

NATIONAL SECURITIES CLEARING CORPORATION

RESPONSE TO THE DISCLOSURE FRAMEWORK FOR SECURITIES SETTLEMENT
SYSTEMS

DECEMBER 2003

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Introduction

The following document consists of the responses made by National Securities Clearing Corporation (“NSCC”) to the questionnaire entitled Disclosure Framework for Securities Settlement Systems (the “Disclosure Framework”). The Disclosure Framework was developed under the auspices of the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions.

Consistent with the purpose of the Disclosure Framework, NSCC’s response provides only a general overview of how NSCC deals with certain risk management issues. Therefore, this document should not be relied upon by NSCC participants or others as a complete discussion of these matters.

Requests for further information may be directed to:

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I. BASIC INFORMATION

A. *What is the name of the SSS?*

National Securities Clearing Corporation (“NSCC” or the “Corporation”)

B. *Where and in which time zone is the SSS located?*

NSCC is located in New York, New York in the Eastern Time zone.

C. *What functions does the SSS perform?*

NSCC clears and settles all streetside equity trading in the United States from the New York Stock Exchange ("NYSE"), American Stock Exchange ("Amex") and NASDAQ markets, as well as from all U.S. regional exchanges and a number of off-board trading markets. NSCC also clears and settles most U.S. corporate and municipal bond trading. NSCC’s Fund/SERV service provides for the automated central processing of mutual fund purchase and redemption orders, settlement and account registration. In addition, NSCC provides an Insurance Processing Service (“IPS”), an automated, centralized processing system that links insurance carriers with broker/dealers, banks and/or their affiliated insurance agencies that sell various types of insurance products.

Additional ancillary services are provided to participants and others, as detailed in NSCC’s Rules & Procedures (the “Rules”).

1. *Does the SSS serve as a securities depository and/or provide securities settlement services?*

NSCC does not serve as a securities depository, but does provide securities clearance and settlement services.

(a) *What types of instruments are eligible for deposit at the SSS (e.g., debt, equities, warrants, etc.)?*

Not applicable.

(b) *What types of instruments are eligible for transfer within the SSS?*

Generally, equity, corporate debt, unit investment trusts and municipal securities are eligible for clearance and settlement at NSCC. In addition, participants may process orders and redemptions for mutual fund and other investment funds.

(c) *Please describe whether eligible securities are dematerialized, immobilized or transferred physically.*

NSCC's services are available to all issuers regardless of the form in which they are issued. Other than for mutual fund and investment fund transactions, how they are processed generally depends upon whether they are eligible for deposit at The Depository Trust Company ("DTC").

(d) *Does the SSS provide safekeeping for physical certificates?*

NSCC does not provide safekeeping for physical certificates.

2. *Does the SSS provide cash accounts and/or provide funds transfers in conjunction with securities transfers? If so, in what currencies?*

NSCC does not provide cash accounts, however, it does require end of day payments in connection with securities delivered through its systems. All settlement currently takes place in U.S. dollars.

3. *Does the SSS provide a trade matching service? Do others provide such services for securities settled at the SSS?*

NSCC provides a trade comparison service that consists of reporting, validating and matching the buy and sell sides of securities transactions submitted by participants, exchanges, marketplaces and other qualifying entities.

Transactions executed on the New York Stock Exchange ("NYSE"), American Stock Exchange ("Amex") and the Nasdaq Stock Market, Inc. ("NASDAQ") are also reported to NSCC as compared transactions.

4. Does the SSS provide a trade netting service (as distinct from undertaking the settlement of securities transfers on a net basis)? Do others provide such services for securities settled at the SSS? In either case, what types of netting (bilateral or multilateral), if any, are performed?

Yes. NSCC provides the Continuous Net Settlement Service (“CNS”), and a Balance Order Accounting Operation. No other entities provide such services for securities cleared at NSCC. Both CNS and the Balance Order Accounting Operation provide multilateral netting.

CNS is an accounting and balancing system, which takes trade input from various marketplaces/sources which carry the same trade date and nets the transactions to one position per security (long or short) per participant. CNS is an ongoing process; it perpetually nets the current day’s settling trades with the prior day’s closing positions, producing new long/short net positions per security issue per participant per day.

Transactions in securities not eligible for CNS are processed through NSCC’s Balance Order Accounting Operation. Through this process, the Corporation will net each days trades per issue and produce netted deliver and receive instructions for each Member each day for each issue.

5. Does the SSS offer a securities lending or borrowing program?

NSCC provides a limited automated stock borrow program (the “Stock Borrow Program”) for the purpose of meeting priority delivery obligations in its CNS system.

6. Does the SSS provide custodial and/or related services such as the collection of interest, dividends, principal or withholding tax reclamations? Which types of service of provided?

No. With respect to fail positions in NSCC’s CNS system, NSCC does perform accounting with regard to dividends and interest. NSCC debits open fail deliver positions and credits open fail receive positions with the value of the interest/dividend payment.

7. Does the SSS act as a central counterparty or principal to transactions with its participants?

Yes. NSCC interposes itself at a certain point in time as the counterparty to certain transactions. At such time, only the receive and deliver obligations are novated. All other rights, obligations, and liabilities remain with the parties to the trade.

8. Other? Please specify.

Other services provided by NSCC are detailed in its Rules & Procedures, which can be found at its website, www.NSCC.com.

D. What type of organization is the SSS?

1. Please indicate whether the SSS is a public sector or private sector entity.

NSCC is a private sector entity.

2. Please indicate whether the SSS is organized on a for-profit or a non-profit basis.

NSCC is organized under the New York Business Corporation Law as a for-profit organization.

3. What is the legal basis for the establishment of the SSS and for the securities transfers made through it?

NSCC is registered as a clearing agency with the U.S. Securities and Exchange Commission (“SEC”) pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

E. Please describe and provide a diagram outlining the organizational and ownership structure of the SSS.

Attached as Exhibit 1 is a diagram of the organizational and ownership structure of NSCC.

1. *Who are the owners of the SSS?*

NSCC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (DTCC). DTCC, in turn, is industry-owned. Participants of NSCC and the other registered clearing agencies that are subsidiaries of DTCC (Fixed Income Clearing Corporation, Emerging Markets Clearing Corporation, and The Depository Trust Company) are allocated entitlements to purchase the common stock of DTCC based upon their usage of all four registered clearing agencies.

2. *What entity or entities operate the SSS? Which functions of the SSS, if any, are outsourced to third parties?*

NSCC is operated as an independent entity. Certain NSCC functions are performed by third parties as follows:

- NSCC out sources computer data and communications processing in part to The Securities Industry Automation Corporation (“SIAC”), and in part to The Depository Trust Company.
- Fixed income processing will shortly be outsourced to Fixed Income Clearing Corporation (“FICC”).
- Certain non-core functions, such as accounting services, are performed by DTCC.

3. *Does the SSS have a Board of Directors?*

Yes.

(a) *What is its composition?*

The following is a list of NSCC’s current Directors and their affiliations:

Bradley Abelow
Goldman, Sachs and Co.

Jonathan E. Beyman
Lehman Brothers

Frank Bisignano
Citigroup/Salomon Smith Barney

Michael C. Bodson
Morgan Stanley

Stephen Casper
Fischer Francis Trees and Watts, Inc.

Jill Considine – Chairman
The Depository Trust & Clearing Corporation

Paul Costello
Wachovia Securities, Inc.

Donald F. Donahue
The Depository Trust & Clearing Corporation

George Hrabovsky
Alliance Global Investor Services

Ronald Kessler
A.G. Edwards, Inc.

