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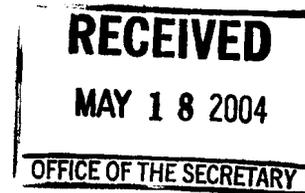
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#9

May 12, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20459-0609



Re: File No. S7-05-04, Proposed Rule: Collection Practices Under Section 31 of the Securities Exchange Act of 1934

Dear Mr. Katz:

National Securities Clearing Corporation ("NSCC") appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission (the "Commission") to adopt Rule 31 (the "Proposed Rule") and Form R31 under Section 31 of the Securities Exchange Act of 1934 (the "Exchange Act").¹ NSCC is a clearing agency registered with the Commission under Section 17A of the Exchange Act. NSCC provides centralized clearance, settlement and information services for a substantial majority of U.S. trades between broker-dealers in equity securities, corporate and municipal bonds, exchange-traded funds and unit investment trust shares.

I. Introductory Remarks and Summary of Comments.

NSCC has been working with the Commission staff for several months to discuss various staff proposals for registered clearing agencies to provide certain information to certain covered self-regulatory organizations ("covered SROs"), as defined in the Proposed Rule, that could be used by those organizations in filing reports with the Commission to help standardize and improve the accuracy of the calculation of fees owed to the Commission pursuant to Section 31 of the Exchange Act ("Section 31 Fees").

In the Proposing Release, the Commission is proposing new procedures that would govern the calculation, payment and collection of fees and assessments on covered SROs pursuant to Section 31. Under these new procedures, a national securities exchange or national securities association, as a covered SRO, would provide the Commission with data on its securities transactions each month. The Commission would

¹ Exchange Act Release No. 49109 (Jan. 20, 2004), 69 Fed. Reg. 4018 (Jan. 27, 2004) (the "Proposing Release").

calculate the amount of fees and assessments due based on the volume of those transactions, and then would bill the covered SRO twice each year for those amounts.

Paragraph (b)(1) of the Proposed Rule would require a covered SRO to submit to the Commission proposed Form R31 ("Form R 31") within ten business days after the end of each month. The form would require a covered SRO to report data on all of its "covered sales" (as defined in the Proposed Rule) having a "charge date" (as defined in the Proposed Rule) in the month of the report. This data would be derived from various sources, including registered clearing agencies such as NSCC (each, a "designated clearing agency" as defined in the Proposed Rule). The dollar amounts of sales captured by each separate source would be added to provide a single figure for the aggregate amount of the covered SRO's covered sales for the month.

In Part II of this letter, NSCC addresses its concerns regarding certain language in the Proposing Release suggesting that a designated clearing agency would be held liable for causing a covered SRO to file a Form R31 late.

In Part III of this letter, NSCC explains how it intends to comply with certain requirements of the Proposed Rule in respect of various types or transactions.

In Part IV of this letter, NSCC responds to certain questions as to which the Commission has solicited comments in Section III of the Proposing Release.

In Part V of this letter, NSCC provides preliminary estimates of its development and operational costs associated with the Proposed Rule.

II. Possible Liability of Designated Clearing Agencies Under the Proposed Rule.

NSCC understands that the Proposed Rule would impose a duty on each designated clearing agency to provide a covered SRO, upon request, with the data in the possession of the designated clearing agency needed by the covered SRO to complete Part I of Form R31. Paragraph (b)(5) of the Proposed Rule would require that a covered SRO provide in Part I of Form R31 *only* the data supplied to it by a designated clearing agency. If a covered SRO were to submit its own data in Part I of the form rather than the data supplied by a designated clearing agency, the covered SRO would be in violation of the Proposed Rule.

The Proposing Release suggests that if a covered SRO did not submit its Form R31 in a timely manner due to a delay caused by a designated clearing agency, the designated clearing agency, rather than the covered SRO, would be in violation of the Proposed Rule.² NSCC notes, however, that this implied imposition of potential liability of a designated clearing agency does not appear in the Proposed Rule itself, and believes

² See Proposing Release, 69 Fed. Reg. at 4024.

that it would be appropriate for the Commission to avoid the implication of such liability in the release accompanying the final version of the Proposed Rule.

