

IMPORTANT NOTICE

National Securities Clearing Corporation



The Depository Trust &
Clearing Corporation

A#6359

P&S #5929

DATE: December 13, 2006

TO: ALL PARTICIPANTS

**ATTENTION: MANAGING PARTNER/OFFICER, OPERATIONS
PARTNER/OFFICER, COMPLIANCE OFFICER**

FROM: General Counsel's Office

**SUBJECT: RULE CHANGE – SR-NSCC-2006-17 (Membership Standards
and Requirements)**

National Securities Clearing Corporation ("NSCC") has filed a rule change with the Securities and Exchange Commission ("SEC"), pursuant to Section 19(b)(2) of the Securities Exchange Act of 1934. This rule change proposes to reorganize NSCC's Rules related to membership standards and membership requirements, conform them to current practice and (where practicable and/or beneficial) harmonize them with similar rules of NSCC's affiliate, the Fixed Income Clearing Corporation ("FICC").

Please refer to the rule filing for full details. The full text of this rule change (SR-NSCC-2006-17) may be obtained by visiting NSCC's website at www.nsc.com.

Rules & Procedures - General Structure

Over the years, NSCC has created a variety of membership classes, each with different initial and continuing membership requirements. These requirements are currently scattered throughout NSCC's Rules. With the objective of promoting greater transparency, NSCC proposes to reorganize and restructure its Rules related to member types, the membership application process and the ongoing requirements of NSCC members, in a form that it believes will make them more readily located and understood by applicants and members alike. Additionally, NSCC proposes to add certain descriptive text to its Rules with regard to the current membership application process and with regard to the voluntary retirement process.

Membership Types – Members and Limited Members

NSCC's Rules (*see* Rule 2) currently provide that an applicant may apply to become a Member, but at its request may limit its use of NSCC's services to those specified by the Corporation -- such participants are termed to be "Mutual Fund/Insurance Services Members". However, there are other types of NSCC members that utilize NSCC's systems and services on a limited basis, including but not limited to Municipal Comparison Only Members (which participate in NSCC's Comparison Operation solely for the comparison of municipal securities) and Non-Clearing Members (which participate solely in the Commission Settlement Service for the payment and collection of commissions).

In restructuring and revising Rule 2 (Members and Limited Members), NSCC will clearly, concisely and in one location, set forth each membership type, differentiating between “Members” (which may generally, unless otherwise limited by NSCC, access all services made available by NSCC) and “Limited Members” (those member types, other than Members that may utilize NSCC’s systems and services only on a limited basis¹). This change is intended to be cosmetic only, and other than logically grouping member types, will not alter in any way each such member’s existing rights and/or obligations. Additionally, NSCC will add text to the proposed revised Rule 2 making clear that no Member or Limited Member may submit or confirm any transaction, charge, request, instruction or transmission through NSCC’s services, or otherwise utilize the Corporation’s services, in contravention of any law, rule, regulation or statute.

Consolidation of Membership Standards and Requirements Within the Rules

The membership qualifications, financial standards and operational requirements for each member type are currently set forth in separate rules and addenda, which are spread throughout NSCC’s Rules².

To consolidate this information, NSCC proposes to create the following new rules: Rule 2A (Initial Membership Requirements), which will provide information regarding initial membership eligibility requirements for all member types and will address the process of membership application and evaluation, and Rule 2B (Ongoing Membership Requirements and Monitoring), which will contain provisions regarding the continuing requirements of members. For ease of reference, NSCC also proposes to relocate and consolidate the detailed membership qualifications, financial standards and operational requirements for all membership types into one addendum (Addendum B – Qualifications and Standards of Financial Responsibility, Operational Capability and Business History).

