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Margaret A. Sheehan

May 9, 2003

Jonathan G. Katz
Secretary
US Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549



Re: Response to SR-NSCC-2003-01

Dear Sir:

We represent CheckFree Corporation ("CheckFree") and, on its behalf, we hereby respectfully submit this letter in response to the request for comments to Release No. 34-47662: Notice of Filing of Proposed Rule Change Relating to New Rule 59, "Information Services for Investment Products" dated April 17, 2003 ("Proposing Release").

A. Background

Founded in 1981, CheckFree's headquarters are located in Norcross, Georgia. Although it began as an electronic payment processing company, CheckFree's business has expanded into a broad range of financial electronic commerce products and services. In particular, CheckFree's Investment Services division provides numerous outsourced portfolio management services to help institutions deliver portfolio management, performance measurement, and reporting services to their clients.

CheckFree offers its portfolio management systems under the product name **APL**. **APL** provides the following range of services: trading modeling and routing capabilities, graphical client reporting, performance measurement, decision support tools, account analytics, tax lot accounting, straight-through processing, billing functions, and system and data security. In addition, CheckFree offers investment performance and reporting products and services under the product names M-Search, M-Watch, and M-Pact. The primary clients of CheckFree's services include: investment advisers, brokerage firms, banks, insurance companies, sponsors of wrap programs, and traditional money managers.

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On January 17, 2003, the National Securities Clearing Corporation (“NSCC”) filed a Form 19b-4: Proposed Rule Change with the Securities and Exchange Commission (“SEC”) pursuant to Rule 19b-4 of the Securities Exchange Act of 1934, as amended (“Exchange Act”).¹ Thereafter on April 17, 2003, the SEC published notice of the NSCC’s proposed Rule 59 (“Proposing Release”) and requested comments on the adoption of such rule.²

Pursuant to Exchange Act Section 19(b)(2)(B), the SEC shall approve the NSCC’s proposed Rule 59 within 35 days of its publication “if it finds that such proposed rule change is consistent with the requirements of this title and the rules **and** regulations thereunder applicable to such organization,” but shall disapprove the proposed rule if it does not make such a finding.³ In either case, the SEC shall not approve Rule 59 prior to the 30th day after the date of publication, unless the SEC finds good cause and publishes those reasons! Thus, the SEC will make a determination regarding proposed Rule 59 after May 17, 2003. Accordingly, on behalf of our client CheckFree, we respectfully submit this response opposing the adoption of NSCC’s proposed Rule 59.

B. Reasons Why CheckFree Opposes the Adoption of NSCC Rule 59

Specifically, our comments and concerns with respect to proposed Rule 59 are as follows:

1) The text of proposed Rule 59 raises substantive and procedural concerns.

a. The text of proposed Rule 59 and the justifications cited for its adoption are unduly vague and broad.

As proposed, the text of Rule 59, Section 1 articulates a very simple statement: “The [NSCC] may provide services for the transmission and receipt of data and information **related** to investment and financial products (“Information Services for Investment Products”).” This statement implies an extremely broad and vague new role for the NSCC by not sufficiently defining the term “Information Services for Investment Products,” the context in which this service will **be** provided, the methods or resources the NSCC intends to use to **develop** the technology to provide the new service, or the justification for undertaking the new service. The consequence of adopting such a vague rule could **have** a negative **impact** on the industry.

¹ Form 19b-4 Proposed Rule Change by National Securities Clearing Corporation, available at <http://www.nsccl.com/legal/2003-01.pdf> (visited May 7, 2003).

² Information Services for Investment Products, 68 Fed. Reg. 19,047 (April 17, 2003) (to be codified at ___ C.F.R. __) (proposed Jan. 17, 2003) [hereinafter *Proposing Release*].

³ Securities Exchange Act of 1934 19(b)(2)(B), 15 U.S.C. §78s (1975), as amended.

