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May 30, 2006

The Honorable Christopher Cox, Chairman  
The Honorable Paul S. Atkins, Commissioner  
The Honorable Roel C. Campos, Commissioner  
The Honorable Cynthia A. Glassman, Commissioner  
The Honorable Annette L. Nazareth, Commissioner  
United States Securities and Exchange Commission  
100 F Street, NE  
Washington D.C. 20549-0609

**Re: Securities and Exchange Commission Rel. No. 34-53742; File No. SR-NSCC-2006-04**

Dear Chairman and Commissioners:

UBS Securities LLC, the U.S. investment banking arm of UBS AG, respectfully submits this letter in response to the above release.<sup>1</sup> UBS opposes the proposed changes since they are unnecessary to effect the stated goals of the NSCC, may have a disproportionate economic impact on certain firms based on the mix of their business without accurately reflecting the costs of that business to the NSCC, and may require certain firms and other industry participants to develop a new real time reporting capacity at a time when firms will be burdened with complying with market structure changes caused by the adoption of SEC Regulation NMS and resulting changes to the trading platforms of most major markets.

### INTRODUCTION

On March 15, 2006, the National Securities Clearing Corporation ("NSCC") filed a proposed Rule Change Relating to Trade Submission Requirements, Fees and Pre-Netting with the Securities and Exchange Commission ("Proposed Rule"). On March 22, 2006, the NSCC amended the Proposed Rule. The Commission published the Proposed Rule in the Federal Register on May 8, 2006 seeking public comment on the proposal. On May 24, 2006, the NSCC

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<sup>1</sup> UBS AG is one of the largest financial institutions in the world serving a diverse client base ranging from affluent individuals to multinational institutions and corporations. The firm has 87 stock exchange memberships in 31 countries, and is widely acknowledged as a leader in the secondary equity trading markets. In the U.S., the firm is active in all of the equity, fixed income and option markets. It is ranked number 1 in equity trading on the NYSE and NASDAQ markets. As such, UBS is a significant participant in the NSCC clearing services, clearing on average over 5.7 billion shares per day. UBS Investment Bank is a business group of UBS AG. UBS Securities LLC is a subsidiary of UBS AG.

issued a notice that changes the deadlines in the Proposed Rule to trigger off the actual date the SEC approves the changes.

In the Proposed Rule, NSCC is seeking to: (1) require that all locked-in trade data submitted to NSCC for trade recording be submitted on a real-time basis; (2) prohibit pre-netting and other practices that prevent real-time trade submissions; and (3) establish a new fee model for equity trade recording and netting services. The stated purpose of the proposed rule is to reduce systemic risk in the settlement process. The NSCC lists four reasons the proposed rule will reduce risk: (1) business continuity; (2) straight through processing; (3) risk mitigation; and (4) trade reconciliation. The NSCC has stated that the Proposed Rule, including the new fee structure, will be revenue neutral.

## **DISCUSSION**

### **1. The Proposed Rule Should be Revenue Neutral to Individual Firms**

The Proposed Rule sets forth a revised fee schedule. The NSCC specifically recognizes that the proposed fee changes are designed to be revenue-neutral to the NSCC, but acknowledges that the mixture of different fees will change. We are concerned that the new formulas and restriction on pre-netting or compression of trades may penalize firms that execute a large number of smaller transactions as well as firms that currently consolidate trade reports to the NSCC. A firm may pay higher overall fees because the number of reported transactions increases even if the total number of shares or notational value of the shares cleared through the NSCC stays the same. More importantly, we believe that the NSCC failed to fully weigh the impending increase in the number of reported transactions due to the implementation of Regulation NMS and other market structure changes, and their disproportionate effect on firms that provide liquidity through active trading and market making.

We believe that the NSCC should attempt to as much as possible make the proposal cost neutral to individual firms. Otherwise the Proposed Rule change will benefit some firms at the expense of others. This is particularly true since NSCC has not provided any evidence that transaction count is correlated with the cost of providing clearing services or its associated risk. Yet, the rule change would mandate that firms that currently compress reports to report many more transactions and absorb higher fees to meet this new requirement.