Catherine R. Kinney
New York Stock Exchange

Peter B. Madoff
Bernard L. Madoff Investment Securities

Thomas J. McCrossan
State Street Corporation

Eileen Murray
Credit Suisse First Boston Corp.

James Palermo
Mellon Financial Corporation

Thomas J. Perna
Bank of New York

Ronald Purpora

Garban LLC

Robert Silver
UBS

Douglas H. Shulman
National Association of Securities Dealers, Inc.

Thompson M. Swayne
JP Morgan Chase

(b) *What are its responsibilities?*

Board Directors have certain responsibilities that are specified by statute or regulation. Key Board functions include: reviewing and guiding corporate strategies, risk management policies and financial controls; approving the annual budget; monitoring corporate performance; overseeing major capital expenditures; and assuring management succession.

In order to operate efficiently, the Board has established committees of the Board and has delegated to these committees significant responsibilities. Board committees having certain of these responsibilities, such as the approval of clearing agency membership applications, risk management policies and service fees, include industry representatives that are not members of the Board in order to help assure that the participants of NSCC are “fairly represented” in making those decisions.

The Board of Directors and Board committees accomplish their objectives primarily through setting policy, with management having the authority and responsibility to implement Board and committee policies and to manage the Corporation’s day-to-day activities.

F. *Please describe the financial resources of the SSS.*

1. *Amount of paid-in capital and retained earnings?*

As of December 31, 2002, NSCC had \$590,000 in paid-in capital and \$29.4 million in retained earnings.

2. Guarantees, insurance coverage or other similar arrangements?

NSCC currently maintains insurance coverage in the following amounts:

<u>Type of Insurance</u>	<u>Amount of Coverage</u>
Blanket Bond and All Risk	\$850 million

3. Credit lines or letters of credit?

In addition to NSCC's clearing fund deposits, NSCC has a committed line of credit in the amount of \$1.65 billion with a consortium of banks.

4. Powers to assess participants or equity holders?

NSCC has the power to assess participants in the event of a loss. Generally, the clearing fund deposit of the member which caused the loss is used first, followed by some or all of the Corporation's retained earnings and, if necessary, a pro-rata charge is assessed among applicable members. For details on how this is applied, please refer to NSCC's Rule 4.

G. Please describe whether the SSS or its operator is subject to authorization, supervision or oversight by an external authority.

NSCC is subject to regulation and examination by the SEC.

II. RULES AND PROCEDURES OF THE SSS

- A. *Does the SSS maintain a complete list of the rules and procedures governing the rights and obligations of participants and duties of the SSS?*

Yes.

1. *How can participants obtain a copy of the rules and procedures?*

Participants can obtain a copy of the rules by visiting NSCC's website (www.nsccl.com).

2. *Does other documentation provided to participants (e.g. user guides) have the same status as rules and procedures?*

No.

3. *Describe the process for changing rules and procedures, including any need for regulatory approval.*

- (a) *What authority is required, and how does this differ depending on the type of change involved?*

Approval by NSCC's Board of Directors or a Committee of the Board (such as the Membership and Risk Management Committee) is required for rule changes that have a significant impact on NSCC's participants (e.g., introduction of new services, changing risk management methodologies, fee changes); NSCC management is authorized to file rule changes in all other cases without the need for prior Board or Committee approval. Certain changes to NSCC's Rules can become effective immediately upon filing the rule change notice with the SEC, while others require SEC approval before they can be implemented.

- (b) *How are participants notified of changes in rules and procedures?*

NSCC notifies participants of revisions to its Rules by Important Notice. In addition, NSCC publishes its rule changes (and amendments) on its website.

(c) *Is there a procedure for participants or others to comment on proposed rule changes?*

Yes. When NSCC issues its Important Notice (see above) to participants, a paragraph is included informing them that they may direct written comments to the Assistant Secretary of NSCC, and that NSCC will forward any such comments to the SEC. The notice also advises participants that they may direct their written comments directly to the Secretary of the SEC, and requests that if doing so, the participant also provide NSCC with a copy of those comments.

B. *Are the rules and procedures binding on the SSS as well as its participants? Under what conditions and on whose authority can written rules and procedures be waived or suspended by the SSS?*

Yes. The Rules of NSCC allow for the extension, waiver or suspension of any NSCC rule/procedure by the Board of Directors or by the Chairman of the Board, the President, the General Counsel or such other officers of the Corporation as the Board of Directors may designate whenever, in its or his judgment, such extension, waiver or suspension is necessary or expedient.

III. RELATIONSHIPS WITH PARTICIPANTS

A. *Please describe the types of membership offered by the SSS.*

NSCC has numerous types of participants. The full requirements for membership are detailed within NSCC's Rules. The following is a general description of member types:

Member – May generally utilize all services available through NSCC, including but not limited to the Continuous Net Settlement System (“CNS”), Trade Comparison and Recording, the Automated Customer Account Transfer Service (“ACATS”), Cost Basis Reporting Service (“CBRS”), Mutual Fund Services (which include Fund/SERV, Networking, Commission Settlement, Mutual Fund Profile Service), Reconfirmation and Pricing Service (“RECAPS) and envelope services (which include Envelope Settlement Service (“ESS”), Intercity Envelope Settlement Service (“IESS”) and Funds Only Settlement Service (“FOSS”)).

A partnership, corporation, limited liability corporation or other organization, entity or person shall be qualified to become a Member if it satisfies at least one of the following qualifications:

- (i) it is a broker or dealer registered under the Securities Exchange Act of 1934, as amended ("Registered Broker-Dealer");
- (ii) it is a bank or trust company, including a trust company having limited power, which is a member of the Federal Reserve System or is supervised and examined by state or federal authorities having supervision over banks;
- (iii) it is a Registered Clearing Agency;
- (iv) it is an Insurance Company or an Insurance Entity;
- (v) it is an investment company registered under Section 8 of the Investment Company Act of 1940, as amended; or
- (vi) if it does not qualify under paragraphs (i) through (v) above, it has demonstrated to the Board of Directors that its business and capabilities are such that it could reasonably expect material benefit from direct access to the Corporation's services.

Mutual Fund Services Member – May only utilize those services available through NSCC's Mutual Fund Services. These include Fund/SERV, Networking, Commission Settlement and the Mutual Fund Profile Service.

A partnership, corporation, limited liability corporation or other organization, entity or person shall be qualified to become a Mutual Fund Services Member if it satisfies at least one of the qualifications as described in (i) through (vi) in “Member” above.

Insurance Processing Service Member - May only utilize NSCC’s Insurance Processing Service.

A partnership, corporation, limited liability corporation or other organization, entity or person shall be qualified to become a Insurance Processing Service Member if it satisfies at least one of the qualifications as described in (i) through (vi) in “Member” above.

Insurance Carrier Member – May only utilize NSCC’s Insurance Processing Service and must meet certain financial requirements.

A partnership, corporation, limited liability corporation or other organization, entity or person shall be qualified to become an Insurance Carrier Member if it is subject to supervision or regulation pursuant to the provisions of state insurance laws and is licensed to sell insurance products.

Fund Member – May only utilize those services available through NSCC’s Mutual Fund Services. These include Fund/SERV, Networking, Commission Settlement and the Mutual Fund Profile Service.

A partnership, corporation or other organization, entity or person shall be qualified to become a Fund Member if:

(a) it is a Principal Underwriter as defined in Section 2(a)(29) of the Investment Company Act of 1940, as amended, or a co-distributor, sub-distributor, or is otherwise authorized to process transactions through the Corporation’s Mutual Fund Services, and is a broker/dealer registered under the Securities Exchange Act of 1934, as amended; or

(b) it is an Investment Company as defined in Section 3 of the Investment Company Act of 1940, as amended; or

(c) it is an Investment Adviser as defined in Section 202(a)(11) of the Investment Advisers Act of 1940, as amended; or

(d) it is an Insurance Company; or

(e) it is a bank or trust company, including a trust company having limited power, which is a member of the Federal Reserve System or is supervised and examined by state or federal authorities having supervision over banks; or

(f) it is an applicant that has demonstrated to the Board of Directors that its business and capabilities are such that it could reasonably expect material benefit from direct access to the Corporation's Mutual Fund Services.