⁴ See *id.*

As it is set forth in the proposed text of the rule, the term “Information Services for Investment Products” does not adequately describe what services the NSCC intends to provide. Instead, the Proposing Release only sets forth one example of such a service, “a messaging system used by participants in the separately managed accounts industry” or “SMAS,” which would be used to transmit information between separately-managed account (“SMA”) sponsors (“SMA Sponsors”) and the management firms providing investment advisory services through the SMA Programs (“SMA Advisers”) for the purpose of coordinating data such as account opening information and the verification of funding amounts. The Proposing Release then cites two footnotes, one referring to The Money Management Institute (“MMI”), and one stating that it will file a separate Section 19(b) rule change proposal with the SEC prior to implementing any services under Rule 59.5 The Proposing Release does not provide additional details regarding the SMAS or any other services that it is currently developing, only hinting that any new services that it would provide under the rule would “facilitate the transmission of information for investment products in a standardized and automated format, using NSCC’s connectivity” and that such services could “be expected to reduce processing errors that are typically associated with manual processes or the use of multiple platforms and methods to transmit information.” If the SMAS is indeed only the first of several services that the NSCC will offer under Rule 59, the NSCC should, at a minimum, disclose what the additional services would be, whether or not they will charge fees for the services, and whether they intend to develop the services independently or with the assistance of industry participants.⁶

In addition, the NSCC provides inadequate justification for adopting such a broad and vague rule. The NSCC notes in the Proposing Release that: “[t]here is significant demand in the financial services industry for NSCC to make additional information services containing a broader range of information available to a broader range of participants,” however the NSCC cites no authority for this bold statement. The Proposing Release states further that “[t]he services would benefit the financial services industry by providing a means whereby information could be transferred in an automated and standardized environment using NSCC’s connectivity.” This statement does not account for the fact that this technology is already available through CheckFree and numerous other third-party service providers. Thus, the NSCC fails to explain in sufficient detail how its involvement would benefit its members.

⁵ *Proposing Release, supra* note 2 at nn.3 & 4; see *infra* Section B(1)(b) for a discussion of the implications of the NSCC’s use of such a procedure to elaborate on the types of services it intends to offer under Rule 59.

⁶ We understand that the NSCC may be working selectively with various industry participants to develop a business plan that defines the data movement and associated costs. Thus, although some firms may have working knowledge of the planned functionality of the NSCC’s future services, they may be creating an uneven playing field for industry participants.

Therefore, as currently written and as explained through the Proposing Release, the NSCC's Rule 59 is unduly broad and vague, failing to articulate clearly the type of services it intends to provide and the reasons why it is necessary or helpful for the NSCC to undertake this new range of services. For these reasons, at a minimum, the NSCC must further clarify and develop proposed Rule 59 before it is adopted.

b. The NSCC's approach to adopting proposed Rule 59 presents a procedural problem.

As the NSCC expressly admits in footnote 4 of the Proposing Release, the NSCC's approach for entering into this new line of services is to first adopt Rule 59 and then to subsequently "file [an Exchange Act] Rule 19(b) proposed rule change with the Commission before implementing any new service, such as the separately managed account service, under Rule 59." As the SEC is well aware, there are two means by which rules may become effective under Section 19(b): the formal process articulated in Section 19(b)(2) and the expedited process articulated in Section 19(b)(3). The formal process outlined in Section 19(b)(2) requires the SEC to first publish the rule proposal and then to "give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change" for at least 30 days prior to making a determination whether the rule shall be approved. Section 19(b)(3), however, enables the SEC to approve a rule proposal immediately upon an SRO's filing of the proposal with the SEC if the SRO designates the new rule as "constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of **an existing rule** of the [SRO]."⁷ Because it is the NSCC's intention that Rule 59 will become an "existing rule," the NSCC will be able to propose new sub-rules to Rule 59 through either the 19(b)(2) process or the 19(b)(3) process.

