

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51174; File No. SR-NSCC-2003-22)

February 9, 2005

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Granting Approval of a 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

I. Introduction

On November 10, 2003, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on November 29, 2004, amended proposed rule change File No. SR-NSCC-2003-22 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposed rule change was published in the Federal Register on December 13, 2004.² No comment letters were received. For the reasons discussed below, the Commission is now granting approval of the proposed rule change.

II. Description

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

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 50797 (December 6, 2004), 69 FR 72238.

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.

The proposed rule change (i) raises the minimum excess net capital requirement applicable to such broker-dealer applicants and members from \$25,000 to \$50,000 and (ii) changes the standards of financial responsibility required of banks and trust companies by referring to different types of criteria than are currently used for this purpose. The effective date for the proposed rule change as applied to current members is 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 amends 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.

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

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 1993.⁴ 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.⁵ At that time, no change was made to the financial requirements 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 will 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 to 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. When the proposed minimum excess net capital requirement is increased to \$50,000, the minimum clearing fund requirements

⁴ Securities Exchange Act Release No. 33525 (January 26, 1994), 59 FR 9805.

⁵ 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 capital.

currently imposed will no longer be applicable because \$50,000 in excess net capital will 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.

Under the proposed rule change, the standards of financial responsibility applicable to banks and trust company applicants applying to use and members using Mutual Fund Services and Insurance Processing Services will 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 will 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 will be replaced by a requirement that all trust companies have \$2,000,000 in capital. Because state regulations vary in their respective capital requirements and because some states do not have a capital requirement, the revised criteria will 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 will 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.⁶

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

III. Discussion

Section 17A(b)(3)(F) of the Act requires among other things that the rules of a clearing

⁶ The proposed rule change makes 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”).

agency be designed to assure the safeguarding of securities and funds in its custody or control or for which it is responsible.⁷ The Commission finds that NSCC's proposed rule change is consistent with this requirement because by enhancing the standards of financial responsibility applicable to NSCC members using NSCC's Mutual Fund Services and Insurance Processing Service, it should help NSCC protect itself and its members from undue financial risk. As a result, the proposal should help NSCC assure the safeguarding of securities and funds which are in its custody or control.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.

⁷ 15 U.S.C. 78q-1(b)(3)(F).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (File No. SR-NSCC-2003-22) be and hereby is approved.

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

Margaret H. McFarland
Deputy Secretary

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).