

## MEMORANDUM

TO: **File No. SR-NSCC-2003-21**

FROM: Catherine Moore

DATE: March 26, 2004

SUBJECT: Meeting with CheckFree Corporation regarding its comments on SR-NSCC-2003-21

On Tuesday March 9, 2004, SEC Staff met with CheckFree Corporation and its representatives for approximately two hours (a list of attendees is provided at the end). CheckFree made a presentation that went over its opposition to the Separately Managed Accounts Service proposed by NSCC, as reflected in its comment letter dated December 23, 2003. Basically, CheckFree argued that the proposed Rule 59, which would allow NSCC to provide SMAS, does not meet the requirements of Sections 17A(b)(3)(F) and (I) of the Act. CheckFree also provided an overview of its business and the separately managed accounts industry.

The following is a summary of CheckFree's presentation.

**I. Section 17A(b)(3)(F).** This section provides, among other things, that the rules of a clearing agency should be designed to protect investors and the public interest . . . and should not be designed to regulate by virtue of any authority conferred by the Act matters not related to the purposes of Section 17A or the administration of the clearing agency.

### **A. Rule 59 is not designed to protect investors and the public interest**

#### **i. Rule 59 will harm investors and the public interest**

- a) SMAS will result in increased costs
  - 1. private businesses will bear the cost/burden to reconfigure their systems to required messaging standards and this cost will be passed on to investors.
  - 2. NSCC, by establishing standards and protocols, is actually making it more difficult and expensive for sponsors and managers to communicate.
- b) CF says there is harm because the increased costs and NSCC's position as an industry utility will push private companies (who are the best candidates to provide a SMAS-type service) out of business.

#### **ii. At the least, Rule 59 will not protect investors and the public interest**

a) NSCC stated in its comment letter that SMAS will protect investors for a number of reasons (standards, centralized connectivity, infrastructure, efficiency and lower cost, competition, technological innovation). CF went through the reasons NSCC provided and stated that none of them showed that SMAS protected investors.

b) CF said that if NSCC hasn't shown that its service is better than the service provided by others, how can it say that Rule 59 is designed to protect investors.

## **B. Rule 59 is designed to regulate a matter not related to the purposes of Section 17A or the administration of the clearing agency**

### **i. Rule 59 is designed to regulate SMAs**

a) NSCC's adoption of data standards and protocols is regulatory

b) NSCC's status as an industry utility makes it a regulator

1. MMI turned to NSCC as an industry utility, not as a vendor

-- CF was excluded from the development of the standards

because it is a vendor, NSCC was not excluded (shows NSCC is not a vendor).

2. Commission staff noted that NSCC cannot regulate the SMA

industry without Commission approval.

3. CF-- doesn't see the difference between regulating and providing the service.

-- NSCC can bring a pressure to industry participants that CF can't.

An SRO can't be a vendor only. Its status as a regulator carries influence and gives the perception to its users that it's a regulator of any service it offers. CF claimed that some people were pressured to write comment letters in support of SMAS.

### **ii. SMAS not related to the purposes of Section 17A or the administration of a clearing agency**

a) comparison to mutual funds is misplaced, SMA industry is really not like the mutual fund industry

b) SEC staff noted that the definition of a clearing agency is pretty broad and that you could argue that the SMAS is a clearance and settlement activity.

c) SEC staff noted that NSCC could offer SMAS through an unregulated affiliate. CF did not have response, would like to think about that issue.

**II. Section 17A(b)(3)(I).** This section provides that the rules of the clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title.

### **A. Rule 59 is a misuse of NSCC's monopoly power**

i) Even though NSCC is not a legislated monopoly, the effect on competition is the same as if it was.

ii) As an SRO, NSCC can pressure its members to use the service.

iii) NSCC has the advantages of fees received for a regulated activity which it will use to subsidize an unregulated activity  
iv) CF is closing the standards so no one can compete  
v) NSCC's other regulated systems could be unfairly leveraged for use in the SMAS.

vi) CF claimed that Rule 59 was drafted purposely vague so that NSCC could add more specific provisions as (b)(3)(A)s. SEC staff explained that all rule changes are noticed for public comment and even if they are effective upon the filing we have 60 days to abrogate the rule.

#### **B. Current SMA industry is not dominated by a monopoly**

i) Contrary to what NSCC states in its comment letter, CheckFree doesn't have a monopoly. The industry is mostly dominated by proprietary systems belonging to the major sponsors (but CF dominates the non-proprietary share).

#### **C. Rule 59 will not alleviate any barriers to entry to the SMA business**

i) NSCC and some of the commenters stated in their comment letters that SMAS will increase competition because by standardizing the communications it will make it easier for sponsors and managers to enter the industry. CF claims that there aren't barriers to entry for managers because of a lack of standards. The reason it's hard for managers to enter the business is because brokers will only work with so many managers, and rule 59 won't help with that.

ii) CF also pointed out that most of the comment letters came from money managers whose fees have been reduced by sponsors over the years. The managers hope that NSCC's initiative will redistribute investor fees between sponsors and managers. There were no letters from investors or an investor advocacy group.

### **III. Background on CheckFree**

-- founded in 1981

-- purchased Security APL, a provider of portfolio accounting services and analytical investment advisory tools, in 1996 and turned it into CheckFree Investment Services.

-- CIS uses Financial Information Exchange (FIX), an open industry protocol, to pass trade information from sponsors to managers.

-- CIS provides analytical tools for Sponsors and Money Managers to manage and report on portfolios. Money Managers are usually unaffiliated with Sponsors, and have no direct access to customers and rely on Sponsors for data.

-- Some of the functionalities of CIS's interfaces include account open, trading, reporting, billing, security, decision support tools, and tax lot accounting.

-- CIS has 1,400 open and proprietary interfaces from 120 unique firms, 74 Broker Dealer clients, 110 SMA manager clients, and over 100 Institutional Money Manager clients.

-- CIS adapts its interfaces to the needs of each client. That is why it has so many interfaces.

-- Large wirehouses, Merrill and Salomon, have their own technology and do not use CIS. They do not share their data with the marketplace.

#### **IV. Background on SMA Industry**

- An SMA is a customized, individual investment account offered principally from wirehouses, banks, and regional broker dealers. (They were formerly called "wrap accounts.")
- fees are fixed rate, similar to a wrap account fee.
- SMAs offer investors the benefits of customization, transparency, tax benefits, and diversification.
- expected to grow to \$747 Billion assets under management by 2007.

#### **V. List of attendees**

CheckFree: Laura Binion, Executive Vice President & General Counsel  
Alex Marasco, Executive Vice President & General Manager  
Jamie Waller, Vice President Strategic Marketing and Business Development

Alston & Bird: Margaret Sheehan, Partner  
Dennis Garris, Partner

SEC: Larry Bergmann, Associate Director  
Jerry Carpenter, Assistant Director  
Catherine Moore