Data Services Only Member – May only utilize the features/services or systems that the Corporation may, from time to time, designate as eligible for access by a Data Services Only Member for the purposes of transmitting data and information only. As of December 2003, the only services that may be utilized are Fund/SERV, Networking, Mutual Fund Profile Service and the Insurance Processing Service.

A partnership, corporation or other organization or entity shall be qualified to become a Data Services Only Member if:

(i) it is a broker or dealer registered under the Securities Exchange Act of 1934, as amended (“Registered Broker-Dealer”);

(ii) it is a bank or trust company, including a trust company having limited power, which is a member of the Federal Reserve System or is supervised and examined by state or federal authorities having supervision over banks;

(iii) it is a Registered Clearing Agency;

(iv) it is an Insurance Company or an Insurance Entity;

(v) it is an investment company registered under Section 8 of the Investment Company Act of 1940, as amended;

(vi) it is a Principal Underwriter as defined in Section 2(a)(29) of the Investment Company Act of 1940, as amended, or a co-distributor, sub-distributor, or is otherwise authorized to process mutual fund transactions;

(vii) it is an Investment Adviser as defined in Section 202(a)(11) of the Investment Advisers Act of 1940, as amended;

(viii) it is an organization or entity that acts as a third-party administrator on behalf of defined contribution plans as defined in Section 414(i) of the Internal Revenue Code of 1986, as amended; or

(ix) it is an applicant that has demonstrated to the Board of Directors that its business and capabilities are such that it could reasonably expect material benefit from direct access to the Corporation's services available to Data Services Only Members.

Third Party Administrator Member – May only utilize certain services available through NSCC's Mutual Fund Services. These include Fund/SERV, Networking and the Mutual Fund Profile Service.

A partnership, corporation, limited liability corporation or other organization, entity or person shall be qualified to become a TPA Member if it demonstrates to the Board of Directors that its business and capabilities are such that it could reasonably expect material benefit from direct access to the Corporation's services.

Municipal Comparison Only Member – May only utilize the trade comparison service for the comparison of municipal securities transactions.

A Municipal Comparison Only Member must be a municipal securities broker or municipal securities dealer, as defined in Section 3(a)(30) and 3(a)(31) respectively, of the Securities Exchange Act of 1934, as amended, and meet the requirements of any clauses in (i) through (vi) as described in "Member" above.

Settling Bank Only Member – May only perform settlement services for NSCC Members, Mutual Fund Services Members, Insurance Processing Services Members, Insurance Carrier Members and Fund Members.

A bank or trust company shall be qualified to become a Settling Bank Only Member if it is a bank or trust company, including a trust company having limited power, which is a member of the Federal Reserve System or has direct access to the Federal Reserve System.

1. How do the types differ?

See above.

2. Within each membership category, are all participants subject to the same rules and procedures? Please describe important exceptions, including both differences in rules and across participants and the rationale for these differences.

Yes.

B. *Can participants establish accounts for their customers' assets that are segregated from their own asset accounts at the SSS?*

No.

1. *If so, is this accomplished through a single omnibus customer account or through a multiplicity of accounts and/or sub-accounts?*

Not applicable.

2. *Is the segregation optional or compulsory?*

Not applicable.

3. *Does the fact that a sub-account at the SSS bears the name of a third party give any rights to that third party as a participant under the rules of the system?*

Not applicable.

C. *Please describe participant requirements for each type of membership.*

1. *Are participants required to be domiciled or resident in a particular jurisdiction?*

No.

2. *Are participants required to be subject to a supervisory regime? If so, please describe.*

Please refer to III. A. above and number 4 below.

3. *Are participants required to hold an equity stake in the SSS?*

No.

4. *Are there financial, economic, personal or other requirements (e.g. minimum capital requirements, “fit and proper” tests)? If so, please describe.*

***Member**

Refer to NSCC Rule 2 (Members) and Addendum B (Standards of Financial Responsibility and Operational Capability). General financial requirements are as follows

Broker/dealers:

- 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

Banks/Trusts:

- have at least \$50 million in capital; or
- 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
- 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.

***Mutual Fund Services Member and/or Insurance Processing Services**

Members:

Refer to NSCC Rule 2 (Members) and Addendum B (Standards of Financial Responsibility and Operational Capability). General financial requirements are as follows

Broker/dealers:

- have \$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.

Banks/Trusts:

- have \$100,000 minimum excess capital over the capital requirement imposed by its state or federal regulatory authority.

Insurance Carrier Member

Refer to NSCC Rule 56 (Insurance Carrier Member) and Addendum Q (Standards of Financial Responsibility and Operational Capability for Insurance Carrier Members). General financial requirements are as follows

- have an A.M. Best rating of "A-" or better, and if rated by (x) Standard & Poor's, a Claims -Paying Ability rating of not less than "AAA", (y) Moody's, a Long-Term Debt rating of not less than "Aaa", or (z) Duff & Phelps, a Long-Term Debt rating of not less than "A-", or
- have an A.M. Best rating of not less than "B+", and if rated by (A) Standard & Poor's, a Claims -Paying Ability rating of not less than "BBB", (B) Moody's, a Long-Term Debt rating of not less than "A", or (C) Duff & Phelps, a Long-Term Debt rating of not less than "BBB-", (y) has demonstrated to the Board of Directors that its business and capabilities are such that it could reasonably expect material benefit from direct access to the Corporation's Insurance Processing Service, and (z) the Corporation has determined that its financial condition does not pose an undue risk to the Corporation or its Members.

***Fund Member**

Refer to NSCC Rule 51 (Fund Member) and Addendum I (Standards of Financial Responsibility and Operational Capability for Fund Members). General financial requirements are as follows

Broker/dealers:

- have \$25,000 in excess net capital over the minimum net capital requirement imposed by the Securities and Exchange Commission or such higher requirement imposed by the broker/dealer's designated examining authority, and aggregate assets under management for all investment companies registered under the Investment Company Act of 1940 for whom it distributes shares shall be at least \$500,000; or
- have \$50,000 in excess net capital over the minimum net capital requirement imposed by the Securities and Exchange Commission or such higher requirement imposed by the broker/dealer's designated examining authority; and,

Investment Company:

- A Fund Member applicant that is an Investment Company registered under the Investment Company Act of 1940 shall have a minimum of \$100,000 in assets under management.

Investment Adviser:

- A Fund Member applicant that is an Investment Adviser registered under the Investment Advisers Act of 1940 shall have a minimum of \$25,000,000 in assets under management and \$100,000 in total net worth.

Settling Bank Only Member

Refer to NSCC Rule 54 (Settling Bank Only Members). General financial requirements are currently as follows:

- must have a minimum Tier 1 capital ratio of 6%.

Data Services Only Member

Refer to NSCC Rule 31 (Data Services Only Member). Such participant has no financial requirements.

Third Party Administrator Member

Refer to NSCC Rule 60 (TPA Member) and Addendum R (Standards of Financial Responsibility and Operational Capability for TPA Members). Such participant has no financial requirements.

Municipal Comparison Only Member

Refer to NSCC Rule 2 (Member). Such participant has no financial requirement.

