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Margaret A. Sheehan

December 23, 2003

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

Re: Response to SR-NSCC-2003-21

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. 34-48846: Notice of Filing of a Proposed Rule Change Relating to the New Separately Managed Accounts Service dated November 26, 2003, proposed by the National Securities Clearing Corporation (“NSCC”).

## A. Background

### 1) **Procedural Background**

On January 17, 2003, the NSCC filed a proposed rule change on Form 19b-4 with the Securities and Exchange Commission (the “SEC” or “Commission”) pursuant to Rule 19b-4 of the Securities Exchange Act of 1934, as amended (“Exchange Act”) to create a new rule, Rule 59.<sup>1</sup> Thereafter, on April 17, 2003, the SEC published notice of the NSCC’s proposed Rule 59 and requested comments on its adoption.<sup>2</sup> On May 9, 2003, Alston & Bird filed a comment letter on behalf of CheckFree, opposing the adoption of Rule 59. The NSCC subsequently withdrew its proposal on June 27, 2003 and gave no reasons for doing so.<sup>3</sup>

<sup>1</sup> Proposed Rule Change by National Securities Clearing Corporation, Form 19b-4, *available at* <http://www.nsc.com/legal> (last visited Dec. 22, 2003).

<sup>2</sup> Notice of Filing of a Proposed Rule Change Relating to New Rule 59; Information Services for Investment Products, Exchange Act Release No. 34-47662, 68 Fed. Reg. 19,047 (Apr. 17, 2003) (proposed Jan. 17, 2003) [hereinafter Information Services].

<sup>3</sup> Notice of Withdrawal of a Proposed Rule Change Relating to New Rule 59; Information Services for Investment Products, Exchange Act Release No. 34-48819, 68 Fed. Reg. 67,708 (Dec. 3, 2003). *See* Modifications to the Rules

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On October 15, 2003, the NSCC again filed a Form 19b-4 with the SEC, proposing new Rule 59: Separately Managed Accounts Service (the "Rule Proposal").<sup>4</sup> On December 3, 2003, the Commission published notice of the NSCC's Rule Proposal (the "Proposing Release") and requested comments on the proposal.<sup>5</sup>

Pursuant to Exchange Act Section 19(b)(2)(B), the SEC is to 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 [the Exchange Act] and the rules and regulations thereunder applicable to such organization."<sup>6</sup> However, the SEC staff must disapprove the proposal if it does not make such a finding.<sup>7</sup> In either case, the SEC staff cannot approve Rule 59 prior to the 30<sup>th</sup> day after the date of publication, unless the SEC staff finds good cause for so doing and publishes the reasons supporting those findings.<sup>8</sup> Thus, the SEC staff will not make their determination regarding the NSCC Rule Proposal until after January 2, 2004. Accordingly, on behalf of our client CheckFree, we respectfully submit this response opposing the adoption of NSCC's proposed Rule 59.

## 2) CheckFree Corporation

Founded in 1981, CheckFree's headquarters are located in Norcross, Georgia. Although it began as an electronic payment processing company, CheckFree's business is now made up of a broad range of financial electronic commerce products and services.<sup>9</sup> In particular, CheckFree's Investment Services division provides 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 CheckFree APL<sup>TM</sup>. CheckFree is the leading provider of outsourced trading, portfolio management, accounting, reporting services and data to broker-dealers, financial advisers and money managers in separately managed accounts ("SMAs" or, in singular, "SMA"). Available on a remote processing basis, CheckFree APL<sup>TM</sup> enables money managers and broker-dealers to interface with each other and operate in a highly automated processing environment. CheckFree develops and maintains 1,400 interfaces with all the leading brokerage firms, money management firms, and banks. In addition, CheckFree offers investment performance and reporting products under

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and Procedures of National Securities Clearing Corporation, Form 19b-4, *available at* <http://www.nsccl.com/legal> (last visited Dec. 15, 2003). *See also* note 69 and accompanying text.

<sup>4</sup> Proposed Rule Change by National Securities Clearing Corporation, Form 19b-4, *available at* <http://www.nsccl.com/legal> (last visited Dec. 9, 2003) [hereinafter Rule Proposal].

<sup>5</sup> Notice of Filing of a Proposed Rule Change Relating to the New Separately Managed Accounts Service, Exchange Act Release No. 34-48846, 68 Fed. Reg. 67,714 (Dec. 3, 2003) (proposed Oct. 15, 2003) [hereinafter Proposing Release].

<sup>6</sup> Securities Exchange Act of 1934 §19(b)(2)(B), 15 U.S.C. §78s (b)(2)(B), as amended.

<sup>7</sup> *Id.*

<sup>8</sup> *See id.*

<sup>9</sup> For more information regarding CheckFree's business, *see* [www.checkfreecorp.com](http://www.checkfreecorp.com).

the product names M-Search®, M-Watch®, and M-Pact™. The primary clients of CheckFree's services include: investment managers, brokerage firms, banks, insurance companies, sponsors of wrap or SMA programs, and traditional money managers.

### 3) The SMA Industry and CheckFree's Role

Amidst the recently publicized mutual fund scandals, the SMA industry is gaining popularity as an alternative investment strategy.<sup>10</sup> SMAs are typically individual investment accounts offered principally by wire houses, banks, and regional broker-dealers (collectively "Sponsors"). Sponsors utilize a range of portfolio managers ("Managers") to customize the account for each individual investor (typically high net-worth individuals and smaller institutional investors). The investor develops an investment strategy through consultation with the Sponsor's financial consultant and the Sponsor then executes that strategy by placing the investor's discretionary assets with one or more Managers who specialize in the types of investment products involved in the strategy.

As the SMA industry has grown, access to the data related to the management of the SMA has become increasingly important to industry participants. The majority of Sponsors make data available to their Managers in an electronic format at little or no cost, by either developing their own interfaces or contracting with a vendor to do so on their behalf. Beginning in 2001, the Money Management Institute ("MMI"), a trade association for Managers, worked in conjunction with various industry participants and vendors to develop proposed standards for the data interchange between Sponsors and Managers. The MMI refers to the proposed standards as the Separately Managed Account Operations, Communications, and Data Standards ("MMI Data Standards"). Thereafter in the fall of 2002, the MMI formed an unusual alliance with the NSCC to recast the original collaboratively-developed MMI Data Standards into the "SMA Services" specifications ("NSCC SMA Specifications"), owned by the NSCC and dependent upon the NSCC's specific technology infrastructure. The NSCC, a clearing agency registered with the SEC, now seeks to override the existing infrastructure developed by Sponsors and vendors, and to provide a central connectivity hub by which client data ("Client Data") of all industry participants will be communicated.

Although the NSCC suggests that a "centralized communications platform" is necessary, the current levels of electronic communication within the SMA industry are already extensive due to the significant efforts made by Sponsors to provide Managers with electronic data. Of the many vendors in this space, CheckFree alone manages the connectivity and processing of electronic data for over 1,400 different connections throughout the SMA industry. In fact, Sponsors representing 71% of the SMA industry currently provide electronic new account opening data to their Managers. Those feeds include most of the data elements required by the MMI Data Standards. New interfaces that CheckFree is developing will load all of the data

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<sup>10</sup> Jeff D. Opdyke, *Scandals Drive Investors to Private Managers*, WALL. ST. J., Dec. 10, 2003, at D1.

