

File No. SR-NSCC-2001-04

**Securities and Exchange Commission
Washington, D.C. 20549**

**Form 19b-4
Proposed Rule Change
By**

NATIONAL SECURITIES CLEARING CORPORATION

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change.

(a) The text of the proposed change to the Rules and Procedures of National Securities Clearing Corporation (“NSCC” or the “Corporation”) relates to procedures for calculating and collecting Clearing Fund deposits from Members, and is set forth on Exhibit A.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization.

(a) The proposed change to NSCC's Rules and Procedures has been approved pursuant to authority delegated to the NSCC Membership and Risk Management Committee of the NSCC Board of Directors.

(b) Contact regarding questions and comments:

Ellen Levine (212) 855-5777, regarding risk-based margining.

Karen Saperstein (212) 855-3203, regarding the revised rule.

Richard Paley (212) 855-3205, regarding the revised rule and for all other questions.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

(a) NSCC has determined to modify and consolidate its Clearing Fund rules. As more fully described below, the Corporation proposes to apply its current Clearing Fund requirements for Settling Members on surveillance (Addendum O) to all Members and, for ease of reference, incorporate these requirements as well as the Clearing Fund requirements found in Addendum B into NSCC's Procedure XV.

Under Addendum O¹ NSCC now collects additional Clearing Fund deposits from Settling Members on surveillance pursuant to a risk-based margining (“RBM”) methodology that includes, but is not limited to, calculations based on portfolio volatility and, where applicable, market maker domination. This rule filing extends these RBM requirements to all NSCC Members in lieu of Procedure XV’s current allocation (Section A.I.(a)(i)(a)) and liquidation (Section A.I.(a)(i)(c)) Clearing Fund requirements.

Since the Commission’s approval of Addendum O in 1996, NSCC studied the impact of RBM on Member firms. The Corporation found that utilization of RBM more accurately reflects NSCC’s exposure than the current allocation and liquidation formulae because it enables the Corporation to more precisely identify the risks posed by a Member’s unsettled portfolio and, as a result, more quickly adjust and collect additional Clearing Fund requirements. Management therefore recommended, and the Membership and Risk Management Committee concurred, that RBM methodologies should be applied to all NSCC Members, not just those on surveillance.

This rule change will modify Procedure XV as follows:

- In respect of Clearing Fund requirements for CNS Transactions, Procedure XV’s allocation (current Section A.I.(a)(i)(a)) and liquidation (current Section A.I.(a)(i)(c)) formulae will be replaced with RBM methodology now found in Addendum O, specifically volatility (new Section I.(A)(1)(a)) and market maker domination (new Section I.(A)(1)(c)) calculations. The volatility formula will continue to permit the Corporation to utilize any generally accepted portfolio volatility model to calculate volatility.

¹ This policy was originally filed as SR-NSCC-95-17. It was most recently re-filed as SR-NSCC-99-9, temporary approval for which expires on May 31, 2001 (Release Number 34-42864; File No. SR-99-9). Until this rule change is approved, the Corporation seeks to extend the temporary approval of the requirements found in Addendum O.

- In addition, the rule will continue to provide that the Corporation may exclude from volatility calculations Net Unsettled Positions in classes of securities whose volatility is (1) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (2) amenable to generally accepted statistical analysis only in a complex manner, such as municipal or corporate bonds. The amount of Clearing Fund required with respect to these Net Unsettled Positions will be determined by multiplying the absolute value of the Net Unsettled Positions by a percentage designated by the Corporation. This percentage will be not less than 10% in respect of the positions covered by item (1) above, and not less than 2% in respect of the positions covered by item (2) above.
- The Clearing Fund requirements in the proposed rule for all When-Issued and When-Distributed Transactions will be consolidated with the calculations for Regular Way Transactions.
- The third prong of the CNS formula, i.e. the calculation of the difference between the contract price and the current market price of compared pending positions, will remain the same (current Sections I.(A)(1)(b) and I.(A)(2)(b)), however these calculations will be undertaken on a daily basis.
- The proposed rule states that all Clearing Fund and other deposit requirements be made by Members within one hour of demand; provided, however, that to the extent the Member is meeting its obligation with (1) a deposit of cash, that such deposit be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire; and, with (2) a delivery of eligible securities, that such delivery be received within the deadlines established by a Qualified Securities

Depository.² The rule further provides that at the discretion of the Corporation, these cash deposits may be included as part of the Member's daily settlement obligation.

- Addendum B, among other things, currently specifies thresholds pursuant to which the Corporation will require additional Clearing Fund contributions. Procedure XV (new Section II.(C)) will now provide that additional Clearing Fund deposits shall not be requested where the amount of the deficiency for a: (1) Member on Class "A" or "B" Surveillance Status is equal to or less than \$5,000 and such amount is less than 5% of such Member's actual deposit; (2) Member on "Advisory" Surveillance Status is equal to or less than \$20,000 and such amount is less than 5% of such Member's actual deposit; or (3) Member not on any Surveillance Status is equal to or less than \$50,000 and such amount is less than 10% of the Member's actual deposit.
- Other changes to the rule result from relabeling and/or moving the placement of the Corporation's Clearing Fund requirements without altering their substantive nature.

As described below, NSCC intends, subject to SEC approval, to begin implementing the proposed Clearing Fund changes on June 15, 2001, and to conclude by December 31, 2002.

Members currently subject to Addendum O will be subject to these rule changes on June 15, 2001. Applicants approved for NSCC membership from and after the date of this filing will also be immediately subject to these rule changes on June 15, 2001. Members who have a position which will subject them to a deposit requirement based on the market maker domination calculations will additionally be subject to these rule changes on June 15, 2001. The Corporation will place every remaining Member into deciles and apply the revised Clearing Fund methodologies pursuant to a step-by-

² Under NSCC rules the only QSD is DTC.

step, decile-by-decile plan based upon the volatility classification of each such Member's unsettled portfolio. Accordingly, Members with the most volatile portfolios will be subject to these rule changes first, on or shortly after June 15, 2001, provided, however, that to the extent any such Member has significant CNS obligations resulting from options exercises and assignments or is a Municipal Securities Brokers' Broker, it will be subject to these rule changes after all other Members, but in no event later than December 31, 2002.

To accommodate this transition the Corporation will keep effective all rules affected by this filing until all Members are subject with the revised rules.

(b) This filing will permit NSCC to assure the safeguarding of funds and securities for which it is responsible because it will permit the Corporation to more appropriately collect collateral to cover NSCC's potential exposures as a result of guaranteeing Members' transactions. Consequently, it is consistent with the provisions of the Securities Exchange Act of 1934.

4. Self-Regulatory Organization's Statement on Burden on Competition.

NSCC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others.

No written comments relating to the proposed rule change have been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

6. Extension of Time Period for Commission Action.

NSCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Act for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2).

- (a) Not applicable.
- (b) Not applicable.
- (c) Not applicable.
- (d) Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission.

The proposed rule change is not based on the rules of either another self-regulatory organization or of the Commission.

9. Exhibits

- Exhibit A - Text of the proposed change to NSCC's Rules and Procedures.
- Exhibit B - Notice of the proposed rule change for publication in the Federal Register.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the self-regulatory organization has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL SECURITIES CLEARING CORPORATION

BY: _____

Karen L. Saperstein
Managing Director and Secretary

Exhibit A

TEXT OF PROPOSED CHANGES TO NSCC'S RULES AND PROCEDURES

Double Underlined and Bolded text indicates additions to NSCC's Rules and Procedures.

~~[Strikethrough and Bracketed]~~ text indicates deletions to NSCC's Rules and Procedures.

[Note: Proposed changes to footnotes may be found at the end of the exhibit.]

XV. CLEARING FUND FORMULA AND OTHER MATTERS³

~~[A.I.(a)]~~ **I.(A)** Clearing Fund Formula for Members

Each Member of the Corporation, except as otherwise provided ~~[below]~~ **in this Procedure**, is required to contribute to the Clearing Fund maintained by the Corporation an amount ~~[approximately]~~ **calculated by the Corporation** equal to:

(1) For CNS Transactions

~~[(i)(a) 2% of the Member's projected total long CNS positions, plus;]~~ **(a)(i) The volatility of such Member's net of unsettled Regular Way, When-Issued and When-Distributed pending positions (i.e., net positions that have not yet reached settlement) and fail positions (i.e., net positions that did not settle on Settlement Date), hereinafter collectively referred to as Net Unsettled Positions. When the Corporation deems it appropriate, the volatility of such positions shall be determined after taking into account offsetting pending transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation.**⁴ **Such calculation shall be made in accordance with any generally accepted portfolio volatility model,**

³ All calculations shall be performed daily or, if the Corporation deems it appropriate, on a more frequent basis.

⁴ The Corporation may, in its discretion, decline to consider any such transactions, as well as other similar transactions referred to in respect of this Procedure, if it has reason to believe that the institutional counter party may not or cannot settle the transaction.

including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

~~[(b) the]~~(ii) The Corporation shall have the discretion to exclude from the above calculations Net Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, such as municipal or corporate bonds. The amount of Clearing Fund required with respect to such Net Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the positions covered by subsection y of this paragraph;

plus

(b) The net of each day's difference between the contract price of ~~pending~~ compared CNS trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be excluded] such Member's Regular Way, When-Issued and When-Distributed net positions that have not yet reached Settlement Date, and the Current Market Price for such positions, provided that the Corporation shall exclude from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number)], plus

~~(c) 1/4 of 1% of the net of all compared pending CNS trades and open CNS positions, plus~~

~~For When-Issued and When-Distributed Transactions~~

~~(d) the net of each day's difference between the contract price of pending compared when-issued and when-distributed trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be excluded from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), plus~~

~~(e) 1/4 of 1% of the net of all compared pending when-issued and when-distributed trades, plus~~

~~];~~

~~plus~~

(c) If such Member clears for one or more Market Makers⁵ (i.e., the Member's Correspondent(s)) or is itself a Market Maker in any security dominated by either the Member or its Correspondent(s) (where domination is calculated for each Member and each of its Correspondent(s) according to criteria determined by the Corporation from time to time), and if the sum of the absolute values of the Net Unsettled Positions in such dominated security or securities of any one or more of such Market Makers exceeds the excess net capital of the respective Market Maker or the Member (whether or not it is a Market Maker), (i.e., such Market Maker's or Member's Excess), the

⁵ As used in this Procedure, the term "Market Maker" shall mean a member firm of the National Association of Securities Dealers, Inc. (NASD) that is registered by the NASD as a Market Maker.