Use of the Terms “Members” and “Settling Members” Throughout the Rules

Currently, a Member that agrees to limit its use of NSCC’s services to those specified by the Corporation (*i.e.*, to the Mutual Fund Services and/or Insurance and Retirement Services³), it is called a “Mutual Fund/Insurance Services Member”. Thus when the term “Member” is used within NSCC’s Rules, it may apply to a Member (which may generally use all NSCC services), a Mutual Fund/Insurance Services Member (which may only utilize the Mutual Fund and Insurance and Retirement Processing Services, or to both, depending upon the context. Additionally, NSCC’s Rules make reference to “Settling Members”, which when used in NSCC’s Rules, may apply to a Member, a Mutual Fund/Insurance Services Member, a Non-Clearing Member, or all three member types. It is only in the context of the term’s use in a given rule that one may determine to which member type the rule or rule provision applies.⁴ Accordingly, NSCC proposes to modify all references to “Settling Member”

¹ Limited Members will include the following: Fund Members, Insurance Carrier/Retirement Services Members, Municipal Comparison Only Members, Mutual Fund/Insurance Services Members, Data Services Only Members, Non-Clearing Members (who will now be renamed “Commission Billing Members”), Settling Bank Only Members and Third Party Administrator Members.

² Members (*see* Rule 2 and Addendum B), Mutual Fund/Insurance Services Members (also defined to be “Members” - *see* Rule 2 and Addendum B), Fund Members (*see* Rule 51 and Addendum I), Insurance Carrier/Retirement Services Members (*see* Rule 56 and Addendum Q), Third Party Administrator Members (*see* Rule 60 and Addendum R), Data Services Only Members (*see* Rule 31), Municipal Comparison Only Members (*see* Rule 3, Sec. 2), Non-Clearing Members (*see* Rule 3, Sec. 2) and Settling Bank Only Members (*see* Rule 54).

³ Previously referred to as the “Insurance Processing Service”, *see* NSCC rule filing SR-NSCC-2006-16).

⁴ For example, as a Mutual Fund/Insurance Services Member may not participate in the Continuous Net Settlement Service (“CNS”), any reference to “Members” within Rule 11 (CNS) would not apply to Mutual Fund/Insurance Services Members,

and (where necessary) to “Member” within each NSCC Rule, to clearly indicate which member type the rule is applicable to. Definitions associated with these terms (contained within Rule 1) will be modified as necessary, and the term “Settling Member” will be deleted from NSCC’s Rules.

Rule 15 – Financial Responsibility and Operational Capability

Rule 15 contains, among other things, the continuing requirements of members with regard to reports to be timely filed on an ongoing basis (e.g., annual audited financial statements, Financial and Operational Combined Uniform Single (“FOCUS”) Reports, etc.), notifications that members are required to timely make to NSCC regarding any failure to maintain their membership qualifications and standards, as well as notifications of certain material changes in business, ownership or control (*see* Rule 15, Sections 2 and 3). NSCC proposes to move these ongoing reporting requirements into the new Rule 2B (Ongoing Membership Requirements and Monitoring). Rule 15 will then be renamed as “Assurances of Financial Responsibility and Operational Capability”.

Within Section 2.A. of Rule 2B (Reports and Information), to assist members in timely meeting their reporting requirements, NSCC also proposes to add clarifying text making clear that unless specifically set forth within the Rule, the time periods established for remitting reports and data to NSCC are set forth in the form of notices posted at NSCC’s website, and that each Member and Limited Member is required (pursuant to Rule 45, Section 7) to retrieve all notices from NSCC’s website daily.

Within Section 2.B of Rule 2B (Notification of Changes in Condition), NSCC proposes to change the reporting requirements of certain member types with respect to providing NSCC with written notice of events that would effect a change in control of the member, or could have a material impact on the member’s business and/or financial condition. Historically, this provision applied to Members (*i.e.*, those full service Members for which certain activity is guaranteed at a fixed point in the clearance and settlement process), as well as Mutual Fund/Insurance Services Members, Fund Members and Insurance Carrier/Retirement Services Members⁵ (*i.e.*, those member types whose activity is limited to use of non-guaranteed services). NSCC has determined that such notification provision should apply solely to Members, and not to any type of Limited Member.

Additionally, NSCC is removing the current requirement that a Non-Clearing Member (now to be renamed “Commission Billing Member”) provide NSCC with written and oral notice if it is no longer in compliance with any of the relevant qualifications and standards for membership. Commission Billing Members participate in NSCC solely for the purpose of paying and receiving broker commissions, and file transmissions in relation to the service are sent to NSCC directly from the Commission Billing Member’s exchange (the New York Stock Exchange or American Stock Exchange). As there are no NSCC financial or operational requirements applicable to this (non-guaranteed) member type and the participation of the Commission Billing Member is coordinated between NSCC and the member’s exchange, the current requirement is not necessary and is now being deleted.

and would apply solely to Members. Any reference to “Settling Member” within Rule 17 (Fine Payments) would apply to all Members, Mutual Fund/Insurance Services Members and Non-Clearing Members (which NSCC now proposes to rename “Commission Billing Members”).

