

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
 WASHINGTON, D.C. 20549
 Form 19b-4

File No. SR - 2003 - 11
 Amendment No. 3

Proposed Rule Change by National Securities Clearing Corporation

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

Initial <input type="checkbox"/>	Amendment <input checked="" type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input checked="" type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action <input type="checkbox"/>	Date Expires <input type="text"/>	Rule <input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6)		

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
 Title
 E-mail
 Telephone Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date

By General Counsel and Secretary
 (Name) (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Karen Saperstein

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

Boldfaced and underlined indicates inserted text
~~Strikethrough and bracketed~~ indicates deleted text
 Highlighted text indicates text modified in prior Amendments

1. Text of the Proposed Rule Change.
 - (a) Text of the proposed rule change was submitted as Exhibit A to the original filing.
 - (b) Not applicable.
 - (c) Not applicable.
2. Procedures of the Self-Regulatory Organization.
 - (a) The proposed change has been approved by NSCC's Board of Directors.
3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.
 - (a) The purpose of the proposed rule change is to modify NSCC's Rules & Procedures (the "Rules") 1) with regard to methodology used by the Corporation when performing the surveillance/monitoring of its participants, and 2) to eliminate all participant/applicant questionnaires in their present form. **NSCC will continually evaluate the methodology and its effectiveness and make such changes as it deems prudent and practicable within such time frame as is determined to be appropriate by the Corporation in its sole discretion.**

1. Surveillance

Under current NSCC Rules, a participant experiencing conditions which may materially impact its financial or operational condition or which may increase or may potentially increase the Corporation's exposure, may be placed on surveillance status. Currently, there are three levels of surveillance **status** and criteria for determining when ~~[to place]~~ a participant **may be placed** on surveillance status. ~~[; Advisory, Class A~~

and Class B.]

~~[The current criteria used for placing participants on surveillance permits the Corporation to capture a number of NSCC's participants that are deemed to pose minimal to no financial and/or operational risk to NSCC. Once on surveillance status, these minimal risk firms must also be scrutinized, which creates an administrative burden upon NSCC's staff that is not necessary for the protection of NSCC or its participants]~~

The guidelines set forth in NSCC's Rules will be replaced with an enhanced methodology that will permit the closer monitoring of those participants that it is believed create greater risk to the Corporation

NSCC will be replacing this process and instead will place participants on surveillance pursuant to ratings assigned to the participant based primarily on its financial strength. **Utilizing a matrix methodology, U.S. regulated broker/dealer and U.S. regulated bank/trust's, as determined by the corporation from time to time¹, will be run through the Credit Risk matrix and thereafter assigned a rating. This methodology will also permit Credit Risk Management to override the rating and downgrade or upgrade a particular Member's rating based on various qualitative factors. For example, one qualitative factor for downgrading a Member might be the Member in question receiving a qualified audit opinion. This override feature permits the Corporation to subject the Member to closer or lesser monitoring if Credit Risk Management feels it is appropriate to do so.** Only those participants assigned a "weak" rating (i.e. those deemed to pose a relatively higher degree of risk to the Corporation) will be placed on a "Watch List" where they will be more closely monitored by the Corporation. Participants placed on the Watch List may be subject to higher clearing fund requirements and/or **(if the Corporation deems it necessary) may**

¹ **This determination is only made against full service Rule 2 Members.**

be required to provide such additional information to the Corporation as permitted by Rule 15.² [~~be requested to submit additional financial reports and/or data~~].

2. Questionnaires

Currently, Addendum's B, I, Q and R (Standards of Financial Responsibility and Operational Capability for various types of participants) include questionnaires that participants and applicants are required to complete and return to the Corporation. Rule 15 Section 2 also provides that the Corporation has the authority to examine the financial responsibility and operational capability of participants and applicants, and in conducting such examinations may require a participant or applicant to furnish such information as deemed sufficient by the Corporation to demonstrate their responsibility/capability. The Corporation has determined to rely on its ability under Rule 15 to obtain pertinent information for applicants and participants, rather than require responses to specific questionnaires. NSCC will solicit such information in such form

² NSCC's approach to the analysis of members will be based on a thorough quantitative analysis. A member's rating on the credit risk matrix will be based on factors including (for broker/dealers): size (total excess net capital), capital, leverage, liquidity and profitability. Banks will be reviewed based on: size, capital, asset quality, earnings and liquidity. Members will also be evaluated based on their compliance with certain "parameter breaks" which will be determined based on applicable monthly and/or quarterly exception reports generated by Credit Risk. A member may be placed on the watch list for failure to fall within, for example, prescribed excess net capital, excess liquid capital, aggregate indebtedness, leverage ratio or financial membership requirement parameters.

Broker/dealer Members not on the "Watch List" are monitored against parameter breaks which may include but are not necessarily limited to, a defined aggregate indebtedness/net capital ratio, a defined net capital/aggregate debit items ratio and a defined net capital/regulatory net capital ratio. Broker/dealer Members placed on the "Watch List" are monitored more closely, and are reviewed against parameters established by the Corporation from time to time. These may include those described above as well as additional parameters that may include but are not necessarily limited to, a defined decline in excess net capital over a one month or three month period and a defined period loss.

Bank/Trust Members not on the "Watch List" are monitored against parameter breaks which may include but are not necessarily limited to, a defined tier one leverage ratio, a defined tier one risk-based capital ratio and a defined total risk-based capital ratio. Bank/Trust Members on the "Watch List" are monitored more closely, and are reviewed against parameters established by the Corporation from time to time. These may include those described above as well as additional parameters that may include but are not necessarily limited to, a defined quarter loss and a defined decline in equity.

and within such timeframes as the Corporation may require from time to time.