NSCC has traditionally sought to cooperate with the U.S. securities marketplaces voluntarily by making certain data available to them, such as reports listing certain daily aggregate fail-to-deliver positions. And, as indicated below, NSCC would be prepared to provide covered SROs with the information necessary to satisfy their Form R31 reporting obligations. Nonetheless, the ability of NSCC to provide covered SROs with this information will involve dealing on a continuous basis with a number of complex definitional and operational complexities relating to the different types of transactions subject to the calculation of Section 31 Fees. It would be inappropriate for NSCC as an intermediary data processing entity to be subject to implied potential liability arising out of delays that it might incur in seeking to perform the data reporting function that would be required by paragraph (b)(4) of the Proposed Rule, particularly because NSCC would have no control over other elements of the preparation of a covered SRO's Form R31.

III. Practical Considerations Relating to NSCC's Ability to Comply with Certain Requirements of the Proposed Rule.

As a general matter, NSCC notes that its ability to provide covered SROs with data to complete Part I of Form R31 will depend on a determination as to how various transaction types should be considered when calculating "covered sales". The following identifies how NSCC intends to treat each of these transaction types.

A. Crossing Trades.

NSCC understands that crossing trades are trades submitted and executed after a covered SRO's close between two brokers at the closing price. There has been some variation among the covered SROs in their submission of crossing trades to NSCC. In the past, for example, the New York Stock Exchange ("NYSE") has given NSCC data from only one of its two crossing sessions, but is now working with NSCC to provide NSCC with data from the second session. NSCC understands that it obtains all crossing trades from all the other covered SROs and is confirming this understanding with each of these other covered SROs.³ As these are all market executions, NSCC intends to include these when calculating "covered sales".

B. Internalized Trades.

NSCC understands that the Commission staff is seeking to develop a common understanding regarding the application of the Proposed Rule to internalized trades. NSCC further understands that it is the Commission's view that, to the extent

market participants effect internalized trades, such trades should be reported to NSCC by the covered SROs. If and when that occurs, NSCC intends to include these transactions when calculating “covered sales” and would be prepared to communicate that information to the relevant covered SROs.

C. Step-Out, Correspondent Clearing, Universal Flip and Riskless Principal Trades.

NSCC understands that there appears to be some variation in the views among the covered SROs and their members as to whether information concerning these transaction types should be included in the data submitted to and by NSCC for purposes of compliance with the Proposed Rule. NSCC intends to take the actions set forth below but is requesting confirming guidance from the Commission in order to make a final determination as to the appropriate treatment of these transactions under the Proposed Rule.

1. Step-Out Trades.

Step-outs are position adjustments that originate at the NYSE, the American Stock Exchange (the “Amex”) and the National Association of Securities Dealers Automatic Quotation System (NASDAQ) subsequent to the execution of transactions in those markets. Step-outs allow a market participant to execute a transaction in a block of shares on behalf of other market participants. This transaction allows the actual buyers or sellers to maintain their anonymity in a trade. It is NSCC's intention to include the market execution transaction when calculating the “covered sale” value and to exclude the market adjustment (Step In /Step Out) transactions.

MARKET EXECUTION

Buyer	Seller
Bkr 0123 buys 100 ABC	Bkr 0125 sells 100 ABC (market transaction)

MARKET ADJUSTMENT

Bkr 0125 buys 100 ABC (Step Out)	Bkr 0150 sells 100 ABC (Step In)
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2. Correspondent Clearing Trades.

The correspondent clearing service is an NSCC application that facilitates a clearing adjustment with respect to the settlement of a trade executed by one broker on behalf of another broker who does not have direct access to the market in which the execution took place. For these trades NSCC receives two types of information. (1) The market place execution data and (2) the corresponding clearing data.

NSCC believes that only the market execution data should be used when NSCC calculates the "covered sale" value.. The corresponding clearing data is a clearing adjustment and NSCC intends to exclude these in calculating covered sale values.

MARKET EXECUTION

Seller

Buyer

Bkr 0ABC sells 100 IBM (NYSE)

Bkr 0XYZ buys 100 IBM (NYSE)

(Bkr 0ABC sold the 100 IBM on behalf of ODEF and submits a Correspondent Clearing adjustment to NSCC to adjust its settlement obligation).