Corporation may then require the Member to contribute an additional Clearing Fund Deposit to the Corporation either in an amount equal to each such Market Maker's or Member's Excess or the sum of each of the absolute values of the Net Unsettled Positions or a combination of both. In performing the calculation, the Corporation may take into account offsetting pending (i.e., non-fail) transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. In addition, where a Market Maker's Net Unsettled Positions in dominated issues are cleared by one or more Members, the Corporation may treat those positions, for purposes of calculations pursuant to this paragraph, as if they were all cleared by the Market Maker's clearing Member, as listed in the records of the Corporation in accordance with Section 3 of Rule 3⁶ :

plus

(d) To the extent any Member has a Net Unsettled Position in a security whose Spread between the bid and ask prices is equal to or greater than twenty percent of the Current Market Price (CMP) of such security (High Risk Security), the Corporation may require the Member to contribute an additional Clearing Fund Deposit in respect of such High Risk Security when the value of the individual position (Position Value) is equal to or greater than ten percent of the total value of all Net Unsettled Positions of the Member (i.e., a concentration of ten percent or more (Percentage of Concentration)). The additional Deposit shall be calculated as follows:

$$\frac{[(\text{Percentage of Concentration}) (\text{Spread}) \times 5] + (10\% \text{ of Total})}{\text{CMP}} \times \text{Position Value} ;$$

plus

(e) To the extent such Member has a Net Unsettled Position in a security where there is a one-day price change of at least ten percent and this price change adversely affects the value of such Net Unsettled Position by at least \$15,000 (Volatile Security), the Corporation may require the Member to contribute

⁶ The Corporation may require or permit such Member to deliver some or all shares necessary to complete a short obligation in lieu of part or all of its requirement under this section or subsection I.(A)(2)(c).

an additional Clearing Fund Deposit when the value of the Volatile Security position (Position Value) is equal to or greater than ten percent of the total value of all Net Unsettled Positions of the Member (i.e., a concentration of ten percent or more (Percentage of Concentration)). The Member's additional Clearing Fund Deposit shall be calculated as follows:

plus $(\text{Percentage of Concentration} \times \text{Factor}^7) \times \text{Position Value}$;

(f) 5% or such greater amount, as determined by the Corporation, not to exceed 10% of such Member's long fail CNS positions plus 5%, or such greater amount, as determined by the Corporation, not to exceed 10% of such Member's short fail CNS positions.

(2) For Balance Order Transactions

(a)(i) The volatility of such Member's net of unsettled Regular Way, When-Issued and When-Distributed positions that have not yet reached settlement and/or positions naming a regional interface account as a contra-side which have failed, hereinafter collectively referred to as Net Balance Order Unsettled Positions. When the Corporation deems it appropriate, the volatility of such positions shall be determined after taking into account offsetting pending transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. Such calculation shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate.

⁷ For purposes of calculating the factor, a price movement of ten to nineteen percent of the previous day's Current Market Price shall equal a factor of 1. Each additional ten percent price movement shall increase the factor by 0.5. The factor, however, shall not exceed 10.

(ii) The Corporation shall have the discretion to exclude from the above calculations Net Balance Order Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (y) amenable to generally accepted statistical analysis only in a complex manner, such as municipal or corporate bonds. The amount of Clearing Fund required with respect to such Net Balance Order Unsettled Positions shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage shall be not less than 10% in respect of the positions covered by subsection x of this paragraph and shall be not less than 2% in respect of the positions covered by subsection y of this paragraph; plus

(b) The~~[(f) the]~~ net of each day's difference between the contract price of ~~[pending compared]~~ **such Member's Regular Way, When-Issued and When-Distributed** Balance Order ~~[trades which]~~ **net positions that** have not ~~[as]~~ yet reached ~~[settlement]~~ **Settlement Date**, and the ~~[current market price]~~ **Current Market Price** for such ~~[trades,]~~ **positions**, provided that ~~[there]~~ **the Corporation** shall ~~[be excluded]~~ **exclude** from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number)~~]~~
plus];

~~[(g) 1/4 of 1% of the net of all compared pending Balance Order trades and open Balance Order trades]~~ **plus**

(c) If such Member clears for one or more Market Makers (i.e., the Member's Correspondent(s)) or is itself a Market Maker in any security dominated by either the Member or its Correspondent(s) (where domination is calculated for each Member and each of its Correspondent(s) according to criteria determined by the Corporation from time to time), and if the sum of the absolute values of the Net Unsettled Balance Order Positions in such dominated security or securities of any one or more of such Market Makers exceeds the excess net capital of the respective Market Maker or the Member (whether or not it is a Market Maker), (i.e., such Market Maker's or Member's Excess), the Corporation may then require the Member to contribute an additional Clearing Fund Deposit to the Corporation either in an amount equal to each such Market Maker's or Member's Excess or the sum of each of the absolute values of the Net Unsettled Balance Order Positions or a combination of both. In performing the calculation, the Corporation may take into account offsetting pending (i.e., non-fail) transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to the Corporation. In addition, where a Market Maker's Net Unsettled Balance Order Positions in dominated issues are cleared by one or more Members, the Corporation may treat those positions, for purposes of calculations pursuant to this paragraph, as if they were all cleared by the Market Maker's clearing Member, as listed in the records of the Corporation in accordance with Section 3 of Rule 3;
plus

(d) 5% or such greater amount determined by the Corporation, not to exceed 10%, of the Member's long fail Balance Order positions naming a regional interface account as a contra-side[, plus]; plus, 5% or such greater amount determined by the Corporation, not to exceed 10%, of the Member's short fail Balance Order positions naming a regional interface account as a contra-side.

[(ii)(a) 2-1/2% of the] **(3) For Other Transactions**

The greater of (i) 2-1/2% of such Member's average daily settlement debits and credits[, excluding] **other than** CNS and Mutual Fund Services debits and credits[,], or **(ii)(b) 5% of [the] such** Member's average daily settlement debits[, excluding] **other than** CNS and Mutual Fund Services debits, [~~whichever greater, adjusted by a factor (as defined below), plus]~~ **for other transactions (Other Transactions) as determined by the Corporation from time to time, adjusted for broker/dealer Members by a factor that shall be calculated as follows:**

~~[(iii) for Members using the Mutual Fund Services:]~~ **Average Daily Settlement Debits As Determined by the Corporation**
Excess Net Capital

**** 1** The factor calculation shall be adjusted in order to provide a minimum of one with a maximum of three.

(4) For Mutual Fund Transactions

(a) \$5,000 if [~~the~~] **such** Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member[, or

];

or

(b) \$10,000 if [~~the~~] **such** Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member[, or

1:

or

(c) \$20,000 if ~~[the]~~ such Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.

I.(B) Additional Clearing Fund Formula for Members on Class "B"

Surveillance Status

(a) In lieu of subsection I.(A)(1)(f), 10%, or such greater amount determined by the Corporation of such Member's long fail CNS positions; plus, 10% or such greater amount determined by the Corporation, of such Member's short fail CNS positions;

plus

(b) In lieu of subsection I.(A)(2)(d), 10% or such greater amount determined by the Corporation of such Member's long fail Balance Order positions naming a regional interface account as a contra-side; plus, 10% or such greater amount determined by the Corporation of such Member's short fail Balance Order positions naming a regional interface account as a contra-side;

plus

(c) In lieu of subsection I.(A)(3), 10%, or such greater amount determined by the Corporation of such Member's average daily settlement debits and credits, other than CNS and Mutual Fund Services debits and credits, for Other

Transactions, adjusted for broker/dealer Members (as defined in subsection 1.(A)(3)).

I.(C) ~~[A.I.(b)]~~ Clearing Fund Formula for Mutual Fund/Insurance Services Members who use the Mutual Fund Services.⁸

Each Mutual Fund/Insurance Services Member is required to contribute to the Clearing Fund maintained by the Corporation an amount, in cash, approximately equal to:

~~[(i)]~~**(1)** If accepted for membership pursuant to **Addendum B** (Standards of Financial Responsibility and Operational Capability), Section (I)(B)(1), (2), **(4)(c)** or (5):

~~[(1)]~~**(a)** \$5,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member~~[, or~~

~~];~~

or

⁸ This section applies to entities whose use of the Corporation's services are restricted to the Mutual Fund Services and/or the Insurance Processing Services. Entities which use or are permitted to use Services other than or in addition to the Mutual Fund Services and Insurance Processing Service are covered by section I.(A).

~~[(2)]~~(b) \$10,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member~~[, or~~

~~];~~

or

~~[(3)]~~(c) \$20,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.

~~[(ii)]~~(2) If accepted for membership pursuant to Addendum B (Standards of Financial Responsibility and Operational Capability) Section (I)(B)(4)(a) or (b):

~~[(1)]~~(a) \$10,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member~~[, or~~

~~];~~

or

~~[(2)]~~(b) \$20,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member~~[, or~~

~~];~~

or

~~[(3)]~~(c) \$40,000 if the Mutual Fund/Insurance Services Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.