<sup>11</sup> Subsequent to developing the specifications through various working groups, the MMI independently copyrighted the standards. See <http://www.moneyinstitute.com/about/about.html> (last visited Dec. 16, 2003).

included in the MMI Data Standards without introducing any incremental expense related to passing of data between Sponsors and Managers. Sponsors representing 94% of the SMA industry provide electronic custodial data to their Managers to automate the reconciliation and maintenance of custodial data. Indeed, CheckFree processes millions of transactions each week and reconciles over 100 million tax lot positions each month. Finally, while virtually all Sponsors provide online trading tools, Sponsors representing 76% of the SMA industry provide the means for the communication of electronic trading data to the Managers that participate in their programs. For instance, CheckFree supports 79 real-time trading interfaces, leveraging the open FIX protocol<sup>12</sup> and several proprietary-trading interfaces without introducing incremental expense to its clients or the industry.<sup>13</sup>

**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) **Rule 59 represents the NSCC's desire to engage in a new private enterprise as an SRO, expanding its role beyond its statutory mandate.**
  - a) *The NSCC inaccurately cites its Fund/SERV service for mutual funds as an example of how it could benefit the SMA industry by offering its SMA Services.*

To support its adoption of the SMA Service under proposed Rule 59, the NSCC points to its introduction of the Fund/SERV service during the mid-1980s.<sup>14</sup> This comparison, however, is inaccurate and misleading. In 1986, at the time that the NSCC issued its rule proposal regarding Fund/SERV, there was no existing private infrastructure supporting interconnectivity in the mutual fund industry and no vendors were competing to provide mutual funds with clearing, settling or data sharing services, a fact that the NSCC freely admits.<sup>15</sup> In addition, the Internet did not exist as an ubiquitous network, interconnecting industry participants as it does today. It was in this context that the NSCC proposed Fund/SERV as a pilot program to fill this void in the rapidly growing mutual fund industry.<sup>16</sup> The NSCC's primary objective was to use its expertise in clearing and settling fixed income and equity securities to benefit the mutual fund industry by providing them with greater stability and efficiency. Ten years later, as an ancillary part of its mutual fund clearing and settling services, the NSCC proposed Rule 52(D), the Mutual Fund

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<sup>12</sup> "The Financial Information exchange (FIX) protocol is a messaging standard developed specifically for the real-time electronic exchange of securities transactions. FIX is a public-domain specification owned and maintained by FIX Protocol, Ltd." *See* www.fixprotocol.org.

<sup>13</sup> *See* chart entitled, "Top Separate Account Consultant Program Sponsors," attached to this letter as Exhibit A.

<sup>14</sup> Rule Proposal, *supra* note 4, at 4.

<sup>15</sup> Self-Regulatory Organizations; Filing and Order Approving on an Accelerated Basis Proposed Rule Change of the National Securities Clearing Corporation, 51 Fed. Reg. 6954, 6955 (Feb. 27, 1986) (proposed Dec. 31, 1985) [hereinafter Fund/Serv Proposal] (noting that "[c]urrently, there are no centralized facilities or system for the processing of mutual fund securities transactions.").

<sup>16</sup> *See id.*

Profile Service (“MFPS”), to fill the remaining void with respect to the sharing of data between mutual fund industry participants.<sup>17</sup> Specifically, the NSCC justified the MFPS by noting the following:

Currently, NSCC members obtain fund price and rate information in a variety of ways including paper transmittals, facsimile, and telephone. NSCC believes that such methods of obtaining information generally are time consuming, labor intensive, and prone to error. Furthermore, NSCC believes the lack of automation and standardization of the process by which information is exchanged between NSCC members delays the receipt of time-sensitive data and contributes to processing difficulties resulting from incorrect or incomplete information. NSCC believes that MFPS will support and will expedite the processing of mutual fund transactions at the ~~firms~~ and funds.<sup>18</sup>

In contrast, the present SMA industry leverages a relatively sophisticated infrastructure of data transmission and data management services. As noted above, several industry participants realized the importance of data connectivity and interoperability many years ago and the marketplace has developed accordingly. Currently, at least ten private businesses compete to develop and provide the best technology and services to the SMA industry. As the SMA industry expands, it is likely that financial institutions may license or sell their proprietary technology and other private businesses will enter the arena as well. The NSCC’s entrance into the marketplace, however, would undermine the private sector and prevent the industry from innovating according to the demands of the market. Although some SMA Managers may argue that the data elements provided by Sponsors are insufficient, such insufficiency is not due to a lack of available connectivity. Rather, some Sponsors do not provide automated data feeds of account profile information (*e.g.*, risk tolerance and investment restrictions) for a variety of reasons, including the reality that data often resides in peripheral or desktop systems discreet from the enterprise systems that feed new account information to Managers. The NSCC’s proposal will do nothing more than create a redundant processing hub; it will not improve the Sponsors’ ability to make available data that is contained within the MMI Data Standards.

Furthermore, as stated above, Fund/SERV is primarily a clearing and settlement service, with the MFPS as a logical extension of that service. The transmission of SMA-related data has nothing to do with the NSCC’s clearing and settling service, as SMAs themselves are not securities, but rather are customized accounts holding cash and a variety of securities.<sup>19</sup> Because there is no need for a separate clearing and settling service for the SMA industry,<sup>20</sup> and the NSCC does not currently provide or propose to provide any clearing or settling function related

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<sup>17</sup> Notice of Filing of Proposed Rule Change to Establish the Daily Price and Rate File Phase of the Mutual Fund Profile Service, 61 Fed. Reg. 10,831 (Mar. 15, 1996) (proposed Jan. 19, 1996) [hereinafter Rule 52 Release]; *see also* Rule 52D: Mutual Fund Profile Service, NSCC Rules & Procedures, *available at* <http://www.nsccl.com/legal/nscclrules.pdf> (last visited Dec. 16, 2003).

<sup>18</sup> *See* Rule 52 Release, *supra* note 17, at 10,831. *But see* Proposing Release, *supra* note 5, at 67,714-15 (supporting the NSCC’s proposed service by noting: “Standardization and automation on these products can be expected to reduce processing errors and delays . . .”).

<sup>19</sup> *See supra* Section A(3).

<sup>20</sup> *See infra* Section B(2)(b).

specifically to SMAs, the NSCC's attempted insertion of itself into the SMA industry is unwarranted and unnecessary.

**b) *There is no statutory authority under Section 17A for the NSCC to become the new SRO for the SMA industry.***

Congress delegated to the SEC the responsibility of regulating clearing agencies pursuant to registration with the Commission, through its adoption of Section 17A of the Exchange Act.<sup>21</sup> Congress' findings as outlined in that section state that "the prompt and accurate clearance and settlement of *securities transactions*...[is] necessary for the protection of investors..."<sup>22</sup> (emphasis added). In light of this need for investor protection, Section 17A directs the SEC "to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of *transactions in securities*..." and "the establishment of linked or coordinated facilities for clearance and settlement of *transactions in securities*..."<sup>23</sup> (emphasis added). Each reference to the authority delegated to the SEC refers to the clearance and settlement of securities transactions. Nowhere within Section 17A does Congress state that the SEC should facilitate the establishment of a national service provider system for the sharing of Client Data. In fact, the only reference to data transfer technology found in Section 17A makes reference to new data processing and communication techniques *for clearance and settlement* that could be more efficiently utilized through a national clearing and settlement system.<sup>24</sup> The NSCC, therefore, cannot rely on this provision to authorize its new SMA Service.