*If processing Investment Fund transactions through NSCC's Mutual Fund Services, this participant must meet the standards set forth in NSCC Addendum V (Financial Standards for Applicants and Participants Processing Investment Fund Transactions Through Mutual Fund Services).

D. Does the SSS engage in oversight of its participants to ensure that their actions are in accordance with its rules and procedures? If so, please describe.

Through its Credit Risk Department, NSCC continuously ensures that participants meet their minimum financial requirements, as applicable. In addition, NSCC staff continuously monitors the clearing fund requirements and operational proficiency of participants, as applicable.

Participants are obligated to comply with the Rules. Under Rule 48 (Disciplinary Proceedings) the Corporation may discipline participants for a violation of any provision

of the Rules or the Procedures of the Corporation, any violation of any provision of the participant's agreements with the Corporation, or for any error, delay or other conduct detrimental to the operations of the Corporation, or for not providing adequate facilities for such participant's business with the Corporation, by expulsion, suspension, limitation of or restriction on activities, functions and operations, fine or censure or any other fitting sanction. NSCC's Addendum P (Fine Schedule) lists the associated fines for such violations.

E. Under what conditions can participants terminate their membership in the SSS? Does this mark the end of all liabilities of the participant? If not, please describe what liabilities could remain.

A participant may terminate its membership at any time by notifying NSCC in writing. Notwithstanding any such notification, a participant remains obligated to satisfy any open obligations and liabilities arising out of its membership in NSCC existing at the time of such notification.

F. Under what conditions can the SSS terminate a participant's membership in the SSS?

NSCC may determine to restrict a participant's access to services and/or to cease to act on behalf of a participant pursuant to NSCC Rule 46 (Restrictions on Access to Services).

Under Rule 46 Section 1., The Membership Committee of the Board of Directors or such other Committee as the Board may designate may suspend a Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member or Data Services Only Member or prohibit or limit such Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member or Data Services Only Member with respect to access to services offered by the Corporation in the event that (a) such Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member or Data Services Only Member has been and is expelled or suspended from any regulatory or self-regulatory organization, or (b) such Settling Member, Insurance Carrier Member or Fund Member is in default of any delivery of funds or securities to the Corporation, (c) such Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member or Data Services Only Member is in such financial or operating difficulty, that the Corporation determined, in its discretion, that such action is necessary for the protection of the Corporation, Settling Members,

Municipal Comparison Only Members, Fund Members, Insurance Carrier Members, TPA Members, Data Services Only Members, creditors, or investors; with respect to a bank or trust company Settling Member (and, in the case of a bank Settling Member electing entry under (i)(B)(2)(a)(ii) of the membership standards, its parent bank holding company) such difficulty shall include but not be limited to impaired capital or the appointment by the primary Federal or State bank supervisor of a receiver to take control of the bank, (d) the Corporation has reasonable grounds to believe that such Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member or Data Services Only Member is subject to a Statutory Disqualification, (e) the Corporation determines that such Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member or Data Services Only Member does not meet the applicable qualifications for membership or limited access set forth in Rule 2, Rule 3, Rule 51, Rule 56 or Rule 60, (f) such Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member or Data Services Only Member has failed to comply with any financial or operational requirement of the Corporation, or (g) in any circumstances in which, in the discretion of the Corporation, adequate cause exists to do so.

G. Please describe the scope of the SSS's liability to participants, including the standard of liability (negligence, gross negligence, willful misconduct, strict liability or other), the force majeure standard, and any limitation to the scope of liability of the SSS (e.g. indirect or consequential damages). Where are these liabilities and their limitations set out (e.g. in statute or contract)?

NSCC has no liability to its participants other than in circumstances arising out of the Corporation's gross negligence and/or willful misconduct.

IV. RELATIONSHIPS WITH OTHER SSSs AND COMMERCIAL INTERMEDIARIES

A. *Does the SSS maintain linkages (including sub-custodian or cash correspondent relationships) or other relationships with other SSSs?*

1. *Please identify each of the other SSSs used and the type of securities transferred via the linkages.*

(a) *What is the name of the other SSS? Where is it located?*

- Japan Securities Settlement & Custody, Inc. (“JSCC”)
- Central Depository (PTE) Ltd. (“CDP”) of Singapore

(b) *What securities are eligible for transfer via the linkage to the other SSS?*

Depository Trust Company eligible securities.

(c) *Are transfers of securities made via the linkage to the other SSS limited to only those that are free of payments or are transfers against payment also made via the linkage to the other SSS? If against payment, please describe the timing of the transfers and the corresponding payments.*

The linkage permits JSCC and CDP to receive/deliver securities through DTC, free of payment.

(d) *Does the other SSS provide custody services to the SSS and, if so, who bears any credit or custody risks?*

Yes. The risk of loss is as set forth under the terms of the linkage agreement.

B. *Does the SSS use securities custodians (other than the other SSSs addressed in the previous question) and/or commercial cash*

correspondents? Please identify the custodians or cash correspondents used and the duties that each performs.

With respect to clearing fund cash deposits, these are deposited with JPMorgan Chase. NSCC has repurchase agreements for clearing fund cash with several counterparties.

C. *Please describe the standards used in approving or reviewing relationships with other SSSs, custodians or cash correspondents, including any financial or operational requirements or the presence of insurance or public supervision.*

Repurchase agreements are entered into with (1) dealers that are primary dealers or (2) banks that meet and maintain the qualifications for being a letter of credit issuer bank as required by the clearing corporation's Rules or (3) member in good standing with the clearing corporation. To further reduce risk, credit limits are established to ensure that investments do not exceed an acceptable level of concentration with any single counterparty. Any changes in credit standards or the formula for determining credit limits require the approval of the Audit Committee.

D. *Does the SSS advance funds or securities to or on behalf of other intermediaries such as issuing or paying agents?*

No.

E. *Please describe measures in place to protect the SSS and its members against the failure of other SSSs or commercial intermediaries to the SSS, including risk controls, collateral or alternative sources of funds and securities.*

Credit limits with counter-parties are re-evaluated quarterly by DTCC's Finance department. Finance Management meets once a quarter with a rating agency representative and reviews the counter-party ratings and if there are any new issues being addressed by the banking community in general. Finance Management works closely with NSCC's Risk department, which monitors the counter-parties daily and provides the Finance department with a financial write up on each counter-party quarterly.

V. SECURITIES TRANSFERS, FUNDS TRANSFERS AND LINKAGES BETWEEN TRANSFERS

A. *Please discuss whether and how settlement instructions are matched between participants prior to processing by the SSS.*

1. *Is matching required for all transactions without exception?*

NSCC does not match “settlement instructions” between participants. Settlement of securities processed in the CNS system takes place as described in section I.C.4 above.

2. *What procedure is used when instructions do not match?*

Not applicable.

3. *Are matching settlement instructions binding on participants?*

Not applicable.

(a) *If so, please describe the consequences of failure by participants to meet obligations (e.g., forced settlement, penalties, short positions).*

Not applicable.

(b) *Please describe whether this is a feature of the SSS’s rules and procedures or of national law or regulations.*

Not applicable.

(c) *Please provide a time line indicating the points at which matched instructions become binding, as well as any pre-matching process that takes place.*

Not applicable.

B. *Are securities transfers within the SSS registered?*

No.

C. Please describe how securities transfers are processed within the SSS.

Through CNS, positions are passed against the participant's Designated Depository positions (at DTC), and available securities are allocated by book-entry. This allocation of securities is accomplished at NSCC through an evening cycle followed by a day cycle. Positions that remain open after the evening cycle may be changed as a result of one day settling trades. Participants may control the receipt and delivery of their securities through the use of exemptions (for deliveries) or priorities (for receipts).

1. Please indicate whether the transfers are processed as debits and credits to members' accounts or via some other method.