~~[A.II. Alternative Clearing Fund Formula~~

~~(a) Each Member of the Corporation who is a Municipal Securities Brokers' Broker that has a Sponsored Account (as defined in Procedure IX.B.) and elects to utilize the following Formula is required to contribute to the Clearing Fund maintained by the Corporation an amount equal to:~~

~~For CNS Transactions~~

~~(i)(a) 2% of the Member's projected total long CNS positions, plus,~~

~~(b) the net of each day's difference between the contract price of pending compared CNS trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be excluded from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), plus~~

~~(c) 1/4 of 1% of the net of all compared pending CNS trades and open CNS positions, plus~~

~~For When-Issued and When-Distributed Transactions~~

~~(d) the net of each day's difference between the contract price of pending compared when-issued and when-distributed trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be~~

~~excluded from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), plus~~

~~(e) 1/4 of 1% of the net of all compared pending when-issued and when-distributed trades, plus~~

~~For Balance Order Transactions~~

~~(f) the net of each day's difference between the contract price of pending compared Balance Order trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be excluded from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), plus~~

~~(g) 1/4 of 1% of the net of all compared pending Balance Order trades and open Balance Order trades naming a regional interface account as a contra-side, plus~~

~~(ii)(a) 2-1/2% of the Member's average daily settlement debits and credits, excluding CNS, Mutual Fund Services and Qualified Securities Depository debits and credits, or~~

~~(b) 5% of the Member's average daily settlement debits, excluding CNS, Mutual Fund Services and Qualified Securities Depository debits, whichever greater, plus~~

~~(iii) such amount as calculated by the Qualified Securities Depository, plus~~

~~(iv) for Members using the Mutual Fund Services Service:~~

~~(a) \$5,000 if the Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member, or~~

~~(b) \$10,000 if the Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member, or~~

~~(c) \$20,000 if the Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member.~~

~~(b) Each Member of the Corporation that has a Sponsored Account and is not eligible to use the Formula set forth above in section A.II.(a), and whose average daily Envelope Settlement System debits is greater than its excess net capital is, in lieu of the requirement set forth in section A.I.(a) above, required to contribute to the Clearing Fund maintained by the Corporation an amount approximately equal to:~~

~~For CNS Transactions~~

~~(i)(a) 2% of the Member's projected total long CNS positions, plus;~~

~~(b) the net of each day's difference between the contract price of pending compared CNS trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be excluded from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), plus~~

~~(c) 1/4 of 1% of the net of all compared compared pending CNS trades and open CNS positions, plus~~

~~For When-Issued and When-Distributed Transactions~~

~~(d) the net of each day's difference between the contract price of pending compared when-issued and when-distributed trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be excluded from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), plus~~

~~(e) 1/4 of 1% of the net of all compared pending when-issued and when-distributed trades, plus~~

~~For Balance Order Transactions~~

~~(f) the net of each day's difference between the contract price of pending compared Balance Order trades which have not as yet reached settlement and the current market price for such trades, provided that there shall be excluded from this calculation any trades for which the Corporation has, under a Clearing Agency Cross-Guaranty Agreement, either obtained coverage for such difference (if the sum of the differences for the trades subject to the agreement is a positive number) or undertaken an obligation to provide coverage for such difference (if the sum of the differences for trades subject to the agreement is a negative number), plus~~

~~(g) 1/4 of 1% of the net of all compared pending Balance Order trades and open Balance Order trades naming a regional interface account as a contra-side, plus~~

~~(ii)(a) 2-1/2% of the Member's average daily settlement debits and credits, excluding CNS, Qualified Securities Depository and Mutual Fund Services debits and credits, or~~

~~(b) 5% of the Member's average daily settlement debits, excluding CNS, Qualified Securities Depository and Mutual Fund Services debits, whichever greater, adjusted by a factor (as defined below), plus~~

~~(iii)(a) \$5,000 if the Member has daily Mutual Fund Services settlement debits of no more than \$100,000 with respect to any one Fund Member, or~~

~~(b) \$10,000 if the Member has daily Mutual Fund Services settlement debits of no more than \$500,000 with respect to any one Fund Member, or~~

~~(c) \$20,000 if the Member has daily Mutual Fund Services settlement debits of more than \$500,000 with respect to any one Fund Member, plus~~

~~(iv) such amount as calculated by the Qualified Securities Depository.~~

A.III. Cash Requirement

~~With respect to each Clearing Fund formula, each Member,]~~ **I.(D) Clearing Fund Formula for Fund Members, Insurance Carrier Members and Certain Mutual Fund/Insurance Services Members**

The Clearing Fund Formula for each Fund Member, Insurance Carrier Member and those Mutual Fund/Insurance Services Members who use only the Corporation's Insurance Processing Service shall be established at such time as the Corporation determines appropriate.

II. Minimum Clearing Fund and Additional Deposit Requirements

(A) Each Member of the Corporation, except for a Mutual Fund/Insurance Services Member, shall be required to contribute a minimum of \$10,000 (the "minimum contribution"). Except with respect to a Mutual Fund/Insurance Services Member, the

first \$10,000 of a Member's contribution is required to be in cash unless ~~[all or]~~ part of the Member's open account indebtedness is collateralized with Letters of Credit, in which case, the greater of \$50,000 or ten percent of the Member's Clearing Fund Required Deposit up to a maximum of \$1,000,000 is required to be in cash; a Mutual Fund/Insurance Services Member's entire deposit is required to be in cash.

~~[Cash deposits to the Clearing Fund]~~ **(B) All Clearing Fund requirements and other deposit requirements shall be made by Members within one hour of demand unless otherwise determined by the Corporation; provided, however, that to the extent the Member is meeting such obligation with a (1) deposit of cash, such deposit shall be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire, and (2) delivery of eligible securities, such delivery shall be received within the deadlines established by a Qualified Securities Depository. At the discretion of the Corporation, cash deposits may be included as part of the Member's daily settlement obligation.**

(C) Additional Clearing Fund requirements shall not be requested where the amount of the Member's deficiency is less than \$1,000. In addition, such requirements shall not be requested where the amount of the deficiency for a:

- (1) Member on Class "A" or "B" Surveillance Status is equal to or less than \$5,000 and such amount is less than 5% of such Member's actual deposit.**
- (2) Member on "Advisory" Surveillance Status is equal to or less than \$20,000 and such amount is less than 5% of such Member's actual deposit.**
- (3) Member not on any Surveillance Status is equal to or less than \$50,000 and such amount is less than 10% of the Member's actual deposit.**

(D) Where the amount of a Member's deficiency is in excess of \$1,000 but less than \$5,000, the Corporation may require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000, the Corporation may require payment in multiples of \$5,000.

~~[A.IV. Non-CNS Factor for Members For the purposes of Section XV, subsections A.I. and A.II., the factor for broker/dealer Members shall be calculated as follows: average daily Envelope Settlement System debits = factor excess net capital]~~

~~[* 1 The factor calculation shall be adjusted in order to provide a minimum of one with a maximum of three.]~~

~~[For all other Members there shall be no factor adjustment until such time as the Corporation determines the appropriateness of developing a factor calculation for such Members.]~~

The formula for Fund Members, Insurance Carrier Members and Mutual Fund/Insurance Services Members who use only the Corporations Insurance Processing Service shall

be established at such time as the Corporation determines the appropriateness of developing such formula.

Additional Mark to the market Payments

Pursuant to Rule 11, Section 6, the Corporation has the authority to require an additional mark to the market payment ("additional mark") from Members in view of price fluctuations in or volatility or lack of liquidity of any security. Without limiting the generality of such authority, the following formulas may be used to determine additional mark requirements for Members maintaining positions in "high risk" and/or "volatile" securities as those terms are herein defined.

1. High Risk Securities. High risk securities are those securities wherein the spread between the bid and ask prices is equal to or greater than twenty percent of the current mark price of the security. An additional mark shall be applied against CNS positions in these securities when the value of the individual CNS position in such security is equal to or greater than ten percent of the total value of all CNS positions of the Member (i.e., a concentration of ten percent or more). The additional mark shall be equal to the percent of concentration adjusted by a factor, determined by multiplying the percentage of risk (i.e., twenty percent or more) by five, plus an additional ten percent of the total, multiplied by the value of the CNS position. In effect, the high risk additional mark equals:

$$\{(\text{Percentage of Concentration})(\text{--- spread ---}) \times 5\} + 10\%$$

mark price

2. Volatile Securities. Volatile securities are those securities wherein there is a one-day price change of at least ten percent and such price change adversely affects the value of the position by at least \$15,000. An additional mark shall be applied against CNS positions in those securities when the value of the individual CNS position in such security is equal to or greater than ten percent of the total value of all CNS positions of the Member (i.e., a concentration of ten percent or more). The additional mark shall be equal to the percent of concentration adjusted by a factor (as defined below) and multiplied by the value of the CNS position. For the purposes of this formula, the factor shall be calculated as follows:

A price movement of ten to nineteen percent of the previous day's current mark price shall equal a factor of 1. Each additional ten percent price movement shall increase the factor by 0.5. The factor, however, shall not exceed 10. In effect, a change of 47% would result in a factor of 2.5, while a change of 150% would result in a factor of 8.

In effect, the volatile security additional mark equals:

$$\{(\text{Percentage of Concentration})(\text{Factor})\} \times \text{Position Value}$$

~~The additional mark shall be collected through the settlement system and added to the Member's Clearing Fund contribution. Adjustments to the additional mark shall be made daily with the excess, if any, returned through the settlement system.~~

~~To the extent that the Member's Clearing Fund contribution exceeds its requirements, the Corporation, in its discretion, may waive part or all of the additional mark provided for in this Procedure.]~~

* * *

ADDENDUM B

STANDARDS OF FINANCIAL RESPONSIBILITY AND OPERATIONAL CAPABILITY

The Corporation shall apply the following standards in determining the financial responsibility and operational capability of Settling Members and applicants for membership and shall follow the Guidelines in making surveillance determinations.

I. MEMBERSHIP STANDARDS

- A. In addition to the requirements established pursuant to the provisions of Rule 2, an applicant for membership shall:
1. have sufficient financial ability to make anticipated contributions to the Clearing Fund and to meet obligations to the Corporation; and
 2. have an established business history of a minimum of six months or personnel with sufficient operational background and experience to ensure the ability of the firm to conduct such a business; and
 3. have adequate personnel capable of handling transactions with the Corporation and adequate physical facilities, books and records and procedures to fulfill anticipated commitments to and to meet the operational requirements of the Corporation and other Settling Members with necessary promptness and accuracy and to conform to any condition and requirement which the Corporation reasonably deems necessary for its protection or that of its Settling Members; and
 4. not be known to be subject to a Statutory Disqualification or an order of similar effect issued by a Federal banking agency or, with respect to an Insurance Company, be in good standing in those states in which it is licensed as an Insurance Company and in its state of organization; and

5. not be known to be subject to any other action or condition the existence of which would require the applicant to be placed on surveillance by the Corporation.

