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August 5, 2013

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Re: File Number SR-NSCC-2013-02

Dear Ms. Murphy:

We are submitting this comment on the above-captioned rule proposal submitted by the National Securities Clearing Corporation ("NSCC") pursuant to Section 19(b) of the Exchange Act and Rule 19b-4 adopted thereunder (the "Rule Proposal")<sup>1</sup> at the request of our client, Charles Schwab & Co., Inc. ("Schwab"), a broker-dealer registered with the Securities and Exchange Commission (the "Commission") under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Schwab has commented on the Rule Proposal multiple times.

Our objectives in submitting this letter are (i) to summarize the results of our review of the record, as of August 5, 2013, in the proceedings initiated by the Commission on July 9, 2013 (the "Record") to determine whether to approve or disapprove the Rule Proposal (the "Proceedings"), (ii) to describe the standards applicable to the Commission's review of the Rule Proposal pursuant to the Proceedings (the "Standard for Review") and (iii) to evaluate whether the Record would permit the Commission to approve the Rule Proposal under the Standard for Review.

For the reasons set out below, we believe that the record to date in the Proceedings (the "Record") does not provide an adequate basis for the Commission to approve the Rule Proposal under the Standard for Review.

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<sup>1</sup> The Rule Proposal was filed with the Commission on March 21, 2013, and noticed in the Federal Register on April 10, 2013, at page 21487 and thereafter was amended twice. The first amendment, which added to the Rule Proposal a comment letter to NSCC dated March 19, 2013, was contained in a submission noticed in the Federal Register on May 29, 2013, at page 32292. The second amendment, which made changes to the Rule Proposal, was contained in a submission noticed in the Federal Register on July 15, 2013, at page 42140.

## The Record

We have reviewed the Record through August 5, 2013, which consists of: the original filing of the Rule Proposal filed on March 31, 2013 and noticed in the Federal Register on April 10, 2013; Amendment No. 1 to the Rule Proposal noticed in the Federal Register on May 29, 2013; comment letters submitted following the original filing and the filing of Amendment No. 1; the Commission's order instituting proceedings to determine whether to approve or disapprove the Rule Proposal; Amendment No. 2 to the Rule Proposal noticed in the Federal Register on July 15, 2013; and comment letters submitted following the filing of the Commission's order instituting Proceedings and of Amendment No. 2. We have also reviewed the comment letter submitted by Schwab on August 5, 2013.

Portions of the Record dealing with the mechanics of the Rule Proposal's operation have been addressed in some detail by NSCC and respond in part to comments submitted following the original filing of the Rule Proposal. Portions of the Record dealing with competition and safety and protection, however, are devoid of factual support. The Record does not contain substantial evidence to support either NSCC's assertions regarding the absence of anti-competitive effects or the basis upon which NSCC has elected not to address a number of the competitive concerns raised in the comments. Similarly, the Record does not contain substantial evidence supporting NSCC's decision not to address concerns raised in the comments regarding the possible negative effects of the Rule Proposal on the safeguarding of funds and securities and the protection of investors and those acting on their behalf.

## Standard for Review

NSCC is registered as a clearing agency<sup>2</sup> pursuant to Section 17A(b) and 19(a)(1) of the Exchange Act.<sup>3</sup> A clearing agency is a self-regulatory organization ("SRO") for purposes of the Exchange Act,<sup>4</sup> and Section 19(b)(1) requires an SRO to obtain approval from the Commission pursuant to Section 19(b)(2) of the Exchange Act prior to implementing a proposed rule change.<sup>5</sup> Approval under Section 19(b)(2) requires that the Commission find the SRO's proposed rule change to be consistent with the requirements of the Exchange Act and the rules and regulations applicable to the SRO thereunder.<sup>6</sup> If

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<sup>2</sup> "Clearing agency" is defined in the Securities Exchange Act of 1934 as "any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparisons of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities..." § 3(23)(A), 15 U.S.C. § 78c(23)(a).

<sup>3</sup> § 17A(b), 15 U.S.C. § 78q-1(b); § 19(b)(1), 15 U.S.C. § 78s(b)(1).

<sup>4</sup> § 3(a)(26).

<sup>5</sup> § 19(b)(1), 15 U.S.C. § 78s(b)(1).