CLEARING ADJUSTMENT

Bkr 0ABC buys 100 IBM

Bkr 0DEF sells 100 IBM

3. Universal Flip Trades.

Universal Flip is an NSCC application which PERMITS an NSCC member to execute trades in one member number ("market execution") and "flip" the trade to another member number for settlement purposes. This service facilitates the transfer of the settlement obligation from one NSCC member to another NSCC member. It is NSCC's intention to include only the market execution when calculating covered sale values and to exclude the transactions that result from the clearing adjustment which transfer the settlement obligation from one member to another.

MARKET TRANSACTION

Buyer

Seller

Bkr 0ABC buys 100 IBM

Bkr 0DEFsells 100 IBM (market execution)

CLEARING ADJUSTMENT

BKR 0DEF BUYS 100 IBM

BKR 0XYZ SELLS 100 IBM (Flip)

This transaction is internally generated at NSCC and is only reflected on the NSCC Consolidated Trade Summary.

4. Riskless Principal Trades.

A riskless principal trade is a market transaction in which the broker executing the trade does not have a principal interest in the transaction, but is acting as an intermediary for other brokers across different markets. For example, an electronic communications network(ECN) may execute one half of the trade in a regional market

and complete the transaction on its own trading platform. As these are market executions, NSCC intends to include in the calculation of "covered sale" values all transactions that carry a Riskless Principal indicator and include them in the data provided to the relevant SROs.

MARKET TRANSACTION

Transaction 1. Broker OABC places an order to sell 100 shares of IBM through Broker ODEF. Broker ODEF is an ECN and knows that the best execution may be found on an Exchange X with broker OXYZ.

Buyer	Seller
Bkr ODEF buys 100 IBM	Bkr OABC sells 100 IBM

Transaction 2. The ECN broker ODEF executes the trade on behalf of Broker OABC on exchange X with Broker OXYZ .

Buyer	Seller
Bkr OXYZ buys 100 IBM	Bkr ODEF sell 100 IBM (riskless principal)

In the NSCC system, NSCC will include OABC's sale transaction and ODEF's sale transaction in calculating "covered sale" value.

D. Reversals and Corrections.

NSCC understands that every covered SRO has protocols to identify reversal or correction trade input that must be disaggregated from the other trade input submitted to covered SROs for purposes of calculating Section 31 Fees, although not all covered SROs use these protocols. Historically, NSCC has not had a need to seek such identification because all of these reversal and correction trades would settle net at NSCC regardless of the way they were marked.

NSCC believes that it would be able to disaggregate reversal and correction trade input from trades which should be included in the determination of "covered sales" provided that the SROs identify reversal and correction trade input.

E. Intermarket Trading System.

NSCC and the covered SROs will have to apply a common convention for treatment of trades that are processed through the Intermarket Trading System ("ITS"). At present, NSCC knows the identification of the broker on the sell side, and the market to which the order was introduced. ITS omnibus accounts identify the marketplace on

which the trade was executed. NSCC proposes to utilize the ITS sell side value to identify the trade data that is included in the "covered sale" value which it reports to the appropriate SRO.

F. Trade Date v. Settlement Date Calculation.

NSCC and the covered SROs will have to reach a common understanding of whether trade date data or settlement date data should be used for purposes of reporting data to covered SROs for use in Part I of Form R31. The Proposing Release indicates that either category of data may be used for these purposes. NSCC believes, however, that only settlement date data should be used, since trade date data may subsequently be modified, and any such modifications could affect the data calculation.

G. Cash, Next Day and Seller's Option Trade Data.

Prior to April 2004 NSCC received data for these types of trades from the NYSE and Amex. As of April 2004, NSCC expects to receive data for these types of trades from all marketplaces. Any calculation by NSCC of "covered sale" value that is required on a retroactive basis will have to take into consideration the date when this data was made available to NSCC.

H. Exempt Sales and Transactions.

NSCC notes that it will have to reach an understanding with the covered SROs for the uniform submission of trade data for sales and transactions that are exempt from Section 31 Fees under the Proposed Rule. NSCC believes that the Commission staff and the covered SROs should develop appropriate criteria, building on paragraph (a)(11) of the Proposed Rule, for easily identifying whether a covered sale is an exempt sale and identifying such transactions to a designated clearing agency on a timely basis.