B. In addition to the foregoing standards,

1. All broker/dealer applicants shall:

a. have excess net capital over the minimum net capital requirement imposed by the SEC or such higher minimum capital requirement imposed by the brokers/ dealer's designated examining authority in the amount of (i) \$500,000, or (ii) \$100,000, if such applicant is a Municipal Securities Brokers' Brokers (as defined in Rule 15c3-1(a)(8) of the Exchange Act) or (iii) \$1,000,000 if such applicant clears for other broker/dealers; and

b. have a capital ratio or percentage that would not require the applicant to be placed on immediate surveillance by the Corporation; and

c. not be known to be on a "closer-than-normal" surveillance by the applicant's designated examining authority as that term is defined by the applicant's designated examining authority.

2. Bank applicants, other than applicants for Settling Bank Only Membership shall:

a. (i) have at least \$50 million in capital;⁹ or

(ii) have furnished to the Corporation a guarantee of its parent bank holding company respecting the payment of any and all obligations of the bank applicant, and such parent bank holding company shall have total consolidated capital of at least \$50 million; or

(iii) in the case of a trust company that is not a bank, but is a member of the Federal Reserve System or is an institution insured under the Federal Deposit Insurance Act, have consolidated capital of at least \$10 million and that is adequate in the judgment of the Corporation to the scope and character of the business conducted by such trust company; and

⁹For the purpose of the membership standards and surveillance status rules applicable to banks, "capital" is defined to include capital stock, surplus, undivided net profits, reserve for contingencies and other capital reserves.

b. not be operating at a loss at the time of its application and not have operated at a loss in any of its previous three fiscal quarters.

3. ~~[3.]~~ Municipal Securities Brokers' Broker sponsored account applicants ~~[who elect the Alternative Clearing Fund Formula, in addition to the requirements imposed by Section I.B.1 above,]~~ shall:

a. be in compliance with SEC Rule 15c3-1(a)(8); and,

b. sign and deliver to the Corporation an agreement in writing whereby the applicant shall agree that

(i) if securities received on a business day are pledged prior to money settlement on that business day, the Corporation shall be paid directly by the pledgee bank the amount the applicant is required to pay for the securities received or the applicant's net settlement obligation for that business day whichever is less; and

(ii) no securities received on a business day through a qualified securities depository shall be placed in transfer, withdrawn or delivered to a third party for no value prior to paying the Corporation the amount the applicant is obligated to pay for the receipt of the securities or the applicant's net settlement obligation for that business day whichever is less.

4. All applicants for membership limited to the use of the Mutual Fund Services and/or the Insurance Processing Service shall meet the following:

a. If a broker-dealer:

(i) has \$25,000 in excess net capital over the minimum net capital requirement imposed by the SEC or such higher minimum capital requirement imposed by the broker/dealer's designated examining authority, and,

(ii) the standards in (I) (B) (1) (b) and (c) set forth above.

b. If a Bank or Trust Company:

(i) has \$100,000 minimum excess capital over the capital requirement imposed by its state or federal regulatory authority, and,

(ii) the standard set forth in (I) (B) (2) (b) above.

c. **If an Insurance Company, the standards set forth in Sections 1(a) and 1(b) of Rule 56.**

d. All others shall:

(i) have the operational capability for membership or have an agreement, concerning the provision of operational support services to such applicant, with an entity acceptable to the Corporation and which may not be replaced without prior approval by the Corporation, and,

(ii) agree to restrict its business activities as the Corporation may require.

5. All other applicants shall be required to meet financial stability standards as are applied to the industry in which the applicant is associated.

C. Unless the context otherwise requires, the parent bank holding company of a Settling Member that has been admitted to membership in accordance with section (i)(B)(2)(a)(ii) of the standards, and any material banking subsidiary of such parent bank holding company, shall, for the purpose of applying the surveillance status rules, be treated as if it were also a Settling Member, so that the Settling Member, the parent bank holding company, and any affiliated material banking subsidiary ~~will~~ **shall** be required individually to meet the standards for a Settling Member not under surveillance, if the Settling Member is not to be placed on a surveillance status.

~~D. A Settling Member who is placed on "Advisory" surveillance status, shall be required to make any additional Clearing Fund deposits within ten (10) business days of receipt of the Corporation's request.~~

~~E. A Settling Member who is placed on Class "A" or "B" surveillance status shall be required to make any additional Clearing Fund deposits within such time period as the Corporation may require but in no event shall such time period be less than two (2) business days.~~

~~F. A Settling Member who is (i) placed on any surveillance status, or (ii) has a position in a security which is placed on surveillance status, and who is required to make additional security mark-to-the-market payments, in amounts to be determined by the Corporation, shall make such payments within such time period as the Corporation may require but in no event shall such time period be less than two (2) business days.~~

- G]. Settling Members who are required to provide information pursuant to the provisions of Rule 15 shall, except for FOCUS Reports for which the time frame has been prescribed and unless the Corporation deems that a longer period is appropriate, provide such information within two (2) business days, provided, however, that if such information is necessary for a determination in a summary action proceeding it shall be produced immediately.
- H] E. Bank and Trust Company Settling Members shall be required to file the following information (Settling Members admitted pursuant to section (i)(B)(2)(a)(ii) shall be required to submit information for the Settling Member, its parent bank holding company and any affiliated material banking subsidiary of such parent bank holding company) and any information filed with the Corporation shall be held confidential to the same extent as is provided with respect to information furnished under Section 2 of Rule 15:

INFORMATION TO BE FILED MONTHLY

1. Whether a Federal banking agency has served the Settling Member with a temporary cease and desist order pursuant to Section 8 (c) of the Federal Deposit Insurance Act regarding any violation of law, rule or regulation or any unsafe or unsound practice which could cause insolvency or substantial dissipation of assets or earnings of the Settling Member or is likely to seriously weaken the condition of the Settling Member or otherwise seriously prejudice the interests of depositors or which could otherwise affect the financial condition of the Settling Member;
 - a. indicate the nature of the violation and whether such violation could affect the Settling Member's financial or operational ability to continue to fulfill its obligations to the Corporation;
2. whether the Settling Member has been instructed by the Securities and Exchange Commission or by a Federal banking agency to reduce or eliminate some or all of its clearing activity;
 - a. indicate what type of activity has been restricted and the extent to which it has been restricted;
3. whether the Settling Member is prohibited from paying dividends or would be required to obtain consent of a bank regulatory authority if it were to pay dividends in an amount equal to 50% of the average amount paid in the past two years;
 - a. indicate the applicable restriction;

4. whether the Settling Member has sought or received financial assistance from the Federal Deposit Insurance Corporation pursuant to section 13(c) or (e) of the Federal Deposit Insurance Act;
5. whether a director or officer of the Settling Member was served by a Federal banking agency with a written notice of intent to remove such person from office pursuant to section 8(e)1 or 8(e)2 of the Federal Deposit Insurance Act;
6. whether the Settling Member was assessed any penalty pursuant to section 8(i) of the Federal Deposit Insurance Act for any violation of any cease and desist order issued by a Federal banking agency or any consent agreement entered into with a Federal banking agency regarding a violation of a law, rule or regulation or any unsafe or unsound practice, which might materially affect the Settling Member's financial condition;
 - a. indicate whether such penalty brings into question the continued financial or operational capability of the Settling Member to continue to fulfill its obligations to the Corporation;
7. whether the Federal Deposit Insurance Corporation has served the Settling Member with written notice of intent to terminate the Settling Member's federal deposit insurance pursuant to section 8(a) of the Federal Deposit Insurance Act;
8. whether the Settling Member has received extended credit from the Federal Reserve discount window other than seasonal credit;
9. if the Settling Member or its parent bank holding company maintains Moody's or Standard & Poor's bond or commercial paper rating, whether such rating has changed or been withdrawn;
 - a. indicate the effective date on which the rating has changed or been withdrawn;
 - b. indicate old rating and new rating;
10. whether the Settling Member or any of its employees is subject to a statutory disqualification as defined by the Securities Exchange Act of 1934, as amended or is subject to an order of similar effect issued by a Federal banking agency;
11. whether the Settling Member has had a decline in capital since the time it was admitted to the Corporation;

- a. explain any extraordinary circumstances that account for the decline in capital;
12. whether a Federal banking agency has served the Settling Member with a permanent cease and desist order pursuant to Section 8(b) of the Federal Deposit Insurance Act regarding any violation of a law, rule or regulation or any unsafe or unsound practice, other than a violation of the consumer lending laws which, in the opinion of the Settling Member, could not have a material negative effect on the Settling Member's financial condition;
- a. indicate the nature of the violation and whether such violation could affect the Settling Member's financial or operational ability to continue to fulfill its obligations to the Corporation.

INFORMATION TO BE FILED QUARTERLY

- 1. Whether the Settling Member has had a material increase or change in volume or in the nature of business which involves additional use of the Corporation's services without corresponding increases in profitability or additions to capital over a period of three or more months;
- 2. whether the Settling Member has incurred net losses in the fiscal quarter exceeding 10% of its capital.

INFORMATION TO BE FILED ANNUALLY

- 1. Whether the Settling Member had a consolidated net loss in the fiscal year just ended;
 - 2. whether the Settling Member has incurred a decline in consolidated net income (after securities gains and losses) in the fiscal year just ended or in the last two fiscal years, amounting to more than 50% of such consolidated net income for the preceding fiscal year;
 - a. indicate whether the Settling Member or its parent bank holding company maintains a Moody's or Standard & Poor's bond rating of at least A, or commercial paper rating of at least P2 or A2;
 - b. indicate whether the Settling Member's capital is 5% or more of its total assets at the end of fiscal year just ended;
 - 3. whether the Settling Member had net losses in the fiscal year just ended exceeding 10% of the Settling Member's capital.
- I. All broker/dealer Settling Members, except Mutual Fund/Insurance Services Members, shall be required to file the following information annually, within such

time period as the Corporation shall prescribe, and any information filed shall be held confidential to the same extent as is provided with respect to information furnished under Section 2 of Rule 15:

NAME OF MEMBER _____

ADDRESS OF MAIN OFFICE _____

I. BACKGROUND INFORMATION

1. Form of Organization

Corporation _____
 Partnership _____
 Sole Proprietorship _____

2. Date Business Started _____

3. Designated Examining Authority _____

4. Exchange Memberships _____

5. Other Memberships _____

6. Briefly describe any recent membership changes as well as those contemplated during the next six (6) months.

7. Chief Executive Officer _____

8. Financial Officer _____

9. Operational Officer _____

10. Number of registered representatives _____

11. Number of operational personnel _____

12. Number of branch offices and state(s) located _____

13. Name of outside counsel _____

14. Name of accounting firm _____

15. Date of last annual outside audit _____

16. Date of last inspection by Designated Examining Authority

17. Is SEC Registration currently effective? Yes___ No___
If yes, on what date? _____

18. Method of Record keeping
Manual _____
Computer _____ (in-house)
Other _____

19. If a Service Bureau is to be used, give name and address:

20. Location of books and records if other than Main Office

21. If Member is affiliated with, controls, and/or is controlled by any another business entity, describe details of relationship.