(b) ~~[This filing]~~ **The proposed rule change** will ensure that NSCC is able to safeguard securities and funds in its ~~[possession]~~ **custody or control by allowing the Corporation to provide more effective, timely and accurate monitoring of its Participants, [T] t** therefore it is consistent with the provisions of the Securities Exchange Act of 1934 (the “Act”), as amended, and the rules and regulations thereunder.

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.

Written comments relating to the proposed rule change have not yet been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

6. Extension of Time Period for Commission Action.

Not applicable.

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

(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 another self-regulatory organization or the Commission.

9. Exhibits

Exhibit 1 - Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 – n/a

Exhibit 3 – n/a

Exhibit 4 – n/a

Exhibit 5 – n/a

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-_____ ; File No. SR-NSCC-2003-11)

SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Securities Clearing Corporation (“NSCC”) relating to the methodology used by NSCC when performing the surveillance/monitoring of its participants, and the elimination of all participant/applicant questionnaires in their present form.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”), 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 text of the proposed rule change is attached hereto as Exhibit 5.

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.

(i) The purpose of the proposed rule change is to modify NSCC’s Rules & Procedures (the “Rules”) 1) with regard to methodology used by the Corporation when performing the surveillance/monitoring of its participants, and 2) to eliminate all

participant/applicant questionnaires in their present form. NSCC will continually evaluate the methodology and its effectiveness and make such changes as it deems prudent and practicable within such time frame as is determined to be appropriate by the Corporation in its sole discretion.

1. Surveillance

Under current NSCC Rules, a participant experiencing conditions which may materially impact its financial or operational condition or which may increase or may potentially increase the Corporation's exposure, may be placed on surveillance status. Currently, there are three levels of surveillance status and criteria for determining when a participant may be placed on surveillance status

The guidelines set forth in NSCC's Rules will be replaced with an enhanced methodology that will permit the closer monitoring of those participants that it is believed create greater risk to the Corporation.

NSCC will be replacing this process and instead will place participants on surveillance pursuant to ratings assigned to the participant based primarily on its financial strength. Utilizing a matrix methodology, U.S. regulated broker/dealer and U.S. regulated bank/trust's, as determined by the corporation from time to time,¹ will be run through the Credit Risk matrix and thereafter assigned a rating. This methodology will also permit Credit Risk Management to override the rating and downgrade or upgrade a particular Member's rating based on various qualitative factors. For example, one qualitative factor for downgrading a Member might be the Member in question receiving a qualified audit opinion. This override feature permits the Corporation to subject the Member to closer or lesser monitoring if Credit Risk Management feels it is appropriate to do so. Only those participants assigned a "weak" rating (i.e. those deemed to pose a relatively higher degree of risk to the Corporation) will be placed on a "Watch List" where they will be more closely monitored by the Corporation. Participants placed on the Watch List may be subject to higher clearing fund requirements and/or (if the Corporation deems it necessary) may be required to provide such additional information to the Corporation as permitted by Rule 15.²

¹ This determination is only made against full service Rule 2 Members.

² Broker/dealer Members not on the "Watch List" are monitored against parameter breaks which may include but are not necessarily limited to, a defined aggregate indebtedness/net capital ratio, a defined net capital/aggregate debit items ratio and a defined net capital/regulatory net capital ratio. Broker/dealer Members placed on the "Watch List" are monitored more closely, and are reviewed against parameters established by the Corporation from time to time. These may include those described above as well as additional parameters that may include but are not necessarily limited to, a defined decline in excess net capital over a one month or three month period and a defined period loss.

Bank/Trust Members not on the "Watch List" are monitored against parameter breaks which may include but are not necessarily limited to, a defined tier one leverage ratio, a defined tier one risk-based capital ratio and a defined total risk-based capital ratio. Bank/Trust Members on the "Watch List" are monitored more closely, and are reviewed against parameters established by the Corporation from time to time. These may include those described above as well as additional parameters that may include but are not necessarily limited to, a defined quarter loss and a defined decline in equity.

2. Questionnaires

Currently, Addendum's B, I, Q and R (Standards of Financial Responsibility and Operational Capability for various types of participants) include questionnaires that participants and applicants are required to complete and return to the Corporation. Rule 15 Section 2 also provides that the Corporation has the authority to examine the financial responsibility and operational capability of participants and applicants, and in conducting such examinations may require a participant or applicant to furnish such information as deemed sufficient by the Corporation to demonstrate their responsibility/capability. The Corporation has determined to rely on its ability under Rule 15 to obtain pertinent information for applicants and participants, rather than require responses to specific questionnaires. NSCC will solicit such information in such form and within such timeframes as the Corporation may require from time to time.

(ii) The proposed rule change will ensure that NSCC is able to safeguard securities and funds in its custody or control by allowing the Corporation to provide more effective, timely and accurate monitoring of its Participants, therefore it is consistent with the provisions of the Securities Exchange Act of 1934 (the "Act"), as amended, and the rules and regulations thereunder.

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

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

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

Written comments relating to the proposed rule change have not yet 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 reasons 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, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

- Electronic comments may be submitted by using the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>), or send an e-mail to rule-comment@sec.gov. Please include File No. [XX] on the subject line.
- Paper comments should be sent in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington D.C. 20549-0609

All submissions should refer to File Number [XX]. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 the provisions of 5 U.S.C 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NSCC. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submission should refer to the file number above and should be submitted within _____ days after the date of publication.

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

Jonathan G. Katz