ 15 U.S.C. 78q-1.

NSCC believes that the proposed rule change will not 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

No written comments relating to the proposed rule change have been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

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

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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. Please include File Number SR-NSCC-2003-22 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-2003-22. 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 Commissions 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 <http://www.nsc.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-2003-22 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Jill M. Peterson
Assistant Secretary

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17 CFR 200.30-3(a)(12).