22. List all banking relationships and available lines of credit.

23. Clearing Arrangements:

OTC:

Self-Clearing Yes [] No []
Through Others []
List Names:

For Others []
List Names:

Listed:

Through Others []
List Names:

For Others []
List Names:

Options:

Through Others []
List Names:

For Others []
List Names:

Briefly describe any changes contemplated in the Member's clearing arrangement.

II. TYPE OF BUSINESS CONDUCTED

1.(a). Check, in appropriate box, types of business engaged in (or to be engaged in, if not yet active) by Member. Do not check any category which account for or is expected to account for less than 10% of annual gross revenue from the securities or investment advisory business.

- Exchange member engaged in exchange commission business.
- Exchange member engaged in floor activities.
- Broker or dealer making inter-dealer markets in corporate securities over-the-counter.
- Broker or dealer retailing corporate securities over-the-counter.
- Underwriter or selling group participant (corporate securities other than mutual funds).
- Mutual fund underwriter or sponsor.
- Mutual fund retailer.
- U. S. Government securities dealer.
- Municipal securities dealer.
- Municipal securities broker.
- Broker or dealer selling variable life insurance or annuities.

Solicitor of savings and loan accounts.

Real estate syndicator.

Broker or dealer selling oil and gas interests.

Put and call broker or dealer option writer.

Broker or dealer selling securities of only one issuer or associated issuers (other than mutual funds).

Broker or dealer selling securities of non-profit organizations (e.g., churches, hospitals).

Investment advisory services.

Broker or dealer selling tax shelters or limited partnerships.

Stock borrowed.

Other (give details).

(b) Does Member effect transactions in commodity futures, commodities or commodity options as a broker for others or dealer for its own account?

Yes _____ No _____

(c) Does Member engage in any other non-securities business? (If "Yes", describe each such other business briefly.)

Yes _____ No _____

2.(a). Record three (3) primary sources of Member's income during most recent twelve (12) month period.

_____ %
_____ %

_____ %

(b) Projected changes:

3. Securities accounts for customers:

Approximate number of active accounts.

Cash _____
Margin _____

Clientele

Retail _____
Institutional _____
Wholesale _____

Types of Accounts

Discretionary _____
Investment Advisory _____
Other (Specify) _____

Services:

Safekeeping [] Proxy [] Research []

Accommodation Transfers []

Other (specify) _____

4. Approximate number of monthly tickets _____

5. Market Making Activities

Does Member make markets? Yes ____ No ____

OTC # _____ Listed # _____

Approximate number of markets to be made on NASDAQ _____, off
NASDAQ_____.

Price range of securities _____

Wire connections _____

6. Does Member act as correspondent for another broker-dealer?
Yes ____ No ____

If yes, for whom? _____

Does another broker-dealer act as correspondent for Member?
Yes ____ No ____

If yes, who? _____

List any current correspondent relationships.

Number currently in registration _____

Number in process of registration _____

Number completed within last twelve (12) months as a sole underwriter

Number completed within last twelve (12) months as a selling group member

Average offering price of those in registration _____

Average offering price of underwriting completed _____

7. Briefly describe any changes contemplated during next six (6) months in the Member's business activities.

III. BONDING

Is Member required to have a fidelity bond?

Yes [] No []

Name of insurance company:

Fidelity\$____
On Premises \$____
In Transit \$____
Misplacement\$____
Forgery and Alteration \$____
Securities Loss \$____
Fraudulent Trading \$____
Amount of Deduction Provision \$____

Expiration date of bond: Mth:_____ Day:_____ Yr:_____

Is there a cancellation rider? Yes _____ No _____

Briefly describe any claims paid.

Briefly describe any changes contemplated in Member's bonding coverage.

IV. PENDING INVESTIGATION(S) AND/OR LITIGATION(S)

Is the Member the subject of any investigation(s), hearing(s), injunction(s), operational restriction(s) or other actions by a regulatory body?

Yes _____ No _____

Is the Member currently involved in any litigation of a criminal or civil nature?

Yes _____ No _____

DATE: _____ SIGNATURE: _____

- J. All Mutual Fund/Insurance Services Members shall be required to file the following information annually, within such time period as the Corporation shall prescribe, and any information filed shall be held confidential to the same extent as is provided with respect to information furnished under Section 2 of Rule 15:

NAME OF MEMBER _____

ADDRESS OF MAIN OFFICE _____

NAME, PHONE, FAX NUMBER OF INDIVIDUAL COMPLETING THIS QUESTIONNAIRE: _____

I. BACKGROUND INFORMATION

1. Form of Organization

Corporation _____
 Partnership _____
 Limited Liability Corporation _____
 Sole Proprietorship _____

2. Date Business Started _____

3. Designated Examining Authority or Primary Regulator _____

4. Exchange Memberships, if applicable _____

5. Other Memberships _____

6. Briefly describe any recent membership changes as well as those contemplated during the next six (6) months.

7. Chief Executive Officer _____

8. ~~{8.}~~ Financial Officer _____

9. Operational Officer _____

10. Number of registered representatives, if applicable _____

11. Number of operational personnel _____

12. Number of branch offices and states(s) located _____

13. Name of outside counsel _____

14. Name of accounting firm _____

15. Date of last annual outside audit _____

16. Date of last inspection by Designated Examining Authority or Primary Regulator _____

17. Is SEC Registration, if applicable, currently effective?
 Yes ___ No ___

If yes, on what date? _____

Is state insurance license, if applicable, currently effective?
 Yes ___ No ___

18. Method of Record keeping

Manual _____
 Computer _____ (In House)
 Other _____

19. If a Service Bureau is to be used or if the Company has a contract relating to the provision of operational and other support services, give name and address of

such Service Bureau or service provider (if there is a contract with a service provider regarding the provision of such services, please attach a copy):

20. Location of books and records if other than Main Office

21. If Member is affiliated with, controls, and/or is controlled by any other business entity, describe details of relationship.

22. Does Member engage in Mutual Fund business?

Yes_____ No_____

Does Member engage in insurance business? Yes____ No ____

Does Member engage in any business other than Mutual Fund business or insurance business? Yes____No____

(If "Yes", describe each such other business briefly.)

II. NATURE OF BUSINESS

1. With what Mutual Funds does Member conduct business?

What is the largest daily money settlement Member anticipates having with any one Mutual Fund Group?

- Less than \$100,000
- Between \$100,000 and \$500,000
- More than \$500,000

2. With what Insurance Carriers does Member conduct business?

What is the largest daily money settlement Member anticipates having with any one Insurance Carrier?

- Less than \$100,000
- Between \$100,000 and \$500,000
- More than \$500,000

III. BONDING

Is Member required to have a fidelity bond?
 Yes No

Name of insurance company: _____

IV. PENDING INVESTIGATION(S) AND/OR LITIGATION(S)

Is the Member the subject of any investigation(s), hearing(s), injunction(s), operational restriction(s) or other actions by a regulatory body? Yes_____ No_____

Is the Member currently involved in any litigation of a criminal or civil nature?
 Yes_____ No_____

DATE: _____ SIGNATURE: _____

~~III. GUIDELINES FOR COLLECTING CLEARING FUND DEPOSITS FOR SETTLING MEMBERS NOT ON SURVEILLANCE STATUS~~

- A. ~~Clearing Fund deposits for Settling Members are computed on a daily basis; except as specified below, however, Settling Members not on surveillance status shall be required to make any additional Clearing Fund deposits on a monthly basis.~~
- B. ~~To the extent a Settling Member's Clearing Fund requirement increases by ten (10) percent (or \$10,000 for a Member with a Clearing Fund requirement of less than \$100,000), the Corporation may require the Settling Member to make an additional Clearing Fund deposit sooner than on a monthly basis.~~
- C. ~~In addition to paragraph B above, as part of its monitoring of Clearing Fund deposit requirements, on a daily basis the Corporation will determine whether changes in Settling Member's required deposits break certain percentage thresholds for the portion of the Clearing Fund deposit relating to CNS activity. These thresholds are:~~
- ~~1. the current Clearing Fund requirement for CNS activity is more than twenty-five (25) percent higher than the previous month-end requirement;~~
 - ~~2. the average of the last five (5) calculations described in paragraph (C)(1) immediately above is more than fifteen (15) percent higher than the previous month-end requirement.~~
- D. ~~If the CNS Clearing Fund requirement exceeds either of the thresholds in paragraph C, and if, as a result, a Settling Member's deposit is insufficient to cover this increase (and the deficiency is at least ten (10) percent of the deposit or \$10,000), the Corporation will require payment of the deficiency sooner than on a monthly basis.~~
- E. ~~The Corporation may grant exemptions to the requirement that deficiencies in the Clearing Fund deposits resulting from the application of paragraphs C and D above be paid prior to month-end if the Corporation determines that the Settling Member does not pose additional risk to the Corporation that would require such an additional deposit prior to the month-end review.~~
- F. ~~The Corporation may require a Mutual Fund/Insurance Services Member to make an additional Clearing Fund deposit sooner than on a monthly basis if such Member's Clearing Fund requirement increase at least \$5,000.~~

