

the Securities Exchange Act of 1934 ("Act").¹ Notice of the proposal was published in the **Federal Register** on October 17, 2003.² No comment letters were received. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

II. Description

The NSCC and DTC proposed rule changes propose that NSCC and DTC consolidate their settlement processing operations. The NSCC proposed rule change proposes that NSCC require all its settling banks to use the Federal Reserve Banks' ("FRBs") Net Settlement Service ("NSS") to satisfy their end-of-day settlement obligations.³

1. Consolidated Settlement Processing Operation

Today, DTC and NSCC settlements are run on two separate systems each of which is fed throughout the day with debit and credit data generated by participant/member activities. At the end of the processing day, the data is summarized and reported by product category (e.g., in the case of NSCC, continuous net settlement, mutual funds, envelope services, etc. and in the case of DTC, delivery orders, stock loans, dividends, redemptions, etc.) through the Participant Terminal System ("PTS") on separate DTC and NSCC screens. The data is netted separately at DTC and at NSCC to produce an aggregate debit or credit at each clearing agency.

Following the determination of final net numbers for each participant/member for each clearing agency, a participant/member's credit balance at one clearing agency is netted against any debit balance at the other ("cross-endorsement"). The settling banks subsequently authorize settlement for their customers in an "acknowledgement" process and then transmit or receive funds to or from DTC's account and to or from NSCC's subaccount at the Federal Reserve Bank of New York ("FRBNY").

In order to promote operating efficiencies, improve risk management, and lower transaction processing costs, DTC and NSCC are seeking to introduce a consolidated settlement processing operation. A consolidated settlement processing operation will provide

participants/members with consolidated NSCC and DTC settlement reporting, a single point of access for both NSCC and DTC settlement information, and reduced settlement risk. This consolidation is intended to be operational only. It is not intended to affect the legal relationship that participants/members and their settling banks have with NSCC or DTC.

As part of the new consolidated settlement processing operation, DTC and NSCC participants/members and their settling banks will be provided with a single set of enhanced PTS functions. Each participant/member will be able to view its DTC and NSCC settlement activity and will be provided a consolidated end-of-day netted DTC/NSCC settlement obligation. A participant/member's debits and credits at DTC and at NSCC will be separately summarized in one consolidated activity statement which will show the final DTC and NSCC balances and the netted amount for each participant/member.

2. Net Settlement Service

To reduce settlement risk and to permit settling banks to settle their net-net debits at NSCC and at DTC with a single payment, NSCC is amending its procedures to require that NSCC settling banks satisfy their daily net-net debit balances at NSCC through the use of NSS. This requirement is consistent with DTC's requirement that its settling banks utilize NSS.⁴

As more fully described below, NSS will permit DTC, as NSCC's settlement agent, to submit instructions to have the FRB accounts of NSCC settling banks charged for their NSCC net-net debit balance. By centralizing DTC and NSCC's settlement processing and by adopting NSS as the payment mechanism, each settling bank's balance at NSCC (whether a net-net debit or a net-net credit) will also be aggregated or netted with its settlement balance at DTC resulting in only a single debit or single credit having to be made to the settling bank's FRB account. Utilization of NSS by NSCC members and their settling banks will eliminate the need for a settling bank to initiate a wire transfer in satisfaction of a net-net debit balance. This should reduce the risk a settling bank would be unable to meet its settlement obligations because of operational problems and should reduce the occurrences of late payment fees due to delays in wiring settlement funds.⁵

As part of requiring the use of NSS, NSCC is making certain technical corrections to assure that defined terms and other provisions are used consistently. Accordingly, NSCC's Rule 1 (Definitions and Descriptions) is being amended to (1) include a new definition of "settlement agent" as DTC will act as NSCC's settlement agent in collecting and paying out settlement monies and (2) set forth a definition of "net credit balance" which is currently used in Rule 12 (Settlement) and elsewhere in the Rules.

NSCC Rule 12 and Rule 55 (Settling Banks) are being amended to make clear that in those instances where NSCC permits a "settling member," "insurance carrier member," or "fund member" to settle other than through a settling bank, it will be deemed to have failed to settle if it fails to pay its "net debit balance."⁶ In addition, rule language is being modified to make clear that settlement of monies will be effected in the manner provided for in NSCC's Procedures.

NSCC Procedure VIII (Money Settlement Service) is being amended to reflect the requirement that settling banks use NSS and to provide the procedures whereby settling banks that act as such for both NSCC and DTC ("common settling banks") will have their settlement balances at both clearing agencies aggregated or netted into a single payment or credit amount.

Prior to using NSS, settling banks will be required to sign with an FRB a "Settler Agreement" which incorporates a requirement that the settling bank agrees to the terms of the FRB's Operating Circular No. 12. Under Section 6.4 of Operating Circular No. 12, the settlement agent (i.e., DTC acts as settlement agent for NSCC) has certain responsibilities regarding allocation among settling banks of a claim for indemnity by the FRB. The allocation of any such claim among NSCC's members would be conducted in a manner as is described in NSCC Procedure VIII, Section 4(iv). The signed Settler Agreement must be on the settling bank's letterhead, signed by an authorized signer recognized by the FRB, and submitted to the FRB through DTC as NSCC's settlement agent. Settling banks that also act as settling banks for DTC participants previously had to sign a Settler Agreement with the FRB designating DTC as their NSS settlement agent. Accordingly, these settling banks will not be required to

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 48614 (October 9, 2003), 68 FR 59834.

³ On September 2, 2003, DTC implemented the requirement that all DTC settling banks use NSS. Securities Exchange Act Release No. 48089 (June 25, 2003), 68 FR 40314 (July 7, 2003) [File No. SR-DTC-2002-06].

⁴ *Supra* note 3.

⁵ Should NSS not be available for any reason, then settling banks are obligated to settle their NSCC and DTC obligations by wire transfer.

⁶ "Net debit balance" as used with respect to a member, insurance carrier member, or fund member means the amount by which the member's, insurance carrier member's, or fund member's gross debit balance for a business day exceeds its gross credit balance on that business day.