If security movements occur on the books and records of DTC, funds related to those movements occur on the books and records of NSCC.

2. On a continuous (real-time basis), or in one or more batches?

For securities in the CNS night cycle, they occur batch. In the CNS day cycle, they occur on a continuous basis.

3. If continuous, during what hours does processing occur? If in batches, at what time or times is the processing initiated and completed?

The CNS night cycle takes place 10:00 PM to 11:00 PM EST

The CNS day cycle takes place from 7:00 AM to 3:10 PM EST (unless extended)

4. Do securities settlements occur daily? Please identify securities for which settlement occurs only on specific days of the week or month.

Settlement occurs every day, with the following exceptions:

New Year's Day (January 1)

Martin Luther King Jr. Day (Third Monday in January)

President's Day (Third Monday in February)

Good Friday (The Friday in April before Easter Sunday)
Memorial Day (The last Monday in May)
Independence Day (July 4)
Labor Day (First Monday in September)
Columbus Day (Second Monday in October)
Thanksgiving Day (Fourth Thursday in November)
Christmas Day (December 25)

D. Please describe whether final funds transfers in conjunction with the SSS are made as debits and credits to balances held at the SSS, at one or more commercial banks, at the central bank, or via some other method.

Settlement of money payments with respect to transactions or matters covered by NSCC's Rules, are made as provided in NSCC's Rule 12 (Settlement).

Rule 12 states in part that the Corporation shall debit or credit itself and members with the amounts payable and receivable in accordance with the provisions of such Rules.

At such time as determined by the Corporation, the Corporation shall produce, each business day, a settlement statement which will reflect the debits and credits which have been entered into the member's account with respect to matters or transactions covered by these Rules, plus debits or credits, if any, reflecting amounts that the Corporation will pay to or receive from any entity under any Clearing Agency Cross-Guaranty Agreement, and shall reflect a net amount payable to or payable by the Corporation. Each member will settle, by such time as established by the Corporation, through a Settling Bank (unless the Corporation permits otherwise), by a Federal Funds wire transfer, the net amount reflected on such settlement statement.

Under NSCC's Procedure VIII (Money Settlement Service), each day at such time as determined by the Corporation, NSCC will make available to Settling Banks the final net-debit or net-credit figure for each of its members' accounts and the Settling Bank's net-net debit or net-net credit figure. This action initiates the settlement process. If the Settling Bank's final settlement figure is a net-net debit, it should wire funds to NSCC's account at the bank specified by NSCC at this time by such time as established by the Corporation.

By such time as established by the Corporation, Settling Banks, without exception, must acknowledge to NSCC via the terminal system their settlement figures and (1) their intention to settle with NSCC their net-net settlement amount by the settlement deadline or (2) their refusal to settle for particular members. This acknowledgment must be sent

even if the Settling Bank has wired the amount of its net-net debit prior to the acknowledgment cut off time.

- 1. Does the SSS maintain cash accounts for its participants? Are these accounts equivalent to deposit accounts at a commercial or central bank or do they serve only as “cash memorandum” accounts?***

No.

- 2. On what entity (SSS or other) does the participant bear cash deposit risk?***

The credit institution utilized by the member.

- 3. Under what circumstances does the SSS provide credit extensions or advances of funds to its participants and thereby expose itself to credit risk?***

None. NSCC does not generally advance funds.

- 4. How long can such credit extensions last? How long do they typically last?***

Not applicable.

- E. Is the SSS a DVP system? If so, please describe the DVP model used according to the models outlined in the DVP Report (see the Introduction). Please also provide a diagram indicating the timing of events in the processing of securities and funds transfers on the SSS. Where the SSS provides more than one alternative for settlement processing, please provide a response for each alternative and indicate the relative importance of each alternative.***

Securities movements occur as described in Section V.C., above. Money settlement occurs once per day through NSCC's money settlement system, as detailed in D above.

1. Are funds transfers and securities transfers processed within the same system or in different systems? If different, how are they linked?

Please see E, above.

(a) Please describe whether each securities transfer is linked to a specific funds transfer on a trade-by-trade basis or on a net basis or via some other method.

Please see E, above.

(b) Does the SSS "split" large transactions into multiple transactions or require participants to do so?

No.

2. When do securities transfers and fund transfers become final?

(a) At what time do securities transfers become final? After what event or events?

Under NSCC's Rule 12 (Settlement), Section 2, notwithstanding any provision in NSCC's Rules to the contrary, until the effective time (as defined below):

(a) any action taken by the Corporation or a Qualified Securities Depository pursuant to an instruction given by the Corporation to deliver securities from the Corporation's account at a Qualified Securities Depository to the account of a Member at a Qualified Securities Depository by book- entry on a business day for which payment is to be made by the Member to the Corporation (a "Depository Instruction") shall, notwithstanding the nature of such action, not constitute an appropriate entry on the books of the Qualified Securities Depository specifically identifying the securities so as to constitute a delivery thereof or reducing the account of the Corporation and increasing the account of the Member by the amount of the obligation or the number of shares or rights subject to the instruction, and

(b) any receipt of securities by a Member pursuant to Rule 9 on such business day for which payment is to be made by the Member to the Corporation (a "physical receipt") shall, whether or not the securities subject to the physical receipt remain in the possession of the Corporation, not constitute a voluntary transfer of possession of such securities by the Corporation to the Member.

The "effective time" referred to in the foregoing sentence shall be the time that is (A) the earlier of (i) the time it is finally determined by the Corporation on such business day that the Member's Gross Credit Balance for such business day equals or exceeds his Gross Debit Balance for such business day, or (ii) if the Member's Gross Debit Balance exceeds his Gross Credit Balance and the Member settles through a Settling Bank, the time as finally determined by the Corporation, that the Settling Bank representing such Settling Member, Insurance Carrier Member or Fund Member has a net-net credit balance or (iii) if the Member's Gross Debit Balance exceeds his Gross Credit Balance, the time as finally determined by the Corporation that the Member has paid its Gross Debit Balance or, if the Member settles through a Settling Bank, the Settling Bank representing such Member has settled its net-net debit balance; and (B) when the Corporation has no obligation on account of a receive or deliver obligation of a Member under the terms of any Clearing Agency Cross Guaranty Agreement which creates an obligation on the part of the Corporation irrespective of whether the Member is in a net credit or net debit position with the Corporation. In the event the Corporation, prior to the effective time, ceases to act for the Member with respect to transactions generally pursuant to Rule 46 or Rule 48, the Corporation shall have the right

- (A) in respect of securities subject to a Depository Instruction to take such actions as permitted under the terms of any Clearing Agency Cross-Guaranty Agreement or as otherwise specified in these Rules and
- (B) in respect of securities subject to a physical receipt, to retain possession of such securities and sell out such securities in the manner specified in Section 3 of this Rule provided, however, that if
 - (i) in the case of a Depository Instruction, any security subject thereto is
 - (A) transferred out of the Member's account at the Qualified Securities Depository by book-entry or

(B) physically withdrawn by the Member from his account at the Qualified Securities Depository and physically delivered by the Member to a third party for value or