GUIDELINES FOR DETERMINING WHEN THE CORPORATION MAY PLACE A SETTLING MEMBER OR SECURITY ON SURVEILLANCE STATUS

A. All Settling Members

1. "Advisory" Surveillance Status

- a. Any condition which could materially impact the operational and financial viability of a Settling Member which increases or may potentially

increase exposure to the Corporation and which does not meet the parameters of Class "A" or "B" surveillance status;

b. a 50% increase in average daily debits and credits calculated weekly over the average daily debits and credits for the previous calendar month;

c. when a Federal banking agency serves a Settling Member with a permanent cease and desist order pursuant to Section 8(b) of the Federal Deposit Insurance Act regarding any violation of a law, rule or regulation or any unsafe or unsound practice which could bring into question the continued financial or operational capability of the Settling Member to continue to fulfill its obligations to the Corporation;

~~d. when the sum of the average daily Envelope Settlement System debits plus the average daily Qualified Securities Depository debits of a Sponsored Member not eligible to use the Alternative Clearing Fund Formula set forth in section XV, subsection A.II.(a) exceeds such Sponsored Member's excess net capital.]~~

B. Broker/Dealer Settling Members

I. Class "A" Surveillance Status

a.(i) Firms computing net capital under basic method having a capital ratio exceeding 9.5 to 1 (950%), but not greater than 10.5 to 1 (1050%);

(ii) firms computing net capital under alternative method having capital percentage less than or equal to 5.25% but not less than 4.0%;

b. net losses in a one-month period of 15% or more of a Settling Member's excess net capital, two-month period of 25% or more, three-month period of 30% or more; or, a reduction in excess net capital of 25% or more in one month attributable to, among other things net losses, increased haircuts, charges to capital or repayment of subordinated loans;

c. temporary inability by a Settling Member to meet settlement obligations in a timely manner or a potential cash flow problem indicated by late daily settlement, payment in uncertified funds, overnight suspense items or a continuous negative unrestricted cash position per monthly financial data received;

d. Settling Member has declared itself to be self-liquidating, merging, being acquired or otherwise retiring and has a history of previous surveillance or financial problems;

- e. potential operational problems of a Settling Member indicated by a significant increase in the number of advisories accepted or an unusual number of DK's or reclaims;
- f. notification by Designated Examining Authority of a pending administrative action or investigation of a Settling Member which could bring into question the continued financial or operational capability of the Settling Member to continue to fulfill his obligations to the Corporation;
- g. Settling Member has two or more unexcused late or materially adjusted monthly financial reports in an 18-month period;
- h. during any two consecutive months, the Settling Member's net capital is equal to or less than 150% of either the SEC's minimum requirement or, if higher, its Designated Examining Authority's basic minimum requirement for a broker/dealer who conducts a general securities business or the Settling Member's equity is equal to or less than 35% of its total capitalization;
- I. any CNS position(s) (Long or Short) of a Settling Member disproportionate to his usual CNS activity;
- j. Settling Member is on any closer-than-normal or special surveillance list by another self-regulatory organization, or any other material data concerning a Settling Member which could impact the Settling Member's financial or operational viability as a participant;
- k. material increase or change in volume, fails, aged fails, inventory, customer exposure, nature of business (i.e., market making activity, underwriting, options, etc.) of a Settling Member without corresponding increases in profitability, or changes in net capital or excess net capital monitored over a period of three or more months;
- l. reorganization of firm due to merger, acquisition, and changes in management which may, but do not necessarily, result in negative capital impact;
- m. firm clearing for other firms which is instructed by its Designated Examining Authority to reduce or eliminate some or all of such activity;
- n. firm with large CNS position in an issue halted, suspended or under investigation by a self-regulatory organization or the Securities and Exchange Commission;
- o. any other condition which could materially impact the operational or financial viability of a Settling Member which increases or may potentially increase exposure to the Corporation.

2. Class "B" Surveillance Status

a.(i) Firms computing net capital under basic method having a capital ratio exceeding 10.5 to 1 (1050%);

(ii) firms computing net capital under alternative method having a capital percentage of less than 4%;

b. net losses in a one-month period of 30% or more, two-month period of 50% or more of a Settling Member's excess net capital or a reduction in excess net capital of 40% or more in one month attributable to among other things: net losses, increased haircuts, changes to capital or repayment of subordinated loans;

c. Settling Member is a Section 5(a) referral to SIPC or Settling Member is filing pursuant to Rule 17a-11;

d. during any two consecutive months, the Settling Member's net capital is equal to or less than 120% of either the SEC's minimum net capital requirement or, if higher, its Designated Examining Authority's basic minimum requirement for a broker/dealer who conducts a general securities business or the Settling Member's equity is equal to or less than 30% of its total capitalization;

e. any CNS position(s) (Long or Short) of a Settling Member which is continually and materially disproportionate to his usual CNS activity;

f. any condition of a Settling Member in Class "A" which significantly deteriorates so as to impact the Settling Member's excess net capital.

C. Bank Settling Members

I. Class "A" Surveillance Status

a. A decline in consolidated net income (after securities gains and losses) in the course of a fiscal year or two consecutive fiscal years amounting to more than 50% of such consolidated net income for the preceding fiscal year, unless the Settling Member's capital is 5% or more of its total assets at the end of the relevant fiscal year(s) in which such consolidated net income has declined, or he or his parent bank holding company maintains a Moody's or Standard & Poor's bond rating of at least A, or commercial paper rating of at least P2 or A2;

b. a consolidated net loss (after securities gains and losses) in any fiscal year;

c. temporary inability by a Settling Member to meet settlement obligations in a timely manner indicated by late daily settlement or overnight suspense items;

d. potential operational problems of a Settling Member indicated by a significant increase in the number of advisories accepted or an unusual number of DK's or reclaims;

e. when a Federal banking agency serves a Settling Member with a temporary cease and desist order pursuant to section 8(c) of the Federal Deposit Insurance Act regarding any violation of a law, rule or regulation or any unsafe or unsound practice which could bring into question the continued financial or operational capability of the Settling Member to continue to fulfill its obligations to the Corporation;

f. any CNS position(s) (Long or Short) of a Settling Member disproportionate to his usual CNS activity;

g. a material increase or change in volume or in the nature of business which involves additional use of the Corporation's services without corresponding increases in profitability, or corresponding additions to capital over a period of three or more months;

h. firm clearing for other firms which is instructed by a Federal banking agency to reduce or eliminate some or all of such activity;

i. firm with large CNS position in an issue halted, suspended or under investigation by a self-regulatory organization or the Securities and Exchange Commission;

j. when a Settling Member's financial condition is such that the Settling Member must obtain the consent of a bank regulatory authority to pay dividends in excess of an amount equal to 50% of the average amount of dividends paid in the past two years;

k. any other condition which could materially impact the operational or financial viability of a Settling Member which increases or may potentially increase exposure to the Corporation.

2. Class "B" Surveillance Status

a. When a Settling Member's financial condition is such that the Settling Member is prohibited from paying dividends by or pursuant to the banking law under which it is chartered;

b. net losses in any fiscal quarter or fiscal year exceeding 10% of a Settling Member's capital;

c. when a Settling Member seeks or receives financial assistance from the Federal Deposit Insurance Corporation pursuant to Section 13(c) or (e) of the Federal Deposit Insurance Act;

d. any CNS position(s) (Long or Short) of a Settling Member which is continually and materially disproportionate to his usual CNS activity;

e. when a Federal banking agency serves a director or officer of a Settling Member with a written notice of intent to remove that person from office pursuant to Section 8(e)1 or 8(e)2 of the Federal Deposit Insurance Act;

f. the assessment of any penalty upon a Settling Member pursuant to Section 8(i) of the Federal Deposit Insurance Act for any violation of the terms of a cease and desist order issued by a Federal banking agency or a consent agreement entered into with a Federal banking agency under circumstances which could bring into question the continued financial or operational capability of the Settling Member to continue to fulfill its obligations to the Corporation;

g. when the Federal Deposit Insurance Corporation serves a Settling Member with written notice of intent to terminate the Settling Member's federal deposit insurance pursuant to section 8(a) of the Federal Deposit Insurance Act;

h. when a Settling Member receives extended credit from the Federal Reserve discount window other than seasonal credit;

i. any condition of a Settling Member in Class "A" which significantly deteriorates so as to impact the Settling Member's financial condition.

D. Securities

1. Class I Security Surveillance Status

a. Volume and/or price movement results in trading halt, temporary suspension, stock watch alert or warning by the SEC or another self-regulatory organization;

b. special or increased initial margin requirement imposed by a self-regulatory organization or security is a recent addition to the approved list of margin securities;

c. security has been delisted by a national securities exchange, or NASDAQ, or has been delisted by the Federal Reserve Board for margin; or delisting proceedings have been initiated by any of the above entities;

d. issuer is the subject of a petition under any provision of the Bankruptcy Code;

e. security is subject to offer of merger, acquisition, tender offer, call or risk arbitrage situation or security is traded, in the Corporation's opinion, in an unusually thin market;

f. substantial increase in an active Short Position of an issue, where there has been a large adverse price movement, particularly with respect to usually inactive issues;

g. issue or issuer is the subject of a market surveillance, stock watch or regulatory report by a self-regulatory organization or the subject of a formal order of investigation by the SEC;

h. securities, the liquidation of which would create a disorderly market in that security;

i. a security position in the CNS system of a Settling Member, which is of such a size as might threaten to create a disorderly market in the event of a closeout.

2. Class II Security Surveillance Status

a. Any sustained activity of a stock in Class I which may have an inordinate financial impact on the Corporation and/or its Settling Members.