The risk, therefore, is that the NSCC will use the 19(b)(3) process to adopt the subsequent rules that will effectively give meaning to Rule 59. This would mean that the NSCC could articulate an expansive **range of services under** the umbrella of "Information Services for Investment Products" without enabling interested parties to effectively comment, participate, and publicly debate the type of services proposed and the impact on the industry. Minimally, the NSCC's proposal of Rule 59 in such a vague and expansive state is premature. Further, the NSCC's two-step methodology for obtaining approval for **the full scope of the** proposed rule is inappropriate and **inconsistent** with the requirements of the Exchange Act and contrary to the protection of investors. As such, CheckFree respectfully requests that the SEC require the NSCC to propose a new rule regarding investment product information services only if and when it is able to set forth

⁷ Securities Exchange Act of 1934 §19(b)(3)(A), 15 U.S.C. §78s (1975), as amended. *See also* Securities Exchange Act of 1934 Rule 19b-4(f), 15 U.S.C. §78s (1975), as amended. In addition, Section 19(b)(3) enables the SEC to put a rule into effect immediately if necessary for the protection of investors. Any SRO rule approved under this Section 19(b)(3) may be repealed by the SEC within 60 days of the filing date if the SEC finds that it is necessary for the public interest or for the protection of investors.

a description of the services that the NSCC actually intends to provide, so that the full impact of its new role may be appropriately considered and debated by interested parties.

c. The procedural risk is particularly significant given the potential of the unduly broad and vague Rule 59 to expand the NSCC's role beyond its statutory mandate.

Exchange Act Section 17A(b)(3)(F) provides that the rules of such clearing agencies must be designed to: (1) promote the prompt **and** accurate clearance and settlement of securities transactions, (2) assure the safeguarding of securities and funds in their custody or control, (3) foster the cooperation and coordination among persons engaged in clearance and settlement of securities transactions, (4) perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and **(5)** protect investors and the public interest?

As articulated in the Proposing Release, the NSCC believes that its proposed Rule 59 meets the requirements of the Exchange Act “because it promotes the prompt and accurate clearance and settlement of securities **and other related transactions.**”⁹ The NSCC specifically states that “[i]nformation services for investment products... would not involve money settlement **at** NSCC, nor the guarantee of any obligations.” **As** we understand proposed Rule 59, the apparent purpose is to develop a system of data sharing between SMA Sponsors and SMA Advisers.¹⁰ Yet, although the offering of “Information Services for Investment Products” does not logically further the NSCC’s ability to promote the prompt and accurate clearance and settlement of securities, the NSCC’s description of the clearing agency rule requirements noted above arbitrarily **expands** the specific language contained in the Exchange Act by adding the phrase “and other related transactions.” Thus, because the NSCC’s **proposed** Rule 59 data-sharing **service** represents an attempt by the NSCC to engage in activities outside the express language in

⁸ Securities Exchange Act of 1934 §17A(b)(3)(F), 15 U.S.C. §78q-1(b) (1975), as amended. The legislative history contained in P.L. 94-29 further discusses the purpose of the statute, and SEC Release No. 34-16900, 17 C.F.R. 241.16900, ¶26,203G (June 17, 1980) identifies standards to be used by the SEC in determining whether clearing agencies satisfy the general criteria under the Exchange Act.

⁹ Emphasis added.

¹⁰ According to the Proposing Release, the:

NSCC anticipates that the first such information service to be authorized under proposed Rule 59 would be a messaging system used by participants in the separately managed accounts industry. It is expected that the Separately Managed Account Service (“SMAS”) would be used for the transmission of information between sponsors of separately managed account programs and the investment managers participating in their programs in order to coordinate information such as account opening data and verification of funding amounts. Currently, this information is generally communicated by a combination of methods such as multiple vendor platforms, faxes, emails, and telephone.

Proposing Release, *supra* note 2 at 19,048.

Exchange Act Section 17A(b)(3)(F), it is particularly important that the new rule be precise, complete, and carefully follow the more conservative statutory procedure for receiving SEC approval.

2) It may be inappropriate for the NSCC to adopt the MMI Standards as its own in conjunction with the services it intends to provide under Rule 59.