There is also no support for the NSCC's Rule Proposal in Section 19 of the Exchange Act, the self-regulatory organization ("SRO" or, in plural, "SROs") rule-enacting legislation. Section 19 prescribes the methodology for SROs to receive SEC approval for "any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization..."<sup>25</sup> Section 3(a)(26) defines "self-regulatory organization" to include clearing agencies. Section 17A described above provides an outline of the responsibilities of registered clearing agencies through its descriptions of Congressional findings and its description of the delegation of authority to the Commission. Pursuant to that section, as a clearing agency, the NSCC is charged with promoting the prompt and accurate clearance and settlement of *securities trades*. Its authority under Section 19 does not, however, reach the prompt and accurate *transmission of Client Data*. The NSCC's proposal to enter into the SMA industry and to provide data sharing services is, therefore, without legislative authorization under either Section 17A or Section 19 of the Exchange Act.

It is true that the NSCC has applied its role as a clearing agency to serving new securities products to the extent that these products required the NSCC's involvement in clearing and

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<sup>21</sup> 15 U.S.C. § 78q-1.

<sup>22</sup> *Id.* at § 78q-1(a)(1)(A) (emphasis added).

<sup>23</sup> *Id.* at § 78q-1(a)(2)(A)(i) & (ii) (emphasis added).

<sup>24</sup> *Id.* at § 78q-1(a)(1)(C).

<sup>25</sup> 15 U.S.C. § 78s(b)(1).

settling transactions. In addition, as described above, the NSCC provides informational services as a natural offshoot of the clearing and settling function it serves for mutual funds.<sup>26</sup> However, in each situation, the NSCC's primary reason for entry into the various businesses was the provision of uniform clearing and settlement services pursuant to its authority under Section 17A and 19 as a registered clearing agency.<sup>27</sup> The same cannot be said for the Rule 59 proposal. An SMA is not a new type of security for which the NSCC's clearing and settling services are necessary or even relevant.<sup>28</sup> SMAs are customized consulting relationships among an investing client, a Sponsor, and one or more Managers. The NSCC's analogy to its entry into other securities industry services is, therefore, without merit.

In addition, not only is the NSCC's attempt to regulate SMAs under a statute that pertains to transactions in securities (i.e., Section 17A) statutorily inappropriate, it also could cause regulatory problems for the entire SMA industry. SMA programs have enjoyed safe harbor protection from the Investment Company Act of 1940 (the "1940 Act") through Rule 3a-4 promulgated thereunder.<sup>29</sup> Although SMA programs often have certain characteristics that resemble mutual funds subject to the 1940 Act's registration requirements, Rule 3a-4 allows the industry to pursue separate account money management services under the general condition that each account is managed, traded, and custodied as a unique entity for individual ownership.<sup>30</sup> Thus, although uniformity and standardization may be appropriate in the mutual fund industry, personalized and specific services are not only appropriate, but required in the SMA context. The NSCC's adoption of Rule 59 could, however, jeopardize this safe harbor for the SMA industry by requiring the SMA Managers and Sponsors to homogenize the data regarding the accounts of their individual investors.<sup>31</sup> In addition, the NSCC's imposition of new standards could have the unintended consequence of encouraging SMA sponsors to design or modify their SMA programs to treat all accounts in a like manner and not adhere to the tenets and principles of uniqueness required by Rule 3a-4.

CheckFree does not deny that the NSCC or its affiliate, the Depository Trust Corporation ("DTC"), may play a role in the SMA industry by clearing and settling certain securities trades made for those SMAs. In fact, the NSCC and the DTC are already providing that service. However, by proposing Rule 59, the NSCC is taking on a completely different role. The NSCC seeks to "provide a messaging hub for the communication of information among sponsors...and investment managers participating in their programs"<sup>32</sup> that does not directly relate to its primary

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<sup>26</sup> See *infra* Section B(1)(a).

<sup>27</sup> See, e.g., Fund/Serv Proposal, *supra* note 15.

<sup>28</sup> See Rule 3a-4 of the Investment Company Act of 1940, as amended ("1940 Act"), 15 U.S.C. § 80a-1 et. seq. [hereinafter Rule 3a-4] (providing a safe harbor from "investment company" status for programs that provide discretionary investment management services).

<sup>29</sup> See *id.*

<sup>30</sup> See Status of Investment Advisory Programs under the Investment Company Act of 1940, Rel. No. 22579, 62 Fed. Reg. 15,098 (Mar. 24, 1997).

<sup>31</sup> See *infra* Section (B)(1)(c).

<sup>32</sup> See Proposing Release, *supra* note 5, at 67,714.

function, namely the clearing and settling of securities transactions.<sup>33</sup> Given that there is no clearing or settling of securities transactions component of Rule 59, as required by the Exchange Act provisions related to clearing agencies, there is no statutory authority under Section 17A or Section 19 for the NSCC to enter the SMA industry as proposed.

As a final means of supporting the NSCC's proposed Rule 59, both the NSCC and the MMI contend that the SMA industry needs "standardized protocols and processes and centralized connectivity" to meet the needs of the industry's rapid growth.<sup>34</sup> In addition, through their collaboration in the development of the SMA Service at the heart of the NSCC's Rule Proposal, both entities have inferred that SRO oversight and rulemaking authority is necessary to achieve these goals.<sup>35</sup> Yet, even if SRO oversight is necessary, the NSCC does not have the authority unilaterally to expand its oversight role into an industry not directly related to the clearing and settling of trades. It is Congress' place to determine whether there is a need for governmental intervention and to provide appropriate enabling legislation for registration of a new type of SRO. It is precisely this process that led to the establishment of a national system for clearing and settling securities transactions<sup>36</sup> and that should be followed in this instance.

c) ***The timing is inappropriate for the NSCC to expand its regulatory authority.***

As the SEC staff is well aware, it is an especially sensitive time for an SRO like the NSCC to attempt a unilateral expansion of its statutory authority. In the post-Enron era, investors have become increasingly skeptical of the securities industry due to the numerous perceived abuses of power among those in positions of authority in the financial industry. The New York Stock Exchange ("NYSE") has come under recent scrutiny for conflicts of interest in its corporate governance structure. Over the last three months, the mutual fund industry has suffered by virtue the New York Attorney General's and the SEC's discovery of a myriad of improprieties concerning late trading and market timing of mutual fund shares.<sup>37</sup> These scandals have had far-reaching consequences, including criminal indictments and financial devastation to both funds and the individuals involved in the illegal activities.<sup>38</sup> As the creator of the omnibus

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<sup>33</sup> In fact, the proposing release itself explicitly states that the service "does not involve money settlement or securities clearance or netting..." without providing an explanation as to where it derives the authority to regulate services that do not at all involve the clearing and settling of securities transactions. See Proposing Release, *supra* note 5, at 67,715. Apparently, the NSCC does not believe that Congress has a role in deciding whether the SMA industry is in need of governmental regulation and/or SRO involvement.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* See also Thomas Coyle, *Battle Lines Drawn on Managed Acct Ops Hub*, FUND FIRE (Dec. 18, 2003).