~~IV. GUIDELINES FOR COMPUTING CLEARING FUND DEPOSITS FOR SETTLING MEMBERS ON SURVEILLANCE STATUS OTHER THAN MUNICIPAL SECURITIES BROKERS' BROKERS THAT HAVE A SPONSORED ACCOUNT AND WHO ELECT THE ALTERNATIVE CLEARING FUND FORMULA.~~

~~A. Clearing Fund deposits for Settling Members on surveillance status shall be computed on a daily basis;~~

~~B. Clearing Fund deposits for Settling Members on "Advisory" Surveillance Status shall be comprised of the normal CNS clearing fund requirement plus, 2-1/2% or in the discretion of the Corporation up to 5% of the Settling Member's average daily settlement debits, excluding CNS and Mutual Fund Services debits, plus 2-1/2% of the average daily settlement credits, excluding CNS and Mutual Fund Services credits;~~

~~C. Clearing Fund deposits for Settling Members on Class "A" Surveillance Status shall be comprised of the normal CNS clearing fund requirement plus, (i) up to 5% of the Settling Member's CNS Long fail positions, plus (ii) up to 5% of the Settling Member's CNS Short fail positions, plus (iii) 2-1/2% or in the discretion of the Corporation up to 5% of the Settling Member's average daily settlement debits, excluding CNS and Mutual Fund Services debits, plus 2-1/2% of the Settling Member's average daily settlement credits, excluding CNS and Mutual Fund Services credits;~~

~~D. Clearing Fund deposits for Settling Members on Class "B" Surveillance Status shall be comprised of the normal CNS clearing fund requirement, plus (i) up to 10% of the Settling Member's CNS Long fail positions, plus (ii) up to 10% of its CNS Short fail positions, plus (iii) an additional percentage, as determined by the Corporation, of the Settling Member's average daily settlement debits and/or credits, excluding CNS and Mutual Fund Services debits and/or credits;~~

~~E. Additional Clearing Fund deposits for Settling Members on surveillance shall not be required where the amount of the deficiency is less than \$1,000. Where the amount of the deficiency is in excess of \$1,000 but less than \$5,000 the Corporation shall require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000 the Corporation shall require payment in multiples of \$5,000. Notwithstanding the foregoing, the Corporation generally will not require additional deposits unless the amount of the deficiency is equal to or greater than 10% of the Settling Member's Clearing Fund deposit;~~

~~F. Except as provided in Section 4 of Rule 53, excess Clearing Fund deposits shall be refunded on a quarterly basis, provided, however, that the Corporation may, but shall not be required to, make refunds at the request of the Settling Member, prior to the end of the quarter.~~

~~V. GUIDELINES FOR COMPUTING CLEARING FUND DEPOSITS FOR MUNICIPAL SECURITIES BROKERS' BROKERS THAT HAVE A SPONSORED ACCOUNT AND WHO ELECT THE ALTERNATIVE CLEARING FUND FORMULA AND ARE ON SURVEILLANCE~~

~~A. Clearing Fund Deposits for Sponsored Account Municipal Securities Brokers' Brokers Members on surveillance status who elect the Alternative Clearing Fund Formula shall be computed on a daily basis.~~

~~B. The Corporation, in its discretion, may require a Sponsored Account Municipal Securities Brokers' Broker Member on surveillance status who elects the Alternative Clearing Fund Formula to meet Clearing Fund requirements set forth in Section IV above or such lesser amounts as the Corporation may in its discretion require.~~

~~C. Additional Clearing Fund deposits for Sponsored Account Municipal Securities Brokers' Brokers Members on surveillance status shall not be required where the amount of the deficiency is less than \$1,000. Where the amount of the deficiency is in excess of \$1,000 but less than \$5,000 the Corporation shall require payment in multiples of \$1,000. Where the amount of the deficiency is in excess of \$5,000 the Corporation shall require payment in multiples of \$5,000. Notwithstanding the foregoing, the Corporation generally will not require additional deposits unless the amount of the deficiency is equal to or greater than 10% of the Member's Clearing Fund deposit.~~

~~D. Except as provided in Section 4 of Rule 53, excess Clearing Fund deposits shall be refunded on a quarterly basis, provided, however, that the Corporation may but shall not be required to make refunds at the request of the Member, prior to the end of the quarter.~~

~~* * *~~

ADDENDUM O

COLLATERALIZATION PROCEDURES FOR FIRMS ON CLASS A SURVEILLANCE

~~Pursuant to Section 3 of Rule 15 of NSCC's Rules any Settling Member (as defined in the Rules) "shall furnish to the Corporation such adequate assurances of its financial responsibility and operational capability as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation". Pursuant to Section 4 of Rule 15, such adequate assurances of financial responsibility or operational capability of a Settling Member "may include, but shall not be limited to: . . . increased Clearing Fund deposits of the Settling Member".~~

~~Pursuant to Section III.B.1.o. of Addendum B to NSCC's Rules and Procedures the Corporation may place any Settling Member on Class A surveillance status due to the presence of "any . . . condition which could materially impact the operational or financial viability of a Settling Member which increases or may potentially increase exposure to the Corporation."~~

~~NSCC's Board of Directors has determined that carrying on a significant clearing business for over-the-counter (OTC) market makers, or engaging in OTC market making, could materially impact the financial viability of any Settling Member, in turn increasing or potentially increasing exposure to the Corporation, when the market maker, either alone or acting in concert with other market makers, takes net street-side trading positions that constitute a disproportionately large percentage of the total net street-side buys or net street-side sells in any issue (i.e., dominates one side of the market in the issue) and has insufficient capitalization (or access to capital) to support the positions in dominated issues. The potential for increased exposure to the Corporation becomes greater to the extent that one or more additional risk factors are present, including, but not limited to, the following:~~

- ~~(1) concentrated short selling in dominated issues;~~
- ~~(2) undue concentration of inventory in the market maker(s) for dominated issues;~~
- ~~(3) dominated issues also being IPOs less than six months past initial issuance, particularly when the current value of the issue is significantly different from its initial~~

sales price or there is undue concentration of inventory in the managing underwriter(s); and

(4) clearing positions of market makers in dominated issues away from their primary clearing brokers.

To the extent that a market maker's net street-side trading positions in dominated issues result from legitimate customer orders, the potential adverse impact on the financial viability of the Settling Member and the potential for increased exposure to the Corporation would be mitigated.

In light of the foregoing, the Corporation has adopted the policy of placing Settling Members on Class A surveillance if they clear for or are themselves OTC market makers and they do not have sufficient capital or access to capital to support either potential increases in market making activity in dominated issues of the type described above or the presence of additional risk factors described above in current volumes of market maker activity.

Where the Corporation has obtained sufficient assurances of a high degree of mitigating circumstances (described above) the Corporation maintains its ability not to place Settling Members on Class A surveillance. The mere fact that a market maker has a large customer base may not necessarily constitute the necessary mitigating circumstances, especially if the customers are retail and/or the market maker has a history of customer complaints or other adverse regulatory or disciplinary actions.

Pursuant to Rule 15, the Corporation has also adopted an interim collateralization policy which would permit the Corporation, in its discretion, to require Settling Members on Class A surveillance who clear for or are themselves OTC market makers to meet special collateralization requirements as follows:

(1) To the extent that the sum of the absolute values of the net unsettled trading positions of any such Settling Member in all the securities dominated by a market maker (where domination is determined according to criteria specified by the Corporation from time to time) exceeds the market maker's excess net capital, the Corporation may require the Settling Member to deposit the amount of the excess with the Corporation at such times and in such manner as the Corporation may designate (including an immediate deposit of same-day funds). In determining the size of net unsettled trading positions, the Corporation may take into account offsetting pending (i.e., non-fail) ID transactions that have been confirmed, and, when the Corporation deems appropriate, affirmed, through DTC's ID system. (The Corporation may, in its discretion, decline to consider any such ID transaction if it has reason to believe that the institutional counter party may not or cannot settle it.) In addition, where a market maker's net unsettled trading positions in dominated issues are cleared by one or more other Settling Members (as well as by the Settling Member on Class A surveillance), the Corporation shall have the discretion, for purposes of calculating the special collateral requirement

set forth in this paragraph, of treating those positions as if they were all cleared by the Settling Member on Class A surveillance.

(2) To the extent that the unsettled positions referred to in the immediately preceding paragraph (1) are short (i.e., net sells), the Corporation may, in its discretion, collect more than 100% of the excess or may require or accept, in lieu of cash collateral, a transfer to the Corporation on the books of DTC of securities sufficient to cover the short position.

(3) The Corporation reserves the right at all times to accept alternative arrangements for its protection in any of the above situations, to require special collateral deposits with respect to trading positions in issues dominated by a market maker even when the value of those positions do not exceed the market maker's excess net capital, or to forego collecting such special collateral even when the value of those positions exceed the market maker's excess net capital (but do not exceed some higher threshold), all as the situation may warrant, depending upon, among other things, the presence or absence of additional risk factors or mitigating circumstances.

The above special collateralization requirements are interim measures for Settling Members on Class A surveillance which will be in effect until the Corporation has gained enough experience in surveillance of OTC market maker trading activities to impose permanent special collateralization requirements. Additionally, when there is concentrated short selling in dominated issues, the Corporation would maintain its right to collect special collateral deposits from the Settling Members clearing the short sales without regard to their surveillance status. Special collateral collected from any Settling Member under the above procedures shall be in addition to the Member's Clearing Fund deposit computed in accordance with the formulae set forth in Procedure XV or in accordance with the alternative method set forth below.

The Corporation also recognizes that Settling Members on Class A surveillance have been determined to present a higher than normal risk of default and insolvency. As a result, such Settling Members should be asked to make Clearing Fund deposits keyed to the close-out risk presented by their unsettled positions in the Corporation's systems. Therefore, pursuant to Rule 15, the Corporation shall have the discretion to compute the CNS Clearing Fund requirements for any Settling Member on Class A surveillance, without regard to particular individual circumstances, in accordance with the following alternative method rather than as set forth in Procedure XV:

(1) The Corporation may calculate on a daily or periodic basis the volatility of any such Settling Member's net unsettled trading positions in CNS eligible issues (Net CNS Trading Positions). Such positions shall be determined after taking into account offsetting pending (i.e., non-fail) ID transactions that have been confirmed, and, when the Corporation deems appropriate, affirmed, through DTC's ID system. (The Corporation may, in its discretion, decline to consider any such ID transaction if it has reason to believe that the institutional counter party may not or cannot settle it.) Such calculation shall be made in accordance with the Capital Asset Pricing Model or any

other generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934, provided, however, that not less than two standard deviations' volatility shall be calculated under any model chosen. Such calculation shall be made utilizing such assumptions and based on such historical data as the Corporation deems reasonable and shall cover such range of historical volatility as the Corporation from time to time deems appropriate. If such volatility is calculated on a periodic basis, it may be expressed as a percentage of the sum of the absolute values of the firm's Net CNS Trading Positions. Any such calculations, whether expressed as a dollar value or percentage, may be rounded as the Corporation deems appropriate.