It is not clear whether the NSCC, through its casual reference **to** the MMI, is proposing as part of Rule 59 to adopt the “Separately Managed Accounts Operations Communications and Data Standards” that MMI recently developed through a collaborative effort of certain SMA Advisers and SMA Sponsors (“MMI Standards”). If so, the NSCC may be inappropriately adopting as its own standards developed by a range of industry participants each with specific business goals.

a. The MMI Standards evolved from a collaborative process.

The process of developing the MMI Standards began in early 2002 when MMI’s Technology and Operations Subcommittee for **Data** Standards first held meetings to collaborate on the development of standards that were to be designed to reduce operational inefficiencies and manual processes. The subcommittee focused on the account opening and funding process that was primarily manual and different at each **firm**. At about the same time, the subcommittee invited the NSCC to participate in the development of the standards. **As** the meetings progressed, the NSCC increased its participation to that of a leadership role.

On July 8, **2002**, the MMI published the first version of their data standards requesting industry feedback. CheckFree provided feedback and **was** asked to participate in a Technical Working Group chaired by the NSCC to develop the standards and protocol. At this point, it **was** the understanding of CheckFree and many participants of the Technical working group that the standards were to be **open** and that the decision to exclusively use a centralized hub through the NSCC had been deferred. Thereafter, CheckFree and other industry participants met weekly between September and December to discuss the data elements and the implications of these data elements for **what** was thought to become the open standard. In December **2002**, participants of the Technical Working Group received abrupt notice that the group’s services **were** not longer needed, **despite** the group having **only** further refined the data elements by determining data formats and not having done any work toward establishing an open protocol.

b. The status of the NSCC’s involvement in the standards project recently shifted from an interested participant to a regulator.

Simultaneously in early December 2002, CheckFree began to receive inquiries from certain of its clients about participating in a pilot program to test standards. Although the program **was** to begin in **January** and run through March, participants did

not receive a complete description or details of the pilot until late December. When the participants finally received more information about the pilot project on December 23, 2002, it became apparent to CheckFree that the NSCC **had taken** the feedback provided by the Technical Working Group and worked the information into its own proprietary infrastructure; in effect, closing the standards.¹¹

Nevertheless, it remains unclear whether the NSCC plans to adopt the MMI Standards **as** its own in conjunction with the services it intends to provide through Rule 59. If so, it is also unclear whether the NSCC will adopt the MMI Standards **as open** standards, available to entities that are not NSCC members and to entities that are not subscribers to NSCC services as well **as** to NSCC members and subscribers, or **as proprietary** standards, available only to members **of** the NSCC and to subscribers to their Rule 59 services. Either way, considering the NSCC's unique status as an SRO comprised of various industry members,¹² its use of the MMI Standards in conjunction with **any** fee-based services it may provide to **the** industry may represent a usurpation of widely-developed work product for its own use.

3) *The proposed rule would have a negative impact on competition.*

Furthermore, CheckFree firmly disagrees with the NSCC's assertion in the Proposing Release that new Rule 59 would have no impact on competition.¹³ In fact, numerous third-party vendors have developed information **services** for investment products specifically designed for the **SMA** industry because the nature of the industry has created a need for transmitting data principally from **SMA** Sponsors to **SMA** Advisers. Firms such as CheckFree have built over one-thousand logical interfaces and

¹¹ Throughout the pilot period, CheckFree has periodically participated in status calls with the NSCC, **but** has not made substantial progress in implementing the standard because **it** is concerned that, when **costs** are ultimately disclosed, the adoption of the NSCC closed protocol will not occur. To date, there has been no public mention of the costs associated with participation. CheckFree has been asked to participate in the next stage of the NSCC's Technical Working Group, though no details have been provided as to what processes will be dealt with and what the group is charged with producing. CheckFree has, thus far, been excluded from the NSCC's development of pricing models.