<sup>36</sup> See In the Matter of The Application of the NSCC for Registration as a Clearing Agency; Order Granting Registration and Statement of Reasons, Exchange Act Release No. 13,163 (Jan. 13, 1977), available at 1977 SEC LEXIS 2664 (describing the legislative history of Section 17A of the Exchange Act).

<sup>37</sup> Floyd Norris, *Can Confidence Be Restored*, N.Y. TIMES at C13 (Oct. 5, 2003).

<sup>38</sup> Karen Damato, *Milestone for 'Timing' Scandal*, N.Y. TIMES at C1 (Oct. 29, 2003) (setting forth a timeline of the scandal and how the following industry giants have been implicated: Canary Capital, Bank of America, Bank One Corp., Janus Capital, Strong Capital Funds, Alliance Capital, Fidelity Investments, Merrill Lynch, Fred Alger Management, and Putnam).



processing infrastructure for mutual fund trading within which the market-timing and late trading activities took place,<sup>39</sup> even the NSCC has had to defend its role in the scandals.<sup>40</sup>

The timing of the NSCC's Rule Proposal to provide a new data service to the lucrative SMA industry, therefore, risks sending the wrong message to the investing public. During a time in which Congress and individual investors are demanding answers and solutions from SROs like the NYSE and from the mutual fund industry, the NSCC is engaging in aggressive tactics to expand its role in the marketplace as a vendor of services. Although the NSCC should be focusing its resources and attention on matters like legitimizing its role as an SRO and helping its existing members increase transparency and regain investor trust,<sup>41</sup> it instead is attempting to grow its own business. In this regard, we find it ironic that the Investment Company Institute, the mutual fund trade association, has formally requested that the SEC consider changes designed to curb perceived industry abuses at exactly the same time that the NSCC has chosen to focus myopically on pursuing its business objective.<sup>42</sup> Not only does the Chairman of the SEC recognize the potential impropriety of such action,<sup>43</sup> but investors also are likely to question the inappropriateness of the NSCC's actions.

- 2) **The NSCC's statement accompanying proposed rule 59 is inadequate and misleading.**
  - a) *The NSCC's arguments and explanations rely too heavily on information provided by the MMI.*

Under Exchange Act Section 19(b)(1), the NSCC is required to submit a "concise general statement of the basis and purpose of [a] proposed rule change."<sup>44</sup> The Proposing Release sets forth a detailed narrative of information regarding the SMA industry and the purported need for

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<sup>39</sup> Proposed Rule: Amendments to Rules Governing Pricing of Mutual Fund Shares, Investment Company Release No. 26,288, at 2, available at <http://www.sec.gov/rules/proposed/ic-26288.htm> (last visited Dec. 16, 2003) [hereinafter Mutual Fund Release].

<sup>40</sup> Karen Damato, *Fund-Order Processing: Fast, Flexible, Flawed*, WALL. ST. J. at C7 (Oct. 27, 2003).

<sup>41</sup> An example of an issue that the NSCC could tackle that would financially benefit the investors instead of the industry players is the elimination of conflicts of interest that taint the achievement of "best execution."

<sup>42</sup> See Investment Company Institute, *Mutual Fund Leaders Take Hard Stand on Soft Dollars: ICI Asks SEC to Dramatically Curtail Soft Dollars and Ban Directed Brokerage*, available at [http://www.ici.org/statements/nr/03\\_news\\_soft.html](http://www.ici.org/statements/nr/03_news_soft.html) (last visited Dec. 16, 2003).

<sup>43</sup> Testimony Concerning Market Structure Issues; Statement of Chairman William H. Donaldson before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Oct. 30, 2003, at 12, available at <http://www.sec.gov/news/testimony/ts103003whd.html> (last visited Dec. 22, 2003). Chairman Donaldson noted that, "[an SRO] has an inherent conflict of interest between its roles as a market and as a regulator."

<sup>44</sup> Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §785(b)(1).

an SRO to provide the SMA Service.<sup>45</sup> In addition, the Proposing Release highlights the significant role that the MMI has played in convincing the NSCC to provide the SMA Service.<sup>46</sup>

Notably, however, the MMI is not an impartial actor in its efforts to lobby the NSCC. As noted in the Rule Proposal, the MMI represents portfolio manager firms and Sponsors of investment consulting programs. Membership in the MMI is not available to individual investment advisers or individual investors.<sup>47</sup> Thus, among the functions of the MMI, and a logical reason for engaging the NSCC to undertake the SMA Service, is the MMI's goal of facilitating industry growth and promoting the success of its members. As such, it is inappropriate for the NSCC to adopt rules and services to profit some of the MMI members based solely on information provided to it by the MMI. Investor protection, and not the MMI members' profitability, is the proper goal of the NSCC.

In this regard, we note that the Rule Proposal cites the MMI as its only source for: (a) presenting the initial SMA Service concept to the NSCC; (b) developing the standards for the NSCC; and (c) approving the NSCC's proposed service.<sup>48</sup> Except for one report commissioned by the MMI,<sup>49</sup> the NSCC does not cite any other sources for its information regarding the SMA industry. The NSCC does not reference any SMA industry studies that it conducted independent of the MMI, nor does it reference any investor groups or industry participants outside the MMI that it consulted prior to launching the proposed service.

If the NSCC was a private entity serving only the interests of the same constituency as the MMI, its virtually exclusive reliance on the MMI's goals and interests might be appropriate. As a clearing agency registered with the SEC to provide a specific service for investors and for the entities facilitating transactions on behalf of investors, however, the NSCC must carefully consider the needs of all industry participants and the burdens launching this new service will impose on them. Exchange Act Section 17A(b)(3)(F) specifically notes that, "[a] clearing agency shall not be registered unless the [SEC] determines that...[t]he rules of the clearing agency . . . are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency..."<sup>50</sup> (emphasis added). As presented, both the Rule Proposal and the Proposing Release suggest that it developed Rule 59 to satisfy the interests of the MMI.

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<sup>45</sup> See Proposing Release, *supra* note 5, at 67,714.

<sup>46</sup> *Id.*

<sup>47</sup> About MMI, available at <http://www.moneyinstitute.com/about/about.html> (last visited Dec. 22, 2003).

<sup>48</sup> See Proposing Release, *supra* note 5, at 4-5.

<sup>49</sup> See *infra* Section B(2)(c).

<sup>50</sup> Section 17A(b)(3)(F) of the Exchange Act, 15 U.S.C. §78q-1(b)(3)(F) (emphasis added).