(2) The Corporation shall have the discretion to exclude from the above calculations Net CNS Trading Positions in classes of securities whose volatility is (i) less amenable to statistical analysis, such as, for instance, OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (ii) amenable to generally accepted statistical analysis only in a complex manner, such as, for instance, municipal or corporate bonds. The amount of Clearing Fund required with respect to Net CNS Trading Positions in such issues shall be determined by multiplying the absolute value of such positions by a percentage designated by the Corporation, which percentage may vary depending on such factors as the Corporation deems relevant.

(3) The amounts calculated in accordance with the immediately preceding two numbered paragraphs shall be substituted for the amount calculated in accordance with paragraph (1)(c) of Sections A.I.(a), A.II.(a) and A.II.(b) of Procedure XV. In addition, the Corporation may in its discretion reduce or eliminate the amount calculated in accordance with paragraph (1)(a) of such Sections.

(4) The Corporation may also, in its discretion, calculate the total Clearing Fund requirement of any such Settling Member on a daily, rather than 20-day rolling average, basis, and may collect deficiencies at such times and in such manner as specified by the Corporation from time to time (including immediate collection of same-day funds).

Nothing in the foregoing should be construed to limit the Corporation's discretion with respect to placing Settling Members on Class A surveillance or requiring Settling Members to furnish adequate assurances of financial responsibility or operational capability as set forth in the Corporation's Rules and Procedures.

* * *]* _____ *

-FOOTNOTE 1-

[Unless] All calculations shall be performed daily or, if the Corporation [determines otherwise, due] deems it appropriate, on a more frequent basis.

-FOOTNOTE 2-

The Corporation may, in its discretion, decline to [market fluctuations or other exigent circumstances, the mark-to-market component of the clearing fund formula for when-issued and when-distributed transactions is the daily market differential, while CNS and Balance Order trades use a rolling twenty day average of such mark-to-market differential] consider any such transactions, as well as other similar transactions referred to in respect of this Procedure, if it has reason to believe that the institutional counter party may not or cannot settle the transaction.

-FOOTNOTE [2] 3-

As used in this [Section A.II., the term "Envelope Settlement System" shall mean such non-CNS activity, other than DTC Sponsored Account activity, as the Corporation may determine from time to time.] **Procedure, the term "Market Maker" shall mean a member firm of the National Association of Securities Dealers, Inc. (NASD) that is registered by the NASD as a Market Maker.**

-FOOTNOTE [3] 4-

[As used in this Section A.IV., the term "Envelope Settlement System" shall mean such non-CNS activity, other than DTC Sponsored Account activity, as the Corporation may determine from time to time] **The Corporation may require or permit such Member to deliver some or all shares necessary to complete a short obligation in lieu of part or all of its requirement under this section or subsection I.(A)(2)(c).**

-FOOTNOTE 5-

For purposes of calculating the factor, a price movement of ten to nineteen percent of the previous day's Current Market Price shall equal a factor of 1. Each additional ten percent price movement shall increase the factor by 0.5. The factor, however, shall not exceed 10.

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-FOOTNOTE 6-

This section applies to entities whose use of the Corporations services are restricted to the Mutual Fund Services and/or the Insurance Processing Services. Entities which use or are permitted to use Services other than or in addition to the Mutual Fund Services and Insurance Processing Service are covered by section I.(A).

-FOOTNOTE [4] 7-

For the purpose of the membership standards and surveillance status rules applicable to banks, "capital" is defined to include capital stock, surplus, undivided net profits, reserve for contingencies and other capital reserves.

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-FOOTNOTE 5-

As used in this subsection III.(A)(1)(d), the term "Envelope Settlement System" shall mean such non-CNS activity, other than DTC Sponsored Account activity, as the Corporation may determine from time to time.]

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NSCC-2001-04)

Proposed Rule Change by NATIONAL SECURITIES CLEARING CORPORATION ("NSCC") regarding procedures for calculating and collecting Clearing Fund deposits from Members. Comments requested within days after the date of this publication.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1), notice is hereby given that on , NSCC filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change.

The proposed rule change relates to procedures for calculating and collecting Clearing Fund deposits from Members.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

(a) NSCC has determined to modify and consolidate its Clearing Fund rules. As more fully described below, the Corporation proposes to apply its current Clearing Fund requirements for Settling Members on surveillance (Addendum O) to all Members and, for ease of reference, incorporate these requirements as well as the Clearing Fund requirements found in Addendum B into NSCC's Procedure XV.

Under Addendum O¹ NSCC now collects additional Clearing Fund deposits from Settling Members on surveillance pursuant to a risk-based margining ("RBM") methodology that includes, but is not limited to, calculations based on portfolio volatility and, where applicable, market maker domination. This rule filing extends these RBM requirements to all NSCC Members in lieu of Procedure XV's current allocation (Section A.I.(a)(i)(a)) and liquidation (Section A.I.(a)(i)(c)) Clearing Fund requirements.

Since the Commission's approval of Addendum O in 1996, NSCC studied the impact of RBM on Member firms. The Corporation found that utilization of RBM more accurately reflects NSCC's exposure than the current allocation and liquidation formulae because it enables the Corporation to more precisely identify the risks posed by a Member's unsettled portfolio and, as a result, more quickly adjust and collect additional Clearing Fund requirements. Management therefore recommended, and the Membership and Risk Management Committee concurred, that RBM methodologies should be applied to all NSCC Members, not just those on surveillance.

This rule change will modify Procedure XV as follows:

¹ This policy was originally filed as SR-NSCC-95-17. It was most recently re-filed as SR-NSCC-99-9, temporary approval for which expires on May 31, 2001 (Release Number 34-42864; File No. SR-99-9). Until this rule change is approved, the Corporation seeks to extend the temporary approval of the requirements found in Addendum O.

- In respect of Clearing Fund requirements for CNS Transactions, Procedure XV's allocation (current Section A.I.(a)(i)(a)) and liquidation (current Section A.I.(a)(i)(c)) formulae will be replaced with RBM methodology now found in Addendum O, specifically volatility (new Section I.(A)(1)(a)) and market maker domination (new Section I.(A)(1)(c)) calculations. The volatility formula will continue to permit the Corporation to utilize any generally accepted portfolio volatility model to calculate volatility.
- In addition, the rule will continue to provide that the Corporation may exclude from volatility calculations Net Unsettled Positions in classes of securities whose volatility is (1) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold (e.g., five dollars), or (2) amenable to generally accepted statistical analysis only in a complex manner, such as municipal or corporate bonds. The amount of Clearing Fund required with respect to these Net Unsettled Positions will be determined by multiplying the absolute value of the Net Unsettled Positions by a percentage designated by the Corporation. This percentage will be not less than 10% in respect of the positions covered by item (1) above, and not less than 2% in respect of the positions covered by item (2) above.
- The Clearing Fund requirements in the proposed rule for all When-Issued and When-Distributed Transactions will be consolidated with the calculations for Regular Way Transactions.
- The third prong of the CNS formula, i.e. the calculation of the difference between the contract price and the current market price of compared pending positions, will remain the same (current Sections I.(A)(1)(b) and I.(A)(2)(b)), however these calculations will be undertaken on a daily basis.

- The proposed rule states that all Clearing Fund and other deposit requirements be made by Members within one hour of demand; provided, however, that to the extent the Member is meeting its obligation with (1) a deposit of cash, that such deposit be made by Federal Funds wire transfer and be received no later than fifteen minutes prior to the close of the Federal Funds wire; and, with (2) a delivery of eligible securities, that such delivery be received within the deadlines established by a Qualified Securities Depository.² The rule further provides that at the discretion of the Corporation, these cash deposits may be included as part of the Member's daily settlement obligation.
- Addendum B, among other things, currently specifies thresholds pursuant to which the Corporation will require additional Clearing Fund contributions. Procedure XV (new Section II.(C)) will now provide that additional Clearing Fund deposits shall not be requested where the amount of the deficiency for a: (1) Member on Class "A" or "B" Surveillance Status is equal to or less than \$5,000 and such amount is less than 5% of such Member's actual deposit; (2) Member on "Advisory" Surveillance Status is equal to or less than \$20,000 and such amount is less than 5% of such Member's actual deposit; or (3) Member not on any Surveillance Status is equal to or less than \$50,000 and such amount is less than 10% of the Member's actual deposit.
- Other changes to the rule result from relabeling and/or moving the placement of the Corporation's Clearing Fund requirements without altering their substantive nature.

² Under NSCC rules the only QSD is DTC.

As described below, NSCC intends, subject to SEC approval, to begin implementing the proposed Clearing Fund changes on June 15, 2001, and to conclude by December 31, 2002.

Members currently subject to Addendum O will be subject to these rule changes on June 15, 2001. Applicants approved for NSCC membership from and after the date of this filing will also be immediately subject to these rule changes on June 15, 2001. Members who have a position which will subject them to a deposit requirement based on the market maker domination calculations will additionally be subject to these rule changes on June 15, 2001. The Corporation will place every remaining Member into deciles and apply the revised Clearing Fund methodologies pursuant to a step-by-step, decile-by-decile plan based upon the volatility classification of each such Member's unsettled portfolio. Accordingly, Members with the most volatile portfolios will be subject to these rule changes first, on or shortly after June 15, 2001, provided, however, that to the extent any such Member has significant CNS obligations resulting from options exercises and assignments or is a Municipal Securities Brokers' Broker, it will be subject to these rule changes after all other Members, but in no event later than December 31, 2002.

To accommodate this transition the Corporation will keep effective all rules affected by this filing until all Members are subject with the revised rules.

(b) This filing will permit NSCC to assure the safeguarding of funds and securities for which it is responsible because it will permit the Corporation to more appropriately collect collateral to cover Members' exposures. Consequently, it is consistent with the provisions of the Securities Exchange Act of 1934.

B. Self-Regulatory Organization's Statement on Burden on Competition.

NSCC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others.

No written comments relating to the proposed rule change have been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action.

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reason for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments.

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with provisions of 5. U.S.C. 552, will be available for inspection

and copying in the Commission's Public Reference Section, 450 Fifth Street N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to the file number in the caption above and should be submitted within days after the date of this publication.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.

Jonathan G. Katz

Secretary

Dated: