

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Jonathan G. Katz,**

Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52445; File No. SR-NSCC-2005-08]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Codify, Consolidate, and Clarify Financial Responsibility and Operational Capability Rules

September 15, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 2, 2005, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The purpose of the proposed rule change is to codify, consolidate, and clarify NSCC's financial responsibility and operational capability rules into NSCC Rule 15 ("Financial Responsibility and Operational Capability").

#### 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 these statements.<sup>2</sup>

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

##### 1. Clarification of "Participants"

Section 1 of Rule 15 sets forth NSCC's general authority to establish standards of membership and guidelines for the application of such standards. Section 1 is amended to make clear that it applies to a Member, Non-Clearing Member, Municipal Comparison Only Member, Fund Member, Insurance Carrier Member, TPA Member, or Data Services Only Member and that each such member is referred to as a "participant" in NSCC's rules.

##### 2. Regular Reporting Required of Participants

Section 2 of Rule 15 is amended to clearly set forth the list of reports and information, such as financial statements and copies of certain regulatory filings, which certain participants are routinely required to submit on a regular basis for NSCC's risk management purposes. The explicit list of reports and information includes all such reports and information currently required by NSCC under its general authority to monitor compliance with membership standards. The submission requirements applicable to certain categories of NSCC participants previously had been set forth on NSCC's Web site and were communicated to participants quarterly by NSCC Important Notice. Codifying the requirements in Section 2 of Rule 15 will further facilitate compliance with these reporting requirements.

The codification of the list of reports and information which are required on a routine basis does not restrict NSCC's current general authority to require additional information in particular instances should NSCC's risk management procedures so require pursuant to new Section 2 of Rule 15.

The timeframes by which participants are required to submit particular information is deleted from Section 2 of Rule 15 because these timeframes may vary according to external parameters such as, for example, regulatory requirements applicable to a certain class of participants. Section 2 now makes reference to the submission of reports and information within the time periods prescribed by NSCC from time to time. Section 2 also directs participants to provide the information in the form and to the person or department specified by NSCC from time to time. NSCC communicates these submission deadlines and requirements to participants by Important Notices

which are reissued quarterly. In addition, the current submission schedule is posted on NSCC's Web site, and new participants are advised of the submission schedule in the NSCC acceptance letter. The reference to the timeframe by which reports are due is also deleted from Addendum B (including the version of Addendum B contained in Appendix 1) since it is now set forth clearly in Section 2 of Rule 15.

Section 2 of Rule 15 is further revised to make specific reference to a participant's obligation to provide amendments and addenda to all reports and to inform NSCC of any extensions granted by its regulator regarding submission of a regulatory report for which NSCC also requires submission. To the extent NSCC's review includes copies of reports submitted by the participant to its regulator, this will facilitate NSCC's review process by making each participant responsible for notifying NSCC of an extension rather than requiring NSCC to make inquiries of the participant after NSCC fails to receive a report by the date on which it is otherwise required to be provided to NSCC.

In addition, Section 2 is amended to make specific reference to a participant's obligation to provide annual financial statements of its guarantor consistent with NSCC's current risk management review procedures. Currently, these procedures are communicated to participants on NSCC's Web site, in Important Notices, and in correspondence. Codification of the requirement in Rule 15 will facilitate compliance.

##### 3. Participant Reporting on Certain Changes

Rule 15 is further amended by new Section 3 which codifies a participant's reporting obligations with respect to certain changes which could have a substantial impact on its business or financial condition, such as: (1) Material organizational changes including mergers, acquisitions, changes in corporate form, name changes, changes in the ownership of a participant or its affiliates, and material changes in management; (2) material changes in business lines, including new business lines undertaken; and (3) defendant status in litigation which could reasonably impact the participant's financial condition or ability to conduct business. Timely notification of such changes and events enables NSCC to analyze the implications of the event and determine an appropriate course of action for risk management purposes.

<sup>11</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> The Commission has modified the text of the summaries prepared by NSCC.

These provisions are currently contained in Addendum T (“Interpretation of the Board of Directors, Continuing Responsibility of the Corporation”), which is being deleted. Including the Addendum T reporting obligations in Rule 15 will facilitate compliance by: (1) Consolidating the reporting requirements in one place; (2) clarifying the time by which notification is due; and (3) using language substantially similar to that used by the Government Securities Division and the Mortgage Backed Securities Divisions of the Fixed Income Clearing Corporation (“FICC”), an affiliated clearing agency to which some NSCC participants are also members.

New Section 3 also clarifies that notice given in connection with such changes is not subject to the provisions in Rule 45 (“Notices”) that govern other types of participant notices. Instead, these notices must be given in the manner and to the persons specified by NSCC for this purpose. Currently, NSCC instructs its participants to communicate such notices to NSCC’s Risk Management staff because this area is responsible for evaluating the impact of the change in the member’s continued compliance with NSCC’s membership requirements. These notice requirements are set forth in NSCC’s Important Notices and on NSCC’s Web site. In addition, Section 3 includes the time by which such notification must be given, which is consistent with the analogous reporting requirements adopted by FICC.

#### 4. Authority To Further Examine Participants

The provisions currently contained in Sections 2(a) and 2(c) of Rule 15 regarding NSCC’s authority to further examine the financial condition and operational capability of a participant or applicant are consolidated in new Section 4.

These provisions are essentially unchanged except that NSCC’s authority to receive reports and information regarding NSCC’s participants from other self-regulatory organizations is expanded to include other regulatory bodies having authority to examine, register, or license the participant. This change accommodates NSCC’s review of regulated entities, such as insurance companies and trust companies, whose regulators are not self-regulatory organizations.