¹² The Depository Trust Clearing Corporation ("DTCC") is the parent company of both the Depository Trust Corporation ("DTC") and the NSCC. CheckFree is not a member of DTC or NSCC, although certain of its competitors are. We understand that certain of CheckFree's competitors are on the DTCC's committee **for** common messaging and communications protocols and are "actively participating with the DTCC" on the project **of** developing the standards that, as discussed above, we understand are to be used in connection with *SAMS*. See Shane Kite, *NSCC's SMA Hub to Level **Playing** Field?*, *SECURITY INDUSTRY NEWS*, Apr. 28, 2003. Even if CheckFree were to be a member of DTC or NSCC, as a "Service Provider Member" it could not serve **on** any of **DTCC's** committees. It would be inappropriate for the NSCC's rulemaking process to become **a means by** which entities with competing business interests seek to gain **a** relative competitive advantage.

¹³ The NSCC does not cite any sources for this claim.

support the movement of over a million data transactions on a weekly basis.¹⁴ Some **SMA** Advisers independently have built fully functional, low-cost links to acquire and transmit data to **SMA** Sponsors.¹⁵ During the past twenty years, the **SMA** industry's cooperation with the movement of data to and from **SMA** Advisers and **SMA** Sponsors has spawned several niche firms that regularly compete to provide these services.

Absent a clear understanding of the NSCC's proposed services, it is reasonable to assume that a burden on competition will arise **as a** result of Rule 59 due to the NSCC's unique position as an SRO. The NSCC, as an SRO, has access to resources that the other competitors in the **SMA** industry do not, which would provide it with **an** unfair advantage over these competitors. In the Proposing Release, the NSCC notes that the "rule change will facilitate the transmission of information for investment products in a standardized and automated format, *using NSCC's connectivity.*"¹⁶ In effect, the NSCC plans to leverage its existing technology that it has developed under its core mandate of clearing and settlement of securities transactions, over which it has a government-sanctioned dominant market share, to provide the new services proposed under Rule 59. Further, the NSCC could potentially subsidize the development and offering of any new services with revenues generated from the fees it earns from its core services to its members." The fees the NSCC earns from these services are not subject to traditional competitive pressures. The access to these resources, derived principally from its status as an SRO, combined with its ability through rulemaking to dictate the form and manner **in** which all data-sharing services are provided in the **SMA** industry, create the very real possibility of a burden on competition.¹⁸

Consequently, we find the statement by the NSCC that the proposed Rule 59 does not burden competition to be unfounded. The NSCC's assertion fails to account for the practical implications of inserting itself in an already active industry and the potential conflicts of interest at stake in creating new, potentially proprietary standards to regulate the industry.

¹⁴ CheckFree's data movement capabilities are embedded in a broad range **of** services that **allow** **SMA** Advisers to create and maintain a shadow database of account information that reflects the holdings of accounts at the **SMA** Sponsors. In general, these portfolio **systems** are concerned with tax lot accounting, portfolio analytics, performance measurement reporting, trade modeling and routing.

¹⁵ To our knowledge, **the** NSCC has not solicited input from **any of** these **SMA** Advisers in **any** of the industry **forums**.

¹⁶ Emphasis added.

¹⁷ The **Proposing** Release does not specify the source of funding for the proposed new services,

¹⁸ **This** is particularly true **if** the NSCC in fact intends to adopt the MMI Standards **as** proprietary standards for the **purpose** of regulating both the type of data flow and the schema of data **flow** between **SMA** Advisers and **SMA** Sponsors.

C. Conclusion

In conclusion, CheckFree wishes to **oppose** the adoption of Rule 59 because the text of the rule raises substantive and procedural concerns, **the** rule's Proposing Release raises the possibility that the NSCC will inappropriately adopt the MMI Standards **as** its own, and the rule would place a burden on competition. Minimally, CheckFree believes these issues deserve further consideration by the SEC **and** the industry **at** large prior to the adoption **of** a rule with such broad potential consequences.

We therefore respectfully request your consideration of the aforementioned issues. Should you have additional questions or need additional information, **please** contact me at (202) 756-3305.

Sincerely,



Margaret A. Sheehan

MAS:kjk

Enclosures

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