(ii) in the case of a physical receipt and physical possession by the Member, any security is physically delivered by the Member to a third party for value, such security shall be deemed for all purposes to have been delivered by the Corporation to the Member; and provided, further, that, to the extent that a Member shall obtain physical possession of any such security by physical withdrawal thereof from the Qualified Securities Depository or receipt from the Corporation or obtain control of any such security, the Member shall hold the same in trust for the benefit of the Corporation and the Corporation shall have the right to reclaim possession thereof from the Member and if the Member shall transfer or pledge the securities to a third party for value by a book-entry transaction on the books of the Qualified Securities Depository or by a physical delivery of securities of which it has obtained physical possession, the Corporation shall have the right to reclaim, and shall be entitled to, any proceeds obtained by the Member as a result thereof. Notwithstanding the foregoing, the Corporation shall not have the right to instruct a Qualified Securities Depository to retain securities pursuant to clause (A) of the foregoing sentence until the Qualified Securities Depository has effected any retention or sale which the Qualified Securities Depository elects to effect pursuant to the rules of the Qualified Securities Depository or the Qualified Securities Depository elects not to effect any such retention and then the Corporation's right to instruct the Qualified Securities Depository to retain securities pursuant to said clause (A) shall be limited to instructing the Qualified Securities Depository to retain such amount of securities as shall not reduce the amount of securities of any issue remaining in the Member's account below the Minimum Amount (as defined in the rules of the Qualified Securities Depository). In the event a Settling Bank which represents a Member with a Net Debit Balance, which Settling Bank has a net-net credit balance or has paid its net-net debit balance to the Corporation prior to such time as the Corporation ceases to act for such Member with respect to transactions generally pursuant to Rule 46 or Rule 48, the Corporation shall thereafter (a) instruct the Qualified Securities Depository to transfer the securities covered by any Depository Instruction from the Corporation's

account at the Qualified Securities Depository to the Member's account at the Qualified Securities Depository by book-entry and such instruction shall constitute an entry on the books of the Qualified Securities Depository reducing the account of the Corporation at the Qualified Securities Depository and increasing the account of the Member at the Qualified Securities Depository by the amount of the obligation or the number of shares or rights subject to the instruction, and (b) deliver the securities covered by any physical receipt to the Member and possession of any securities shall be deemed to have been voluntarily transferred by the Corporation to the Member, and the Corporation shall make appropriate adjustments in the accounts of the Members to reflect such transactions.

(b) At what time do funds transfers become final? After what event or events? Does this timing allow for same-day retransfer of funds received in exchange for securities?

Funds transfers become final at the time of the funds' movements per Federal Reserve regulations regarding Fedwire.

(c) If final delivery of securities precedes the final transfer of funds, can participants dispose freely of such securities prior to funds finality? If so, what actions will be taken if funds are not received?

No.

(d) If final delivery of funds precedes the final transfer of securities, can participants dispose freely of such funds prior to securities finality? If so, what actions will be taken if securities are not received?

Transfers of securities are not final until the effective time, as detailed in NSCC's Rule 12 (see 2.(a) above)

(e) Does the timing of finality differ depending on the type of security transferred or the currency in which payment is to be made? Please describe.

No.

3. Please discuss whether participants are notified of securities or funds transfers while they are still provisional, only when final, or both.

Neither. Participants have one net settlement obligation (either debit or credit, buy or sell) each day (see D, above).

F. Does the SSS itself “guarantee” funds or securities transfers?

See below.

1. Under what circumstances and at what point are transfers guaranteed by the SSS?

As detailed in Addendum K (Interpretation of Board of Directors, Application of Clearing Fund), the Corporation guarantees the completion of compared and locked-in CNS and balance orders transactions from a fixed point in the clearance and settlement process.

CNS transactions are guaranteed as of the later of: (i) midnight of T+1, and (ii) midnight of the day they are reported as compared or as of midnight on the day they appear on T-Contracts for locked-in trades. With respect to balance order transactions, such transactions are guaranteed as of the later of: (i) midnight of T+1, and (ii) midnight of the day they are reported to Members as compared/recorded on contracts and, in either case, through the close of business on T+3. The Corporation guarantees one day settling trades as of the completion of trade comparison or trade recording processing and with respect to balance order transactions, the Corporation guarantees one day settling trades as of the completion of trade comparison or trade recording through T+3. The Corporation has also adopted a policy of guaranteeing the completion of when-issued and when-distributed trades, as of the later of: (i) midnight of T+1, and (ii) midnight of the day the trades are reported to Members as compared/recorded on contracts.

Subject to the restriction in Addendum D to NSCC’s Rules, the Corporation guarantees that a Member will be paid for an envelope delivery which is made pursuant to Rule 9 unless the envelope is returned to the Member by the Corporation. For additional information, please refer to Addendum D (Statement of Policy, Envelope Settlement Service) of NSCC’s Rules.

2. *What actions does the guarantee obligate the SSS to take?*

When NSCC becomes the contra party to a transaction, NSCC is obligated to pay for securities received by CNS, and to deliver securities through CNS to receiving participants.

3. *Please indicate whether the guarantee is a feature of the SSS's rules and procedures or of national law or regulations.*

This guarantee is a feature of the Rules of NSCC.

VI. DEFAULT PROCEDURES

A. *Please discuss the events or circumstances that would constitute default of a participant under the rules and procedures of the SSS or that would lead the SSS to make use of exceptional settlement arrangements or unwind procedures.*

1. *Failure by a participant to meet a test of its solvency under the applicable laws of its jurisdiction?*

Please see details provided previously in section III F.

2. *Failure to make payments or deliveries of securities within the time specified?*

Please see details provided previously in section III F.

3. *To the extent that the rules and procedures grant discretion in the determination of the use of default or other exceptional procedures, please discuss where the authority to exercise such discretion resides and the circumstances in which this authority would be used.*

Please see details provided previously in section III F.

B. *What procedures are followed by the SSS once it has determined that a default event has occurred or that exceptional settlement arrangements are to be employed?*

1. *How and at what point are participants notified that this has occurred?*

Once a determination has been made to cease to act on behalf of a participant (see Section III F above), NSCC issues an Important Notice to its participants advising them of such determination.

NSCC's Rule 18 (Procedures for When the Corporation Declines or Ceases to Act) states that when the Corporation has declined or ceased to act for a

participant pursuant to Rule 46, it shall provide members with notice pursuant to the provisions of Section 3 of Rule 45.

2. ***Would the SSS be expected to continue to meet all its obligations to participants under these circumstances? Please discuss the resources in place to ensure that this would occur (e.g., collateral, Participants fund, insurance, loss sharing arrangements, etc.).***

Please see Section V, F. above regarding NSCC's obligation to complete transactions. To the extent NSCC is so obligated, NSCC would utilize clearing fund deposits and its line of credit (as described in Section I, F.3, above) to meet its obligations.

3. ***Please describe and provide a time line indicating the order in which these resources would be used as well as the timing of participant notifications and important deadlines (e.g., when the SSS's obligations to participants would be met, when participants would need to cover their loss sharing obligations).***

NSCC would first utilize the clearing fund deposit of the participant for which the Corporation was ceasing to act, followed by the existing retained earnings of the Corporation or such lesser part thereof as the Corporation determines followed by the Clearing Funds of all participants. In this latter event, participants would be charged on a pro-rata basis, as provided in NSCC Rule 4 (Clearing Fund), and the Corporation will provide 5 business days' prior notice to each member stating the amount to be applied and the reasons therefore.

4. ***Please describe all conditions under which provisional transfers of securities or funds could be unwound by the SSS.***

Please see Section V, E.2.(a) above.

5. ***Can bankruptcy or insolvency be declared retrospectively in the SSS's jurisdiction (e.g., under a "zero-hour" rule), and could this cause provisional securities or funds transfers to be unwound?***

No.

6. *Please describe any circumstances in which transfers of securities or funds that were defined as final in response to questions V.E.2 above would ever be unwound.*

Transfers of securities or funds so defined are final and would not be unwound.

- C. *Has a participant in the SSS ever been declared in default or become insolvent?*

Yes.

1. *Have loss sharing procedures been invoked?*

No.