#### 5. Additional Assurances From Participants

The provisions regarding NSCC’s authority to require additional

assurances from its participants are currently set forth in Section 2(b), Sections 3(a) and 3(b), and Sections 4(a) and 4(b) of NSCC’s Rules. Rule 15 is revised to consolidate these provisions in new Section 5(b). Specific references regarding NSCC’s authority to restrict the activities of Mutual Fund/Insurance Services Members and/or to require them to enter into specific agreements regarding operational support are deleted because such authority is included in NSCC’s general authority in Rule 15 to restrict activities of its participants or to impose specific conditions on their participation.

#### 6. Technical Changes

A new Section 6 is added to Rule 15 containing text that is currently contained in Section 2 of Rule 15. Section 6 clarifies that all information submitted to NSCC by a participant under any section of Rule 15 is subject to confidentiality requirements imposed by law or regulatory authority.

A new Section 7 is added to Rule 15 cross-referencing NSCC’s authority to take disciplinary action, impose fines, restrict access to services, or otherwise take action with respect to a participant’s failure to comply with Rule 15. This will facilitate NSCC’s enforcement of the requirements of Rule 15.

An identical technical change regarding the requirement that an applicant shall provide such other reports and information as NSCC determines appropriate is made to each of the following rule provisions: Rule 2 (“Members”), Section 2; Rule 31 (“Data Services Only Member”), Section 2; Rule 51 (“Fund Member”), Section 2; Rule 56 (“Insurance carrier Member”), Section 2; and Rule 60 (“TPA Member”), Section 2. The terminology is made consistent among these analogous provisions.

The proposed rule change is consistent with the requirements of Section 17A of the Act<sup>3</sup> and the rules and regulations thereunder applicable to NSCC because it assures the safeguarding of securities and funds in NSCC’s custody or control or for which it is responsible by clarifying rules for applicants and members. As a result, NSCC’s ability to maintain a financially and operationally sound participant base should be enhanced.

#### (B) Self-Regulatory Organization’s Statement on Burden on Competition

NSCC does not believe that the proposed rule change will have any

impact on 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

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

The foregoing rule change has become effective upon filing pursuant to Section 19(b)(3)(A)(i) of the Act<sup>4</sup> and Rule 19b-4(f)(1)<sup>5</sup> thereunder because the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within sixty days of the filing of such rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### 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

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/sro.shtml>) or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2005-08 on the subject line.

##### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-NSCC-2005-08. 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

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>5</sup> 17 CFR 240.19b-4(f)(1).

<sup>3</sup> 15 U.S.C. 78q-1.

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 Section, 100 F Street, NE., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NSCC and on NSCC's Web site at <http://www.nsc.com>. 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 submissions should refer to File Number SR-NSCC-2005-08 and should be submitted on or before October 12, 2005.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52435; File No. SR-NYSE-2005-62]

### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change To Add Exchange Rule 123G Prohibiting Trade Shredding

September 14, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended, ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 9, 2005, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") 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 the Exchange. 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 Exchange proposes to add NYSE Rule 123G to prohibit members, member organizations and associated persons from unbundling orders for execution for the primary purpose of maximizing a monetary or like payment to the member, member organization or associated person without regard for the best interests of the customer.

The text of the proposed rule change appears below. Additions are *in italics*.

\* \* \* \* \*

#### Order Entry Practices

##### Rule 123G

*No member, member organization, allied member, approved person or registered or non-registered employee of a member or member organization may engage in conduct that has the intent or effect of unbundling orders for execution for the primary purpose of maximizing a monetary or in-kind amount received by the member, member organization, allied member, approved person or registered or non-registered employee of a member or member organization as a result of the execution of such orders. For purposes of this section, "monetary or in-kind amounts" shall be defined to include commissions, gratuities, payments for or rebate of fees resulting from the entry of such orders, or any similar payments of value to the member, member organization, allied member, approved person or registered or non-registered employee of a member or member organization.*

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

In its filing with the Commission, the NYSE 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. The NYSE 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 the Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

"Trade shredding" is the practice of unbundling customer orders for securities into multiple smaller orders for the primary purpose of maximizing payments to the member or member organization, and thereby possibly disadvantaging the customer by, for example, charging excessive fees or commissions, or failing to obtain best execution of an order. Such payments may create a conflict of interest between the customer and the member or member organization. For example, as a result of the manner in which market data revenues are calculated, market centers can derive a greater share of market data revenue by increasing the number of trades that they report to the consolidated tape. At the same time, some markets have adopted a practice of sharing these increased revenues with market participants, including non-members, who send in orders. Thus, the Commission has expressed concern that an incentive exists for market participants receiving rebates to engage in distortive behavior, such as trade shredding, as a means to increase their share of market data revenues. Other economic arrangements between members or member organizations and their customers may create similar incentives to engage in similarly distortive behavior.

The Commission has requested that all U.S. self-regulatory organizations implement rule changes to inhibit the practice of trade shredding. The NYSE does not rebate revenues from tape reporting to members or non-members. Thus, there is no incentive in this area for NYSE order providers to engage in trade shredding on orders sent to the Exchange. However, a member or member organization may engage in conduct that has an impact similar to trade shredding, in that it unbundles a customer's order for the primary purpose of maximizing payments to the member or member organization at the customer's expense and to the customer's detriment.

In response to the Commission's request, the Exchange proposes to adopt a new Rule 123G prohibiting all such practices. Specifically, new Rule 123G would prohibit a member, member organization or any associated person from unbundling orders for execution for the primary purpose of maximizing a monetary or like payment of a type described in the rule.

<sup>6</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.