***b) The Rule Proposal and the Proposing Release provide an insufficient analysis of the SMA industry.***

Furthermore, as a result of relying too heavily on one source, the NSCC misconstrues the current SMA industry and over-generalizes the views of the industry participants. For example, the Proposing Release notes that:

It was the consensus of industry representatives through their participation in the MMI that this current operational infrastructure, which depends upon nonstandard and manual processing over multiple platforms, could not support the projected growth and even at the current levels, resulted in excessive processing costs, delays, and errors.<sup>51</sup>

It does not follow, however that the mere participation of Managers and Sponsors in the MMI necessarily signifies a unified consensus on this matter.<sup>52</sup>

In addition, the NSCC's arguments for why it should provide the SMA Service are insufficient. Throughout the Proposing Release, the NSCC lists rationales for the industry's adoption of uniform standards and the need for a centralized communications platform; however, the NSCC fails to justify why it is appropriate for an SRO to fulfill that role.<sup>53</sup> Sponsors and Managers have not made a collective request for the NSCC's involvement. The NSCC notes that the MMI, encouraged by the NSCC's role in the mutual fund industry, tapped the NSCC to become involved "with the view of increasing operational efficiency and decreasing operational risks inherent in the current processing structure."<sup>54</sup> Yet, it is unclear from the Proposing Release and from the Rule Proposal what risks the NSCC will help deter and why an SRO should replace the current private vendors. The NSCC's proposed Rule 59 expressly states in Section 4 that the NSCC will not assume any liability "for the completeness or accuracy of any SMAS Data nor for any errors, omissions or delays which may occur relating to the SMAS Data." The NSCC also has pronounced its passive role in preventing the timing errors connected with its mutual fund services.<sup>55</sup> Thus, it is unclear how the involvement of the NSCC, in its role as an SRO that expressly rejects responsibility for ensuring the correctness of the data being

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<sup>51</sup> See Proposing Release, *supra* note 5, at 67,714.

<sup>52</sup> See Jeff Benjamin, *Separates Biz Closer to a Common Language*, *INV. NEWS* at 1 (Oct. 27, 2003); see also *M.S., DTCC's SMA Service to Attract Technological Laggards*, *OPERATIONAL MGMT.* at 1 (Nov. 9, 2003) (noting that some of the largest Sponsors will not initially participate in the NSCC's SMA Service because they have other systems in place.) In fact, without any evidence or studies to indicate otherwise, it is conceivable that a significant number of MMI members do not support the NSCC's proposed rule. CheckFree is just one example of an MMI member that opposes the NSCC's proposed involvement in the SMA industry.

<sup>53</sup> See Proposing Release, *supra* note 5, at 67,714-15.

<sup>54</sup> *Id.*; see generally Proposing Release, *supra* note 5.

<sup>55</sup> See Damato, *supra* note 40, at C7. The article cites an interview with Ann Bergin, a managing director of the DTCC (the NSCC's parent). The article notes that the "NSCC says its job, as a clearing agency regulated by the [SEC], doesn't include policing the find-trading network." See also Mutual Fund Release, *supra* note 39, at 6. In response to the recent mutual fund scandals, the SEC recently proposed modifications to the mutual fund trading rules and processes. If adopted, the proposed rule would require the NSCC to act as a "time-stamping organization[], ensuring that orders are assigned the correct day's price."

transferred and the responsibility of overseeing the operations of its members, will benefit the SMA industry.

The NSCC mentions in the Proposing Release that it provides “guaranteed” services as well as “nonguaranteed” services, the former relating to settlement-related guarantees for trades that are cleared and settled at the NSCC and the latter relating to services that do not receive the protection of the NSCC guarantee.<sup>56</sup> The NSCC’s examples of “nonguaranteed” services include: (a) clearing and settling services that do not receive the protections, or guarantee, of the NSCC and (b) services that involve the communication only without the settlement of transactions or funds through the NSCC (e.g., the Profile Service).<sup>57</sup> What the NSCC fails to acknowledge, however, is that both of these examples relate to its core responsibility as a registered clearing agency. Clearly any clearing and settling services are a part of the NSCC’s core responsibility and the communication services fall within the scope of the NSCC’s mandate because they are fundamentally related to a clearing and settling service. What is novel about Rule 59, therefore, is that it is a “nonguaranteed” service that is not related to any clearing or settling function.

This is especially problematic because, unlike the NSCC’s role in the mutual fund industry, the NSCC’s unnecessary entrance into the SMA industry will not result in the netting of trades or an equivalent service that is specifically beneficial to investors. Although the Proposing Release alludes to the hope that the new NSCC SMA Specifications will reduce errors, delays, and inefficiencies that result in an adverse economic impact,<sup>58</sup> it is unclear whether the direct economic benefit to the Managers will translate into an indirect economic benefit to the individual investors. In fact, despite the NSCC’s participation in the mutual fund industry, costs to investors have actually risen over the last few decades.<sup>59</sup> In comparison, fees paid by SMA investors have been on the decline as competition among Sponsors and the industry as a whole has flourished,<sup>60</sup> despite the NSCC’s lack of participation in the SMA industry.

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<sup>56</sup> See Proposing Release, *supra* note 5, at 67,715 n.7.

<sup>57</sup> *Id.*

<sup>58</sup> See Proposing Release, *supra* note 5, at 67,715.

<sup>59</sup> See Division of Investment Management: Report on Mutual Fund Fees and Expenses (December 2000), available at <http://www.sec.gov/news/studies/feestudy.html> (last visited Dec. 22, 2003) (citing as a key observation that, “Overall, mutual fund expense ratios (*i.e.*, a fund’s total expenses, including 12b-1 fees, divided by its average net assets) have increased since the late 1970s, although they have declined in three of the last four years.”). See also *id.* at Table 2 (listing the increase in average expense ratios from a low of 1.14% in 1979 to a high of 1.36% in 1999).

<sup>60</sup> See Cerulli Associates, *Quantitative Update—Asset Managers 2003*, Exhibit 97 at 116 (2003) (highlighting the decline in average annual fees collected from SMA clients, down from 2.12% in 1999 to 1.75% in the first quarter of 2003).

c) ***The NSCC's reliance on the Deloitte & Touche report demonstrates a lack of independent and unbiased analysis.***

The NSCC cites a study by Deloitte & Touche as further substantiation of the need for an “industry-wide approach that would allow the SMA industry to achieve the type of standardization and centralized processing accomplished by the mutual fund industry over the last twenty years.”<sup>61</sup> The Deloitte & Touche study, however, was expressly commissioned by the MMI and bases its analyses on interviews of only four Sponsors and ten Managers of varying sizes and maturity.<sup>62</sup>

Deloitte & Touche's brief study cites only anecdotal evidence for its conclusion that inefficiencies in data sharing are a result of a lack of common business practices in the SMA industry.<sup>63</sup> Yet, the reasons for the lack of common business practices actually reflect the particular growth stage of this industry. The SMA industry, in its generally young state, is still in a period of rapid product differentiation. Many Sponsors have made major investments developing products and accompanying systems specific to their individual needs and would reject a homogenized system. In fact, many Sponsors view Managers as sub-contractors with limited direct client contact. Attempting to force standardization of business practices by imposing specific protocols on the industry could simply squash innovation during the developmental cycle of the industry and/or encourage Sponsors to sell proprietary products or services that actually could reduce investors' options.