⁵ Previously referred to in NSCC’s Rules as “Insurance Carrier Members”, *see* NSCC Rule Filing SR-NSCC-2006-16)

Rule 2A (Initial Membership Requirements)

Applicant Operational Testing Requirements - NSCC proposes to insert additional text within its Rules to make clear NSCC's current requirement with regard to applicant testing (see Rule 2A, Section 1.C., Application Documents).

Member's Agreements - NSCC's Rules currently provide that all applicants for membership or limited membership sign and deliver to NSCC a member's agreement. The applicable provisions of each type of member's agreement have historically been set forth in the Rule that applies to that member type (e.g., a Fund Member's agreement provisions are contained in Rule 51, a Member's provisions are contained in Rule 2, a Third Party Administrator Member's provisions are contained in Rule 60). NSCC proposes to create one section in Rule 2A that will address the main membership agreement provisions for all member types, as well as address the requirements with regard to any other agreements.

Rule 2B (Ongoing Membership Requirements and Monitoring)

Annual audited financial statements - NSCC's Rules currently state that a member whose membership is contingent upon a guarantee of a third party must provide a copy of the annual audited financial statements of the guarantor. If such statements for the member or its guarantor are not available, NSCC may accept at its sole discretion, consolidated financial statements prepared at the level of the parent of such entity. NSCC is modifying this text to make clear that it may accept consolidated financial statements or financial information prepared at the level of the parent of such entity.⁶

Call Reports - NSCC has modified its requirement with regard to Call Reports filed with NSCC by members that are banks or trust companies. To the extent that such information is not contained within the report (or the member is a bank or trust company that is not required to file a Call Report), such members must provide NSCC with information containing each of its capital levels and ratios).

15c3-1 Notification - NSCC is adding to its Rules the current GSD requirement that a broker-dealer that has provided to the SEC any notice required pursuant to paragraph (e) of the SEC's Rule 15c3-1 (Limitation on Withdrawal of Equity Capital) shall notify NSCC, and shall provide NSCC with a copy of such notice by close of business on the day such notice is provided to the SEC.

Operational Testing - NSCC now proposes to add text to its Rules that specifically sets forth NSCC's operational testing requirements.

Ongoing Monitoring (Surveillance Status) - Currently, the provision relating to NSCC's ongoing monitoring of Members (NSCC's "credit risk matrix") appears within Addendum B. NSCC proposes to move this provision into new Rule 2B. Additionally, NSCC will replace in this section, the term "Settling Member" with "Member" (see Rule 2B, Section 4, Ongoing Monitoring (Surveillance Status)), as the credit risk matrix only applies to "Members"⁷.

⁶ NSCC is also correcting a typographical error, as "each" guarantor, should read "such" guarantor (see Rule 2B, Section 2.A.(a)).

⁷ See SEC Release No. 34-51362; File No. SR-NSCC-2003-11 (Federal Register Vol. 70, No. 32)

Voluntary Retirement - NSCC proposes to add to its rules the current process by which an active participant may voluntarily retire its NSCC.

The proposed rule change also includes certain other rule clarifications, modifications and technical corrections designed to better conform the Rules to current practice, all of which are more fully described in the text of the filing.

The full text of this rule change (SR-NSCC-2006-17) may be obtained by visiting NSCC's website at www.nsccl.com. Written comments on the proposed rule filing may be addressed to Lisa T. Siebold, Assistant Secretary, National Securities Clearing Corporation, 55 Water Street, New York, New York 10041, and your comments will be forwarded to the SEC. You may also address your written comments to the Secretary of the Commission, Securities and Exchange Commission, 100 F Street NE, Washington, D.C. 20549. We request that you provide NSCC with a copy of your comments.

Questions regarding the rule filing may be directed to Lisa T. Siebold, Director and Assistant Secretary, at (212) 855-3206, or to the undersigned at (212) 855-3208.

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