<sup>6</sup> § 19(b)(2), 15 U.S.C. § 78s(b)(2)(C).

the Commission does not make such a finding, the Commission must disapprove the proposed rule change.<sup>7</sup>

### Requirements under the Exchange Act

The Exchange Act's requirements for the approval of clearing agency rule changes are set forth in Sections 17A(a)(1) and (2). Those sections, in pertinent part, provide:

"The Congress finds that...[t]he prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors..."<sup>8</sup> and "[t]he Commission is directed, therefore, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents to use its authority under this title..."<sup>9</sup>

We believe that the Record is deficient in supporting the requirements that the Rule Proposal increase "...the protection of investors and persons facilitating transactions by and acting on behalf of investors..." and that it have "...due regard for ... the protection of investors, the safeguarding of funds and securities and the maintenance of fair competition among brokers and dealers [and] clearing agencies..."<sup>10</sup>

Section 25(a) of the Exchange Act allows a person aggrieved by a Commission order approving an SRO rule change to seek review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing a written petition within sixty days after the entry of the order.<sup>11</sup> Once the petition is filed in an appropriate court, the court has jurisdiction to "affirm or modify and enforce or to set aside the order in whole or in part."<sup>12</sup>

The judicial standard applicable to a court's review of a Commission order is provided in part by Section 25(a) of the Exchange Act, which requires that the court treat the Commission's findings of fact in connection with its order as conclusive, if such

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<sup>7</sup> *Id.*

<sup>8</sup> § 17A(a)(1)(A), 15 U.S.C. § 78q-1(a).

<sup>9</sup> § 17A(a)(2)(A), 15 U.S.C. § 78q-1(a).

<sup>10</sup> § 17A(b)(3)(i)(4)(a), 15 U.S.C. § 78q-1(b)(3); § 17A(a)(1)(2)(a), 15 U.S.C. § 78q-1(a)(1).

<sup>11</sup> § 25(a), 15 U.S.C. § 78y(a)(1).

<sup>12</sup> *Id.*

findings are supported by "substantial evidence."<sup>13</sup> Applied in the context of a Commission order approving the Rule Proposal, Section 25(a) of the Exchange Act would require that the court find "substantial evidence" in the Record to support the Commission's findings, required by Section 19(b)(2) of the Exchange Act, that the Rule Proposal is consistent with the requirements for clearing agencies set forth in Sections 17A(a)(1) and (2) of the Exchange Act.

#### Requirements under the APA

Furthermore, because the Commission is a federal "agency" whose "agency actions" are subject to review under the Administrative Procedures Act ("APA"),<sup>14</sup> the APA's standards of judicial review also apply to a court's review of a Commission order.<sup>15</sup> The APA provides judicial review standards for both formal (Sections 556 and 557) and informal (Section 706) rulemaking actions of federal agencies. The issuance of a final order approving an SRO's proposed rule change is an informal rulemaking action and therefore subject to review under Section 706.<sup>16</sup> Section 706 requires courts to hold as unlawful and set aside informal rulemaking actions that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."<sup>17</sup>

The application of the APA's "arbitrary and capricious" standard, as well as the intersection of that standard with the Exchange Act's "substantial evidence" standard, was first addressed in the context of the judicial review of a Commission order approving a registered clearing agency's rule change in *Bradford Nat'l Clearing Corp. v. Commission*.<sup>18</sup> In *Bradford*, the D.C. Circuit reviewed a Commission order approving two rule changes proposed by NSCC.<sup>19</sup> The court stated that the standard of review, "while controlled by the 'substantial evidence' rule in its factual aspects, is left otherwise unspecified, and therefore, is apparently limited to review for arbitrariness, caprice and abuse of discretion."<sup>20</sup> *Bradford's* application of the Exchange Act's "substantial

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<sup>13</sup> § 25(a)(4), 15 U.S.C. § 78y(a)(4).

<sup>14</sup> 5 U.S.C. §§ 551, *et seq.*

<sup>15</sup> 5 U.S.C. § 551(1) defines "agency" as "each authority of the government of the United States, whether or not it is within or subject to review by another agency," with certain exceptions, such as the courts and Congress. 5 U.S.C. § 551(13) defines "agency action" to include the whole or a part of an agency rule, order, license, sanction, relief, or the equivalent or denial thereof, or failure to act."

<sup>16</sup> 5 U.S.C. § 553 (establishing the procedural requirements for notice-and-comment rulemaking).