Furthermore, the Deloitte & Touche study asserts that the SMA industry is similar to the mutual fund industry of the mid 1980s, but fails to provide any data to support the assertion or account for the major differences between the industries.<sup>64</sup> For example, the study compares the speed with which mutual fund accounts are set up under Fund/SERV with the time it takes to set up an SMA account. The implication of the comparison is that, given the similarity between the two industries, the NSCC can provide similar efficiencies to SMAs through the SMA Service as it provides to mutual funds through Fund/SERV. Yet, the study fails to take into account how, due to the heavily customized nature of SMAs, Sponsors and Managers must spend comparatively more time analyzing the new account, holdings, history, and profile data for compliance and complex suitability issues.<sup>65</sup> The process of opening a new SMA also often involves the movement of existing securities into the account or the decision by the Manager to sell certain securities or individual tax lots to yield an appropriate investment allocation. The study also fails to acknowledge that technology has developed dramatically over the last twenty years, as have the providers of technology.<sup>66</sup> In fact, the SMA industry appropriately has

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<sup>61</sup> See *id.* at 67,715 n.7.

<sup>62</sup> Deloitte & Touche, *Operational Interfaces in the Separately Managed Account Industry*, MONEY MGMT. INST. at 1 (Aug. 2002) [hereinafter D&T Article].

<sup>63</sup> See generally *id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 4.

<sup>66</sup> *Id.*

developed a rich, scalable supporting infrastructure for this emerging industry. Accordingly, the NSCC's reliance on the MMI-commissioned Deloitte & Touche study further illustrates the lack of independent analysis that the NSCC has undertaken prior to proposing Rule 59.

*d) The MMI Data Standards are not open despite the NSCC's claims in the Proposing Release*

The NSCC asserts in the Proposing Release that the MMI Data Standards will be "available to all vendors, sponsors, and managers to use in programming their...[own] applications."<sup>67</sup> This assertion, however, is very questionable.

*i. The MMI is claiming an intellectual property interest in the MMI Data Standards.*

First, it appears from the MMI's website that the MMI is claiming a copyright interest in the MMI Data Standards. As available on the website, the MMI Data Standards are clearly labeled as being the intellectual property of the Money Market Institute. Each page of the document describing the standards includes as a footer the following label: "Copyright © 2002 Money Management Institute. All Rights Reserved".<sup>68</sup> This copyright assertion raises the question of the degree to which the MMI intends to make the MMI Data Standards truly open. The MMI can restrict participation in further development of the standard to MMI members or a select subset thereof. Likewise, the MMI can control access to the standard and which vendors are allowed to build products that conform to the standard and under what terms those products may be offered in the marketplace. Consequently this past November, CheckFree submitted a list of questions to the MMI seeking clarification on the MMI's view of the openness of the MMI Data Standards going forward.<sup>69</sup> We have yet to receive any response to these questions from the MMI. Further, it is not clear whether the material incorporated into the MMI Data Standards was included with express permission from all the owners of the material. Without specific clarification of the terms under which the MMI Data Standards will be governed, made available, and licensed, the Proposing Release's claim that the MMI Data Standards are open is misleading.

*ii. The NSCC may also be claiming a proprietary interest in the MMI Data Standards.*

Even if the MMI is not claiming a copyright interest in the MMI Data Standards themselves or if their claim is deemed invalid, it is unclear from the Proposing Release whether the NSCC is adopting the MMI Data Standards as its own as part of the SMA Service. As the NSCC notes in the Proposing Release, the NSCC was invited to work with the MMI's Technology/Operations Committee for data standards in early 2002. On July 8, 2002, the MMI

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<sup>67</sup> See Proposing Release, *supra* note 5, at 67,714.

<sup>68</sup> See The Money Management Institute, Separately Managed Accounts Operations Communications Data Standards Cite Data Standards, available at <http://www.moneyinstitute.com/multimedia/standards.pdf> (last visited Dec. 18, 2003).

<sup>69</sup> For a list of the specific questions CheckFree posed to the MMI, see Exhibit B to this letter.

published the first version of the MMI Data Standards requesting industry feedback.<sup>70</sup> CheckFree provided feedback and participated in a Technical Working Group chaired by the NSCC to develop the standards and protocol. At that point, it was the understanding of CheckFree and many participants of the Technical Working Group that the standards were to be open and available to all industry participants for use in developing competing data sharing technology.

Thereafter, CheckFree and other industry participants met weekly between September and December to discuss the data elements and their implications for what was thought to become the open standard. In December 2002, however, participants of the Technical Working Group received abrupt notice that the group's services were no longer needed, despite having only further refined the data elements by determining data formats and not having done any work toward establishing an open protocol. Simultaneously in early December 2002, CheckFree began to receive inquiries from certain of its clients about participating in a pilot program to test the MMI Standards. Although the program was scheduled to begin in January and run through March, participants did not receive a complete description of or details regarding the project until late December. When the participants finally received more information on December 23, 2002, it became apparent to CheckFree that the NSCC had taken the feedback provided by the Technical Working Group with respect to the MMI Data Standards and worked the information into the NSCC SMA Specifications.

In light of the NSCC's actions, it appears that it is the NSCC's intention is to adopt the MMI Data Standards as its own in conjunction with the services it intends to provide through proposed Rule 59. If this is true, the NSCC will be usurping a widely-developed work product and preventing other vendors such as CheckFree from using the MMI Data Standards to develop products that compete with the SMA Service.

- **3) 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 concept: "The [NSCC] may provide a service to enable Members, Fund Members and Data Services Only Members to transmit and receive such data and information relating to managed accounts (the "SMAS Data") as the [NSCC] may determine...[and] [s]uch service will be known as the Separately Managed Account Service ("SMAS")..."<sup>71</sup> Although this text seems simple and straightforward, the simplicity of this section can be misleading. By not sufficiently defining the terms "Separately Managed Account Service" and "SMAS Data", the methods or resources the NSCC intends to use to develop the technology to provide the new service, or the statutory authority on which the NSCC's entrance into this industry is based, the NSCC is creating an

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<sup>70</sup> See Proposing Release, *supra* note 5, at 67,714.

<sup>71</sup> See Rule Proposal *supra* note 4, at 10.

extremely broad and vague new role for itself as an SRO for the SMA industry, a role for which there is no statutory authority. Adopting such a vague rule and thereby expanding the NSCC's regulatory authority beyond the text of Section 17A of the Exchange Act will have a negative impact on the industry by granting the NSCC broad powers to expand its role without seeking further regulatory or statutory approval.

- i. *The text of the Proposed Rule 59 does not adequately define Separately Managed Account Service.*

As it is set forth in the text of the proposed rule, the term "Separately Managed Account Service" does not adequately describe what services the NSCC intends to provide. The text of the rule simply states that the NSCC will provide a service that will enable certain of its members to transmit and receive such SMAS Data as the NSCC will determine from time to time. The Proposing Release provides a more detailed explanation of what the NSCC intends to provide.<sup>72</sup> This language, however, is not the controlling text. The text of the rule itself will govern the provision of the SMA Services and, as previously stated, the text of the rule itself is quite broad. What actually occurs after the adoption of this rule could turn out to be quite different from what is described in the text of the release.