2. *Please describe whether any of these defaults or insolvencies resulted in losses for the SSS or its participants and how they were absorbed.*

Losses not satisfied from insolvent participant's clearing fund deposit were absorbed by NSCC from a) excess operating revenues, and/or b) as a creditor of the estate of the insolvent participant.

VII. SECURITIES OVERDRAFTS, SECURITIES LENDING AND BACK-TO-BACK TRANSACTIONS

A. *Is it possible for debit positions (overdrafts) in securities accounts at the SSS to arise?*

No.

1. *Under what conditions could such debit positions occur?*

Not applicable.

(a) *Do these conditions always result in debit positions in securities accounts rather than failed transactions? If not, please explain the basis for differential treatment by the SSS.*

Not applicable.

(b) *Are these situations covered explicitly by the rules and procedures of the SSS?*

Not applicable.

2. *How long can such debit positions last? How long do they typically last?*

Not applicable.

3. *How are debit positions in securities accounts prevented, rectified or managed?*

Not applicable.

4. *What procedures would be followed by the SSS in case the debit cannot be rectified (e.g., failure by a participant with a debit balance in a securities account or unavailability of the securities in the market).*

- (a) *Application of loss-sharing provisions allocating the loss to participants?*
- (b) *Absorption of loss by the SSS?*
- (c) *Other? Please specify.*

Not applicable.

B. *Under what circumstances does the SSS provide for the lending of securities to ensure settlements?*

NSCC provides a limited automated stock borrow program (See Section I, C.5. above).

C. *How does the SSS settle back-to-back transactions?*

- 1. *Under what conditions are delivery instructions by participants receiving and redelivering securities on the same day under back-to-back transactions settled for same-day value?*

Since in the CNS system each participant has a single settlement obligation per issue per day, the CNS obligations all settle on a net basis, and there are no back-to-back transactions.

- (a) *Only if the participant has securities on deposit with the SSS that have been received pursuant to a final securities transfer?*
- (b) *If the participant has securities on deposit with the SSS that have been received pursuant to a provisional securities transfer?*
- (c) *Before securities have been received either provisionally or finally, but when a matched receipt instruction exists for the same or greater value? Is such practice limited to markets where matching is binding?*
- (d) *Before securities have been received either provisionally or finally, but when a third party has promised to deliver to the SSS securities of the same or greater value? Must*

the provider of the guarantee have itself received the securities through a final transfer? Please describe how the SSS evaluates such promises, and whether they are addressed by the written rules and procedures of the SSS.

(e) Other. Please specify.

Not applicable.

2. Please describe limits or controls in place with respect to any of the above arrangements for the settlement of back-to-back transactions, including limits on amounts involved or related to the liquidity of the underlying securities.

Not applicable.

3. Under what conditions are payment instructions by participants in the SSS under back-to-back transactions settled for same-day value? Can participants use the proceeds of an on-delivery of securities without the need for an extension of credit?

Not applicable.

VIII. RISK CONTROL MEASURES

A. *Please describe the roles and responsibilities of those areas of the SSS responsible for risk management and control.*

1. *Please describe the process for the internal review of risk management policies and procedures.*

NSCC's Credit Risk department oversees day-to-day risk management, and continuously review risk management policies and procedures.

There is an internal risk committee whose members represent each of the DTCC clearing agencies and which evaluates risk in order to identify and quantify both financial and non-financial risks (such as new business initiatives) within the DTCC organization.

In addition, risk management policies and procedures are reviewed by the Membership and Risk Management Committee of NSCC's Board of Directors. Under the Membership and Risk Management Committee charter the Committee is responsible for the following:

- i. the admission of any prospective member and the continuance of any member;
- ii. the placing of restrictions on or the termination of any member;
- iii. administering, and where appropriate, enforcing on behalf of the Board, member financial accountability and disciplinary Rules including the requiring of additional assurances as to a member's ability to meet its financial commitments to NSCC or to fulfill its operating responsibilities;
- iv. approving the waiver of any Rule, Procedure or requirement applicable to members when such is deemed necessary or appropriate for the protection of NSCC and its members;
- v. identifying significant policy considerations that merit Board review and bringing such matters promptly to the Board;
- vi. review any new changes to standards for eligibility and continuance for members as appropriate;
- vii. approving changes to the Rules with respect to all membership and risk management related issues that require action by the Board;

viii. periodically reviewing its responsibilities and recommending any changes to the Board

2. *Is there a risk management policy that addresses the review and approval of new products and services offered by the SSS? At what level of the organization is risk management approval given for a new product or service?*

As described above, there is an internal DTCC Risk Committee. This Committee reviews the existing risks in NSCC's business line, including potential exposures resulting from membership, credit, trade surveillance, liquidity, settlement operations, systemic, regulatory and legal issues. It is the responsibility of this committee to review risks for new products and services.

3. *Does the SSS have a risk management function with clear independence from and authority over operational marketing functions?*

Yes.

4. *Does the Board of Directors review risk management policies and procedures? Does the Board have a risk management or audit committee?*

Please refer to numbers 1 and 2 above.

B. *Please describe any internal or external audits or supervisory/regulatory examinations that are performed with respect to the SSS. For each such audit or examination, please address the following questions.*

1. *Who performs the audit or examination?*

NSCC's Internal Audit Department and its independent accountant regularly review the adequacy of NSCC's internal controls, procedures and records. In addition, the SEC routinely examines NSCC.

2. *What is the scope of the audit or examination?*

(a) Please indicate whether and how it addresses the sufficiency and compliance with internal controls.

Evaluations of NSCC's financial statements and internal controls are conducted on a periodic basis. Such examinations cover all critical processing areas of the operation, as well as the data processing environment.

(b) Please indicate whether and how its addresses the SSS's compliance with its own rules and procedures.

All examinations are designed to test for compliance with the rules and procedures of NSCC. Any instances of noncompliance are reported to senior NSCC management and are corrected.

3. What is the frequency of the audit or examination?

NSCC's independent accountant conducts an annual review. The SEC conducts an annual inspection of NSCC's data processing areas and has conducted periodic inspections of other critical areas.

NSCC's Internal Audit Department conducts, on a rotation schedule, an annual audit of all critical areas.

4. Are audit or examination reports available for review by participants?

NSCC's independent accountant issues a report on internal controls which is provided to all participants and interested third parties.

C. Please discuss whether the SSS has the capacity to value (i.e., mark to market) the securities that it holds.

1. Please describe how these valuations are used by risk control systems at the SSS.

The only securities held by NSCC are in relation to clearing fund deposits of participants. Securities are haircut by NSCC as stated in Section VIII E.5. above.

2. How frequently are securities revalued?

Securities are revalued daily.

3. What are the sources for security valuations?

(a) What outside price or data sources are used?

Securities pledged to NSCC with regard to the clearing fund are priced by NSCC utilizing a price file received from an affiliated clearing corporation.

(b) If pricing models are used, please describe how the models are chosen and how the model inputs are obtained.

See (a) above.

D. Please discuss whether the SSS has a lien on the securities held in or transferred through it.

1. Does the lien apply only to securities owned by participants themselves or does it extend to the securities beneficially owned by customers or participants?

2. Under what circumstances and in what manner would such a lien allow the SSS to use the securities?

As provided within NSCC Rule 18, Section 7(b), as security for any and all liabilities now existing, or hereafter arising, of a member to the Corporation, the Corporation shall maintain a lien on all property placed by a member in its possession, including but not limited to, securities and cash in the process of clearance or on deposit with, or pledged to, the Corporation in satisfaction and/or in excess of a member's Clearing Fund deposit pursuant to Rule 4, Section 1, and Rule 12, Section 1; provided, however, that in no event shall the Corporation have any lien on securities carried by a member for the account of its customers where such lien would be prohibited under SEC Rules 8c-1 and 15c2-1.