I. Multiple Sources of Data.

As suggested above, NSCC notes that its rules do not uniformly require the submission of trade data by covered SROs that is not required for settlement of the trades at NSCC. As a consequence, the data to be provided by NSCC to covered SROs for use in preparing Part I of Form 31R may vary from covered SRO to covered SRO.

For this reason, NSCC and the covered SROs will have to reach a common understanding, in consultation with the SEC, as to all of the trade data to be submitted by the covered SROs to NSCC to assure uniformity in the treatment of aggregate data to be provided by NSCC to the covered SROs for purposes of compliance with the Proposed Rule.

J. Clarification of Certain Functions Performed by Qualified Special Representatives.

NSCC notes that common understandings will have to be reached with covered SROs as to the procedures for reporting trades by a qualified special representative (a "QSR"), *i.e.*, an NSCC member that operates, has an affiliate that operates or clears for a broker-dealer that operates an automated execution system where the NSCC member is on the contra side of every transaction. The Proposing Release indicates that QSRs summarize and possibly net trades they give to NSCC (with the implication that the SEC does not have any concerns about QSRs netting trades). While NSCC recognizes that some QSRs do summarize trades, based on the information NSCC has received, NSCC does not believe the QSRs net trades. NSCC's present rules, however, do not prohibit a QSR from summarizing and netting its trades before reporting the trades to NSCC.

Due to risk concerns (not having all the data that could impact NSCC's analysis) and timing issues (if QSRs net, it delays when NSCC can obtain the data and this could have business continuity impact), NSCC suggests that the Commission confirm in the release accompanying the final version of the Proposed Rule that QSR trades should come to NSCC non-netted.

K. Exchange Traded Funds

NSCC facilitates the creation and redemptions of domestic Exchange Traded Funds through its ETF application. NSCC receives a nightly file, containing the composition for the following days trading, from each Index Receipt Agent. On trade date, Index Receipt Agents send NSCC instruction to create and/or redeem ETF baskets for specified participants. NSCC uses the file provided the night before to allocate securities and the ETFs to the appropriate parties. These instructions are then sent to CNS for settlement and hence an ETF is created or redeemed. Positions are adjusted in the Depository like any other trade.

Create and redeem activity is clearly identified within the NSCC applications as buys and sells.

Since ETF creations and redemptions are done away from the exchanges, an exchange would not be aware of the activity. The SEC needs to determine if it is appropriate to collect a covered sale charge on an item created through the NSCC for the creates and redemptions.

IV. Responses to Certain Questions Raised in the Proposing Release.

NSCC would also want to respond to certain questions as to which the Commission has solicited comments in the Proposing Release.

A. Extent of Submission of Data to NSCC.

Question 2 of the Proposing Release asks whether the exchanges report to a designated clearing agency every transaction that occurs on the exchange, even if the transaction does not result in a net change of position in any participant account of the designated clearing agency. The question is also raised whether the designated clearing agencies have the means to be able to tabulate these transactions.

NSCC is still consulting with certain exchanges as to the types of trades that they currently report to NSCC. As indicated above, for example, NSCC has experienced some variation in the reporting of crossing trades, internalized trades and similar transactions.

B. Payment of Section 31 Fees by Designated Clearing Agencies.

Question 14 of the Proposing Release asks whether the Commission should allow covered SROs to request a designated clearing agency to pay Section 31 bills on their behalf.

NSCC believes that, in general, it should be able to accommodate such a request, but would need to know more about the value in question and how frequently these payments would be required to be made before NSCC could determine if this is a service it could reasonably provide to a covered SRO.

V. Cost Estimate.

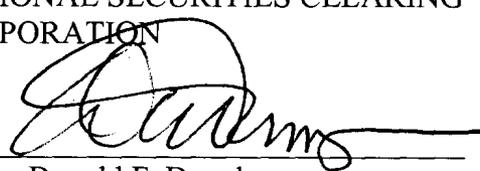
NSCC estimates that it would take approximately 1000 hours, at a total cost of \$140,000, to be able to develop the systems and procedures needed to fulfill its role under the Proposed Rule. NSCC's monthly operating costs following this development process are expected to be minimal.

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NSCC appreciates the opportunity to comment on the Proposing Release.

Sincerely yours,

NATIONAL SECURITIES CLEARING
CORPORATION

By: 

Donald F. Donahue
President