- ii. *The NSCC does not provide any information regarding its funding of the SMA Service.*

Furthermore, neither the text of the proposed rule nor the Proposing Release provides any indication of how the NSCC intends to fund its entry into the SMA industry or how it has funded the process thus far. Instead, the Proposing Release simply states that the fees to be charged investors to fund this new effort "will be the subject of a separate rule filing."<sup>73</sup> Where will these funds come from and how has the NSCC funded this initiative **up** until this point? As far as can be discerned from the annual report of the Depository Trust & Clearing Corporation (the "DTCC"), NSCC's parent company, the NSCC's only source of revenue is the fees paid by its members for the clearing and settlement services it provides to mutual funds and other industries.<sup>74</sup> This means that, assuming costs are passed on, investors in these industries may be subsidizing the NSCC's development of services completely unrelated to its core function of clearing and settling trades.<sup>75</sup> This is the only logical assumption that can be made given that the

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<sup>72</sup> The proposing release states that messages sent through the SMA Service will consist of "account opening data" and "account maintenance data". See Proposing Release, *supra* note 5, at 67,715. The release goes on to state that the SMA Service "will provide [a] centralized platform for the basic account opening and maintenance data among sponsors and investment managers." *Id.* The actual text of the proposed rule, however, does not provide this type of explanation and leaves further elaboration on what services will be provided to a later rule proposal. See Rule Proposal, *supra* note 4, at 10.

<sup>73</sup> See Proposing Release *supra* note 5, at 67,715.

<sup>74</sup> DTCC, 2002 Annual Review: DTCC Delivers (2002), available at [http://www.dtcc.com/AboutUs/2002annual1/dtcc\\_2002\\_annual.pdf](http://www.dtcc.com/AboutUs/2002annual1/dtcc_2002_annual.pdf) [hereinafter Annual Review].

<sup>75</sup> In light of the NSCC's substantial presence in the mutual fund market (*i.e.*, the value of the mutual fund transactions processed by the NSCC in 2002 was \$1.6 trillion (*see* Annual Review, *supra* note 72, at 27)), a large



Proposing Release does not even attempt to provide an explanation of how the initiative has been and will be funded. If the NSCC is going to be permitted to enter into and regulate what is now a privately managed marketplace, it should, at the very least, be required to disclose how it has funded this initiative and what it will charge investors for its services in the future.

iii. *There is no statutory justification for the NSCC's adoption of Proposed Rule 59.*

Finally, the NSCC provides inadequate statutory justification for adopting proposed Rule 59. The NSCC proposed Rule 59 pursuant to the procedure under Section 19(b)(2) (described more fully below).<sup>76</sup> However, the NSCC's rulemaking authority under Section 19(b) is derived from its status as a registered clearing agency under Section 17A. As stated above, Section 17A grants the NSCC authority over clearing and settling securities transactions only and not over the processing of Client Data. The NSCC, therefore cannot appropriately rely on Section 19(b) for authority to enact Rule 59.

The only other justification put forward by the NSCC for this Rule Proposal is that the SMA industry needs "standardized protocols and processes and centralized connectivity" to meet the needs of the industry's growth.<sup>77</sup> Even if this statement is accurate, it fails to provide adequate justification for the new rule for two reasons. First, it fails to account for the fact that current technology is constantly being improved by CheckFree and other third-party providers<sup>78</sup> through competition that can meet the growth needs of the industry without the need for regulation. Second, and more importantly, the NSCC does not have the legislative authority to meet this need by declaring itself the SRO of the SMA industry through the adoption of Rule 59 without Congress' adoption of additional legislation granting this authority. Thus, the NSCC fails to provide sufficient justification for its adoption of Rule 59.

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, the SEC staff should reject the NSCC's proposal.

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

As the SEC staff is well aware, there are two means by which rules may be enacted under Section 19(b) of the Exchange Act: the formal process articulated in Section 19(b)(2) and the expedited process set forth in Section 19(b)(3). The formal process outlined in Section 19(b)(2), the section pursuant to which the NSCC proposes Rule 59, requires the SEC to publish the rule

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percentage of the subsidy for the SMA initiative, an industry which caters primarily to institutional and high net worth investors, comes from middle income investors.

<sup>76</sup> Securities Exchange Act of 1934 §19(b)(2) [hereinafter Exchange Act], 15 U.S.C. §78s(b)(2), as amended.

<sup>77</sup> See Proposing Release, *supra* note 5, at 67,715.

<sup>78</sup> See Sydney LeBlanc, LEGACY: THE HISTORY OF SEPARATELY MANAGED ACCOUNTS 101-02 (MMI 2002).

proposal and “give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change” for at least thirty days prior to making a determination as to whether the rule will be approved or rejected.<sup>79</sup> 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].”<sup>80</sup> Because Rule 59 will become an “existing rule” of the NSCC, the NSCC will be able to propose new sub-rules to Rule 59 through either process outlined above.

The risk inherent in the adoption of Rule 59 in its current state is that the NSCC will use the 19(b)(3) process to adopt subsequent rules that fully define the SMA Service, that determine the breadth of the NSCC’s regulatory reach in the SMA industry and that outline the fees to be charged, without allowing interested parties to effectively comment, participate and publicly debate the rule’s impact on the industry and on investors.<sup>81</sup> We believe that the NSCC’s only real objective is to grow its revenues. We believe the NSCC seeks to do this by creating new products and cross-selling its other services into the SMA market. The NSCC’s two-step methodology for obtaining approval for the full scope of the proposed rule, therefore, is inappropriate and inconsistent with the requirements of the Exchange Act and contrary to the protection of investors. Furthermore, this risk is compounded by the fact that Rule 59 represents an attempt by the NSCC to serve as an SRO for an industry about which Congress has made no findings of a need for regulation and to which Congress has not granted the NSCC the authority to unilaterally extend its regulatory function. As such, CheckFree respectfully requests that the SEC reject the current Rule Proposal and require the NSCC to file a new proposal if and when Congress provides appropriate legislation and the NSCC is able to fully describe the SMA Service and the relevant fees, within the text of the rule.

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<sup>79</sup> Exchange Act §19(b)(2), 15 U.S.C. §78s(b)(2).

<sup>80</sup> Exchange Act §19(b)(3)(A), 15 U.S.C. §78s(b)(3)(A), as amended. *See also* Exchange Act Rule 19b-4(f), 17 C.F.R. 240.19b-4(f). 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.

<sup>81</sup> As an example of how this procedure works, the NSCC submitted proposed Rule 31 to the SEC in June 2003 using the expedited review available under 19(b)(3). Interestingly, part of Rule 31 expands the definition of “Data Services Only Members” to include investment advisers. As the SEC staff will recall, the NSCC proposed in its original Rule 59 proposal to include “investment advisers” to the group of entities that it would provide the SMA Service. *See* Information Services, *supra* note 2, at 7. Four days after withdrawing the original Rule 59 proposal, the NSCC proposed an expedited approval of a change to existing Rule 31, proposing to include “investment advisers” in the definition of “Data Services Only Members,” a term that is included in the current Rule 59 proposal. If Rule 59 is adopted as proposed, the SMA Service will become available to investment advisers by virtue of new Rule 31. Thus, the NSCC is essentially able to accomplish part of its objectives with respect to Rule 59 without a public comment period.