The NSCC should thus consider implementing the following specific limitations on fees:

- a. Fees should not be based on per transaction side charges but rather should be oriented to notational value of overall share transfers or other indicators of share volume. Per side costs are not good overall indicators of the actual cost and risk incurred by NSCC;
- b. If the NSCC continues to consider the number of transactions, it should put a cap on fees charged when a certain level of transactions is reached or give discounts when certain levels of transactions are achieved.

## **2. The Proposed Rule Should More Clearly Articulate the Exception for Clearing Arrangements**

The NSCC recognizes that trades executed as position movements to a correspondent should be excluded from the prohibition on compression of transactions and the requirement for real time reporting. While we fully support this exemption because of the nature of those transactions, we believe that the definition of clearing broker and original transaction should be clarified to remove any confusion about the extent of this exception.

## **3. The Proposed Rule is not Necessary to Address the Risks Identified by the NSCC**

The NSCC states that the Proposed Rule is necessary to reduce systemic risks. In particular, the Proposed Rule contains the conclusory statement that requiring real time submission of locked in trade data reduces operational risk and promotes business continuity lessening the risk of an intraday event that would disrupt delivery of the data. The NSCC does not, however, present any evidence to support its view that compression and batch submission of transactions increase the risk to the system. Indeed, the Rule Proposal may actually increase risk to the system due the substantial increase in transactions that the NSCC must process based on the proposed limitations on compression and the introduction of Regulation NMS.

More importantly, the Proposed Rule is unnecessary to accomplish its stated goals. The disaster recovery changes required by the SEC over the past few years will effectively mitigate the risk that a market disruption would impose on the clearing system. Firms are in much better position today to continue business in face of a severe disruption particularly in view of recently mandated geographic separation of disaster recovery sites from primary sites and associated real time trade capture at those disaster recovery sites. These changes permit delayed but near-complete submission to NSCC in worst case scenarios. To further mitigate systemic risk, changes less intrusive than those proposed could be implemented. For example, periodic reporting throughout the day would have the same beneficial effect on risk without the negative consequences discussed in this letter. While the NSCC claims that risk mitigation is the primary motivation for the change, they take the somewhat contradictory position that prompt delivery of transaction data, compressed for clearing purposes, would not be acceptable. Thus, the proposed rule seems to be less about risk mitigation and more about getting rid of compression.

## **4. The Timing of the Proposed Rule is Inappropriate Based on Other Pending Market Structure Changes**

Implementation of an entirely new real time reporting system at the same time as all of the market changes required by Regulation NMS and the changing platforms at most major trading markets and exchanges is an unnecessary complication to the trading markets. Over the next year, SRO's and broker dealers will be expending substantial resources to implement technology and other changes mandated by Regulation NMS and other market structure changes. In fact, the recently released schedule for NMS implementation requires firms to implement system changes during the period February through May in order to assure compliance on the effective date of the rule. The effective dates of Regulation NMS are May 21, 2007 for the first 250 securities; July 9, 2007 for the remaining NMS securities; and October 8, 2007 for full implementation by all

markets. In setting the implementation date for real time reporting, the NSCC specifically recognized that many market participants will have to make system changes to comply with this requirement. While the NSCC has subsequently delayed the effective date and tied it to the Commission approval date, the implementation date for real time reporting (approximately 10 months after SEC approval) would still fall squarely in this period of time. The NSCC failed to weigh additional stresses on firms caused by these development requirements. The Commission should carefully weigh the potential cost, risk and resources necessary to implement the Proposed Rule against the benefit deriving from implementation of this proposed change, particularly on the currently proposed schedule, in deciding whether to approve the proposal.

### **CONCLUSION**

While we believe that the NSCC intent to reduce systemic risk is good, we believe that the method chosen by the NSCC to effect this change is flawed. As a result, we believe that the SEC should reject the rule proposal as submitted and direct the NSCC to work with the industry on alternative methods of reducing systemic risk.

Sincerely,

s-Matthew Price

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Regional Head of Equities  
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