<sup>17</sup> *Id.* § 706(2)(A).

<sup>18</sup> 590 F.2d 1085 (D.C. Cir. 1978) [hereinafter *Bradford*].

<sup>19</sup> *Id.*

<sup>20</sup> *Bradford* at 1093 (citing *Industrial Union Dep't v. Hodgson*, 499 F.2d 467 (1974) (162 U.S. App. D.C. 33) (applying the APA's "arbitrary and capricious" standard as the judicial review standard for informal rulemaking action of an agency).

evidence" standard in tandem with the APA's "arbitrary and capricious" standard has been followed by various circuits reviewing Commission orders approving rule changes proposed by, among others, the Chicago Board of Options,<sup>21</sup> the National Association of Securities Dealers,<sup>22</sup> and NYSE Arca,<sup>23</sup> each of which was an SRO for purposes of the Exchange Act.<sup>24</sup>

#### Ability of the Commission to Approve the Rule Proposal under the Standard for Review

We believe that the Record does not contain an adequate basis for satisfying the requirements of the standard for review concerning the effects on competition and on safeguarding funds and securities and protecting investors and those acting on their behalf. As developed to date, the Record contains, with respect to those requirements, little beyond unsubstantiated assertions by NSCC. Comments challenging those assertions, or raising issues about competition and safety and protection, have not been addressed by NSCC appropriately and, in some cases, have not been addressed at all.

The dual Exchange Act and APA requirements of substantial evidence in the Record and the Commission's actions approving or disapproving the Rule Proposal not being arbitrary or capricious raise significant impediments to the Commission's ability to approve the Rule Proposal. NSCC's incomplete response to the competition issues raised in the Record would put the Commission at risk of running afoul of the precedent articulated by the D.C. Circuit in *Netcoalition v. SEC* that the court would not defer "...to the agency's conclusory or unsupported positions."<sup>25</sup> NSCC's failure to respond at all to issues raised in the comment letters about the protection of investors and persons facilitating transactions by and acting on behalf of investors and safeguarding of funds and securities, would leave the Commission with nothing in the Record to address the commenters' concerns.

The Rule Proposal's treatment of anti-competitive and protection and safety concerns is not and, of necessity, any Commission approval of the Rule Proposal would not be, supported adequately, or at all, by the Record. And, absent a supporting evidentiary record, a decision by the Commission approving the Rule Proposal would be open to challenge both for that reason and as arbitrary and capricious.

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<sup>21</sup> *Belenke v. SEC*, 606 F.2d 193 (7th Cir. 1979) (reviewing a Commission order approving an amendment to the rules of the Chicago Board of Options).

<sup>22</sup> *See, e.g., Domestic Securities v. SEC*, 333 F.3d 239 (D.C. Cir. 2003) (reviewing a Commission order approving a proposal by the National Association of Securities Dealers ("NASD") to implement a new quotation and trade execution system); *NASD v. SEC*, 801 F.2d 1415 (D.C. Cir. 1986) (reviewing a Commission order rejecting as excessive a fee proposed by NASD for access to certain computerized securities information that it collected).

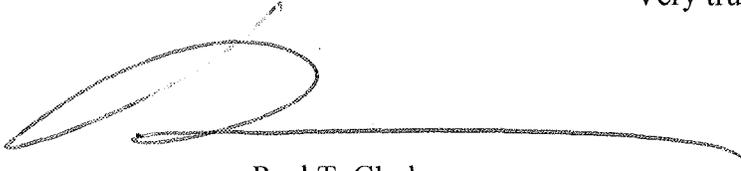
<sup>23</sup> *Netcoalition v. SEC*, 615 F. 2d 525 (D.C. Cir. 2010) (reviewing a Commission order approving NYSE Arca's proposal to begin charging a fee to investors for access to proprietary information).

<sup>24</sup> § 3(a)(26).

<sup>25</sup> *Netcoalition v. SEC*, *supra* note 23.

We appreciate the opportunity to comment on the Rule Proposal. If you have any questions, please do not hesitate to contact either of the undersigned at 202-737-8833.

Very truly yours,

A handwritten signature in black ink, consisting of a large, stylized loop followed by a long horizontal line that tapers to the right.

Paul T. Clark

A handwritten signature in black ink, featuring a series of connected, somewhat jagged loops and lines.

Anthony C.J. Nuland

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