E. Please discuss the circumstances in which the SSS requires collateral to limit or mitigate risks.

All participants of the CNS and balance order services are required to make deposits to the clearing fund. Certain participants of the Mutual Fund Services are also required to make limited clearing fund deposits.

1. *Does the SSS manage its own collateral system?*

Yes.

2. *Does the SSS share a collateral system with another SSS or payment system?*

No.

NSCC has entered into a limited multilateral cross-guaranty agreement with The Depository Trust Company, Emerging Markets Clearing Corporation, Fixed Income Clearing Corporation and The Options Clearing Corporation which provides a mechanism for the sharing of excess collateral of a common defaulting participant held at one clearing agency to cover losses incurred at another clearing agency due to the default of the participant.

3. *Can collateral at the SSS be posted and returned on the same day?*

Collateral can be posted and returned on the same day, subject to the timeframes published by NSCC; at all times, however, participants must meet their minimum collateral requirements.

4. *What types of transactions at the SSS involve the use of collateral?*

Please see number 1, above.

5. *What are the policies with regard to the type of collateral used or haircuts required?*

Under Rule 4, the Corporation, in its discretion, may permit part of a member's deposit to be evidenced by an open account indebtedness (a) secured by unmaturing bonds which are either direct obligations of, or obligations guaranteed as to principal and interest by, the United States or its agencies (the "qualifying bonds") and/or (b) secured by one or more irrevocable Letters of Credit with a maturity of no more than one year.

Under Procedure XV (Clearing Fund Formula and Other Matters), Qualifying bonds pledged to secure Clearing Fund deposits shall be haircut as follows, or as otherwise determined by the Corporation from time to time:

Security Type:

US Treasury & Agency Securities, including Government Zero Coupon Bonds:

Interest bearing with remaining terms

to maturity of up to 10 years

- 2% Haircut

Interest bearing with remaining terms

to maturity in excess of 10 years

- 5% Haircut

Zero coupon with remaining terms

to maturity of up to 5 years

- 2% Haircut

Zero coupon with remaining terms

to maturity in excess of 5 years

- 5% Haircut

6. *How are collateral valuation methodologies developed and reviewed?*

A periodic Risk Assessment is performed, and changes to the methodology are reviewed by the Membership and Risk Management Committee of the NSCC Board of Directors.

7. *To what extent are collateral policies described in the written rules and procedures of the SSS?*

Collateral policies are documented in NSCC's Rules, and identified in Important Notices sent to participants.

F. *Please describe the SSS's use of limits on exposures to monitor and control risks.*

- 1. Please explain the types of limits used and the exposures to which they apply.***

The only restriction NSCC imposes is with respect to the use of Letters of Credit – no more than 20% of the clearing fund may be evidenced by letters of credit from any single credit institution. No more than 40% of a member's clearing fund deposit may be satisfied through the use of letters of credit.

- 2. Do the limits apply to all participants and/or to other SSSs with which the SSS is linked? What are the exceptions to the limit?***

Yes.

- 3. Do limits apply to participants individually or in the aggregate or both?***

In the aggregate and individually as set forth in number 1, above.

- 4. Do limits apply to implicit as well as explicit extensions of credit or securities (e.g., when on-deliveries of securities are permitted pursuant to provisional but not final delivery of securities)?***

Not applicable.

- 5. Does the SSS automatically reject transactions that exceed limits or is compliance determined ex post?***

Letters of credit which exceed the limits would not be accepted.

- 6. How are limit policies developed and reviewed?***

The policy was established by the Board of Directors and is reviewed as part of the risk assessment performed by the Risk department.

- 7. To what extent are limit policies described in the written rules and procedures of the SSS? Where does additional authority to set or amend limit policies reside?***

See NSCC Rule 4 and Rule 15.

G. Please describe other controls to mitigate or reduce risks at the SSS.

1. Does the SSS or its participants have the capacity to monitor participants' accounts continuously during the processing?

NSCC Rule 15 (Financial Responsibility and Operational Capability), states in part that NSCC may establish, as it deems necessary or appropriate, standards of financial responsibility, operational capability, experience and competence for membership.

Adequate assurances of the financial responsibility or operational capability may include, but shall not be limited to:

- (i) additional reporting of financial or operational condition at such intervals and in such detail as the Corporation shall determine;
- (ii) increased Clearing Fund deposits;
- (iii) additional payments to the Corporation in such amounts as may be determined by the Corporation;
- (iv) delivering securities only against payment; and
- (v) assurances as may be required pursuant to the Corporation's Guidelines and/or Procedures.

2. Is there a special risk control regime that the SSS would apply to a participant known to be experiencing financial difficulties?

NSCC would place a participant known to be experiencing financial difficulties on a watch list, which would subject the participant to increased surveillance. This would permit NSCC to take extraordinary measures to protect NSCC and its participants.

3. Does the SSS maintain or administer loss-sharing arrangements other than those applicable to events of default and addressed in Section VI above? Are these loss-sharing pools pre-funded by participants?

No.

IX. OPERATIONAL RISKS

A. *Please provide assessments of the operational reliability of the computer and other systems used by the SSS, including any criteria that the SSS uses internally for this purpose.*

1. *What is the percentage uptime of the systems used by the SSS?*

(a) *Whole system overall?*

(b) *Broken down by major components (e.g., communications network, central processing facility)?*

(c) *During critical processing periods?*

NSCC's whole system overall, including its major components and during critical processing, is essentially up 100 percent of the time.

2. *Has the SSS experienced major operational problems during the past two years?*

a. *Have settlements been delayed, been disrupted or otherwise failed because of operational problems during this period?*

b. *Please describe the nature of any such problems.*

Outside of the events of September 11, 2001 (which did not cause NSCC to experience operational problems themselves, but rather others in the industry with whom NSCC does business), NSCC has not experienced major operational problems during the past two years.

B. *Please describe contingency or disaster recovery planning at the SSS.*

1. *Does the SSS have a formal plan for business continuity in place?*

2. *Is this plan available for review by participants?*

3. *How often is this plan tested? Does this involve participants in the SSS?*

4. ***What are the major elements of the business continuity plan?***
5. ***How long would it take the SSS to resume operations if primary systems become unusable?***

NSCC has a formal plan for business continuity in place. The plan is not available for review by participants, but is reviewed by the SEC.

NSCC has a multiple site configuration (for services provided via SIAC, NSCC has a dual site configuration, and for those provided by DTC, a triple site configuration), with production databases maintained in multiple places simultaneously. The time required for site fold-over is ½ - 2 hours, depending upon the time of day that the failure occurs.

- C. ***What are the key features of the internal controls covering operations and security at the SSS (e.g., change controls or those covering remote access)?***
1. ***Please describe controls or security procedures in place to ensure that the SSS acts only on authentic settlement instructions from valid participants.***
 2. ***Are internal operational and security controls included in the internal and/or external audits of the SSS?***
 3. ***Are internal operational and security controls covered by regulatory requirements applicable to the SSS?***

NSCC ensures that it acts only upon authentic instructions from valid participants by restricting access to systems and processing screens with appropriate security restrictions. These controls are included in the internal and external audits of NSCC and are covered by regulatory requirements applicable to NSCC.

- D. ***Does the SSS impose minimum operational or performance standards on third parties (e.g., communications providers)?***
1. ***How does the SSS ensure that such standards are met on a continuing basis and what sanctions are available to the SSS if they are not?***

2. *How would the SSS allocate losses incurred due to operational problems caused by third parties?*

As stated in section III.G., above, NSCC limits its liability to losses arising from gross negligence and/or willful misconduct. Any other loss between participants and third parties is born solely by that participant.