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

CheckFree also firmly disagrees with the NSCC's assertion in the Proposing Release that Rule 59 will have no impact on competition. In the Proposing Release, the NSCC makes the blanket assertion that, in its opinion, the proposed rule changes will have no impact on and will not impose a burden on competition.<sup>82</sup> The release provides no further explanation or justification for this statement, nor does it state to which market or markets it is referring. The NSCC effectively leaves the SEC and the rest of the industry to trust that the NSCC's opinion is correct.<sup>83</sup>

The proposed rule, as initially released by the NSCC in October, provides further insight into the NSCC's rationale. The NSCC states that it "has been advised by several participants in the managed account industry, representing sponsors, investment managers and service providers, that NSCC's SMA Service will potentially foster competition among vendors offering *other services* to the industry."<sup>84</sup> (emphasis added). The NSCC, however, does not identify who these industry participants are and cites no support for its conclusion that the rule will foster and not impose a burden on competition.

Furthermore, the NSCC's statement that the SMA Service will foster competition among vendors providing services other than the connectivity and data transfer services to be provided by the NSCC completely fails to account for the fact that CheckFree and numerous other third-party vendors currently support the movement of over a million data transactions weekly, providing precisely the type of service the NSCC intends to provide. Although CheckFree welcomes additional industry competitors that are similarly situated, it believes that the NSCC's position as an SRO will give it an unfair advantage in three respects. First, as an SRO it has regulatory powers to dictate the parameters in which vendors must operate in this space. Second, the NSCC's proposed new role may create the potential for the NSCC to impose technological standards on the industry. Third, the NSCC would be at a financial advantage because, given its position as an SRO, the NSCC would be in a position to offer the SMA Services at below cost prices by subsidizing its initial development of its SMA Service as well as its services with fees generated from its existing self-regulatory activities. The NSCC could thereby drive out of the market third-party vendors such as CheckFree currently providing similar data transfer and connectivity.

In light of the substantial risk to competition that Rule 59 poses, CheckFree respectfully opposes the Rule Proposal. Given the substantial investigation into issues of competition performed during the NSCC's initial application to become a registered clearing agency,<sup>85</sup>

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<sup>82</sup> See Proposing Release, *supra* note 5, at 67,715.

<sup>83</sup> *Id.*

<sup>84</sup> Rule Proposal, *supra* note 4, at 7.

<sup>85</sup> See *In re*: App. of the NSCC for Registration as a Clearing Agency: Order Granting Registration and Stmt. of Reasons, Exchange Act Release No. 13,163, 1977 SEC LEXIS 2664 (Jan. 13, 1977).

CheckFree believes that, at a minimum, the NSCC should be required to further elaborate on and provide factual support for its contention that there will be no effect on competition.

**C. Conclusion**

In conclusion, CheckFree wishes to oppose the adoption of Rule 59 because Rule 59 represents the NSCC's desire to engage in a new private enterprise as an SRO, expanding its role beyond its statutory mandate; the NSCC's statement accompanying proposed rule 59 is inadequate and misleading; the MMI Data Standards are not open despite the NSCC's claims in the Proposing Release; and the text of proposed Rule 59 raises substantive and procedural concerns. For these reasons, CheckFree believes that these issues, at a minimum, deserve further consideration prior to the SEC's final decision regarding the NSCC's Rule Proposal. Furthermore, we would welcome the opportunity to discuss our concerns with you in an in person meeting with our client.

We, therefore, respectfully request your consideration of the aforementioned issues. Should you have additional questions or need additional information, please do not hesitate to contact me at (202) 756-3305.

Sincerely,

Handwritten signature of Margaret A. Sheehan in black ink, with the initials 'SFB' written to the right of the signature.

Margaret A. Sheehan

SFB:sfb

cc: Carol A. Jameson  
National Securities Clearing Corporation  
55 Water Street  
New York, New York 10041

Laura E. Binion  
General Counsel  
CheckFree Corporation  
441 1 East Jones Bridge Road  
Norcross, Georgia 30092

## EXHIBIT A

### Top Separate Account Consultant Program Sponsors

Sponsor*	3Q AUM*	Marketshare*	Trading**	New Accounts**	Custodial <sup>1</sup>
1 Smith Barney	\$147,707,870,717	32.84%	X	X	X
2 Merrill Lynch	\$105,751,000,000	23.51%	X	X	X
3 Morgan Stanley	\$36,728,600,000	8.17%			X
4 UBS Financial Services	\$32,308,149,399	7.18%			X
5 Prudential Financial	\$17,194,970,201	3.82%	X	X	X
6 Raymond James	\$11,168,939,032	2.48%	X		X
7 Charles Schwab	\$10,968,000,000	2.44%	X		X
8 AG Edwards	\$10,761,992,513	2.39%			X
9 DB Alex Brown	\$10,269,000,000	2.28%	X	X	X
10 Wachovia Securities	\$8,541,252,984	1.90%	X	X	X
11 Lockwood Financial	\$6,921,000,000	1.54%	X	X	X
12 Oppenheimer & Co.	\$5,591,276,856	1.24%			
13 RBC Dain Rauscher	\$4,027,000,000	0.90%	X	X	X
14 Bank of America	\$4,000,000,000	0.89%	X	X	X
15 Janney Montgomery Scott	\$3,837,258,957	0.85%	X	X	X
16 London Pacific Advisors	\$3,837,258,957	0.85%			
17 Brinker Capital	\$3,544,605,000	0.79%	X	X	X
18 Legg Mason	\$3,525,175,818	0.78%	X	X	X
19 Pershing	\$3,517,052,122	0.78%	X	X	X
20 Financial Service Corp	\$2,634,965,024	0.59%			
		96	76	71	94
Total Separate Account Assets	\$ 449,800,000,000				

\* Source: Cerulli Associates

\*\* Source: CheckFree Corporation

## EXHIBIT B

### CheckFree's Questions to the MMI (posed November 25, 2003)

#### **Licensing terms (in place or contemplated):**

- Does an implementor have to be an MMI member?
- Can the implementor be sponsored by an MMI member?
- If **so**, are there restrictions imposed that would prevent general sales of a product developed under said sponsorship?
- Is the license royalty free?
- Does marketing literature or product documentation referencing the MMI specification need to acknowledge the MMI specification copyright or specific license terms and/or IP obligations (see below)?

#### **Certification**

- What are your goals for interoperability between implementations?
- Does the MMI plan to put a certification process in place to insure that products and services adhere to some level of specification compliance?
- Do you plan to develop a formal test suite that vendors can license along with the specification to do compliance / interop testing?
- If not, how will you achieve your interoperability goals?
- Will there be an "MMI mark" available to products & services that pass your certification requirements?

#### **Intellectual Property Rights**

- Has the MMI pursued any process to insure that the specification is unencumbered by participants' intellectual property rights, particularly issued patents?
- Do participants in the specification process agree to license any related IP on a royalty free or RAND (Reasonable and non-discriminatory) basis?
- Are specification licensees and implementors required to waive related IP rights?

#### **Cooperation / Collaboration with other standards groups**

- There are numerous XML and data standard initiatives underway within the Securities industry
- How is the MMI keeping abreast of related initiatives?
- How do you plan to avoid overlap and conflict with other efforts (even basic ones like FIXml and SWIFTml)?