

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51458; File No. SR-NSCC-2004-09)

March 31, 2005

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change To Establish a Comprehensive Standard of Care and Limitation of Liability to its Members

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ notice is hereby given that on December 8, 2004, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) and on March 15, 2005, 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

NSCC is seeking to establish a comprehensive standard of care and limitation of liability with respect to its members.

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 below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.²

¹ 15 U.S.C. 78s(b)(1).

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

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

NSCC is seeking to establish a comprehensive standard of care and limitation of liability with respect to its members. Historically, the Commission has left to user-governed clearing agencies the question of how to allocate losses associated with, among other things, clearing agency functions.³ The Commission has reviewed clearing agency services on a case-by-case basis and in determining the appropriate standard of care has balanced the need for a high degree of clearing agency care with the effect the resulting liabilities may have on clearing agency operations, costs, and safekeeping of securities and funds.⁴ Because standards of care represent an allocation of rights and liabilities between a clearing agency and its members, which are sophisticated financial entities, the Commission has refrained from establishing a unique federal standard of care and generally has allowed clearing agencies and other self-regulatory organizations and their members to establish their own standard of care.⁵ In addition, the Commission has recognized that a gross negligence standard of care is appropriate for certain noncustodial functions where a clearing agency, its board of directors, and its members determine to allocate risk to individual service users.⁶

³ Securities Exchange Act Release Nos. 20221 (September 23, 1983), 48 FR 45167 and 22940 (February 24, 1986), 51 FR 7169.

⁴ Id.

⁵ Id.

⁶ Securities Exchange Act Release No. 26154 (October 3, 1988), 53 FR 39556. NSCC's services provided to members are noncustodial in that, other than clearing fund deposits, it does not hold its members funds or securities.

NSCC believes that adopting a uniform rule⁷ limiting NSCC's liability to its members to

⁷ The proposed language of new Section 2 of Rule 58 is as follows:

SEC. 2. Notwithstanding any other provision in the Rules:

(a) The Corporation will not be liable for any action taken, or any delay or failure to take any action, hereunder or otherwise to fulfill the Corporation's obligations to its Members including Settling Members, Settling Bank Only Members, Municipal Comparison Only Members, Insurance Carrier Members, TPA Members, Mutual Fund/Insurance Services Members, Non-Clearing Members, Fund Members and Data Services Only Members, other than for losses caused directly by the Corporation's gross negligence, willful misconduct, or violation of Federal securities laws for which there is a private right of action. Under no circumstances will the Corporation be liable for the acts, delays, omissions, bankruptcy, or insolvency, of any third party, including, without limitation, any depository, custodian, sub-custodian, clearing or settlement system, transfer agent, registrar, data communication service or delivery service ("Third Party"), unless the Corporation was grossly negligent, engaged in willful misconduct, or in violation of Federal securities laws for which there is a private right of action in selecting such Third Party.

(b) Under no circumstances will the Corporation be liable for any indirect, consequential, incidental, special, punitive or exemplary loss or damage (including, but not limited to, loss of business, loss of profits, trading losses, loss of opportunity and loss of use) howsoever suffered or incurred, regardless of whether the Corporation has been advised of the possibility of such damages or whether such damages otherwise could have been foreseen or prevented.

(c) With respect to instructions given to the Corporation by a Special Representative/Index Recipient Agent, the Corporation shall have no responsibility or liability for any errors which may occur in the course of transmissions or recording of any transmissions or which may exist in any magnetic tape, document or other media so delivered to the Corporation.

(d) With respect to the Corporation's distribution facilities, the Corporation assumes no responsibility whatever for the form or content of any tickets, checks, papers, documents or other material (other than items prepared by it) placed in the boxes in its distribution facilities assigned to each Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member and Data Services Only Member, or otherwise handled by the Corporation; nor does the Corporation assume any responsibility for any improper or unauthorized removal from such boxes or from the Corporation's facilities of any such tickets, checks, papers, documents or other material, including items prepared by the Corporation.

direct losses caused by NSCC's gross negligence, willful misconduct, or violation of Federal securities laws for which there is a private right of action would: (1) memorialize an appropriate commercial standard of care that will protect NSCC from undue liability;⁸ (2) permit the resources of NSCC to be appropriately utilized for promoting the accurate clearance and settlement of securities; and (3) would be consistent with similar rules adopted by other self-regulatory organizations and approved by the Commission.⁹

(e) With respect to Fund/Serv transactions, the Corporation will not be responsible for the completeness or accuracy of any transaction or instruction received from or transmitted to a Settling Member, Data Services Only Member, TPA Member, TPA Settling Entity, Mutual Fund Processor or Fund Member through Fund/Serv, nor for any errors, omissions or delays which may occur in the transmission of a transaction or instruction to or from a Settling Member, Data Services Only Member, TPA Member, TPA Settling Entity, Mutual Fund Processor or Fund Member.

(f) The Corporation will not be responsible for the completeness or accuracy of any IPS Data and Repository Data received from or transmitted to an Insurance Carrier Member, Member or Data Services Only Member through IPS nor for any errors, omissions or delays which may occur in the transmission of such IPS Data and Repository Data to or from an Insurance Carrier Member, or Data Services Only Member.

⁸ NSCC has always operated under a gross negligence standard of care and both internal and external counsel have consistently advised members that this is the case. NSCC is seeking to eliminate any confusion due to the absence of a clear standard set forth in its rules and to memorialize its historical practice. In addition, NSCC has in effect a service agreement with the Fixed Income Clearing Corporation ("FICC") pursuant to which FICC provides services for NSCC's fixed income products. This service agreement provides for a gross negligence standard of care. In the absence of this proposed rule, NSCC could be in the position of having to pay for losses caused by FICC that are not recoverable under the agreement.

⁹ See, e.g., Securities Exchange Act Release Nos. 37421 (July 11, 1996), 61 FR 37513 [File No. SR-CBOE-96-02]; 37563 (August 14, 1996), 61 FR 43285 [File No. SR-PSE-96-21]; 48201 (July 21, 2003), 68 FR 44128 [File No. SR-GSCC-2002-10]; and 49373 (March 8, 2004), 69 FR 11921 [File No. SR-FICC-2003-09].

NSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act¹⁰ and the rules and regulations thereunder applicable to NSCC because it will permit the resources of NSCC to be appropriately utilized for promoting the accurate clearance and settlement of securities.

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

NSCC does not believe that the proposed rule change will 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

NSCC has not solicited or received any written comments on this proposal. NSCC will notify the Commission of any written comments it receives.

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.

¹⁰ 15 U.S.C. 78q-1.

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-2004-09 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-2004-09. 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 Commission's 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 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-2004-09 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.¹¹

Margaret H. McFarland
Deputy Secretary

¹¹ 17 CFR 200.30-3(a)(12).