

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51359; File No. SR-NSCC-2004-07)

March 11, 2005

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Granting Approval of a Proposed Rule Change to Amend the Membership Standards Required of Insurance Companies

I. Introduction

On October 26, 2004, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change File No. SR-NSCC-2004-07 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>1</sup> Notice of the proposed rule change was published in the Federal Register on January 24, 2005.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is now granting approval of the proposed rule change.

II. Description

The proposed rule change amends NSCC’s Rules regarding the membership standards required of insurance companies. As a general matter, the current membership standards for insurance companies are based in part on ratings provided by rating agencies. The proposed rule replaces these standards in relevant part with a measure based on Risk-Based Capital (“RBC”) ratios.

The RBC model was developed by the National Association of Insurance Commissioners (“NAIC”), the organization of insurance regulators from the 50 states, the District of Columbia, and the four U.S. territories. State insurance regulators created the NAIC in 1871 to address the need to

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

<sup>2</sup> Securities Exchange Act Release No. 34-51035 (January 13, 2005), 70 FR 3413.

coordinate regulation of multistate insurers. The NAIC has developed uniform financial reporting by insurance companies and an RBC model. The NAIC's RBC model is designed to calculate the minimum amount of capital that an insurer needs to support its overall business operations based on the degree of risk taken by the insurer and to protect the policyholders and business against adverse developments. Currently substantially all of the U.S. state insurance jurisdictions have adopted laws, regulations, or bulletins that are considered to be substantially similar to the NAIC's RBC for Insurers Model Act.

The calculation of the RBC ratio is based on an insurer's Total Adjusted Capital ("TAC"). TAC is comprised primarily of capital plus surplus divided by a capital level determined by the RBC formula called the Authorized Control Level Risk-Based Capital ("ACL RBC"). The ACL RBC is comprised of asset risk, credit risk, underwriting risk, and business risk.

In general, state regulatory authorities require no corrective action so long as an insurance company maintains an RBC ratio over 200%. NSCC's membership requirement would be an RBC ratio of 250% as derived from financial data reported by the insurance company to its state regulatory authority as part of its annual statutorily-required financial statements. All current insurance company members of NSCC would meet the proposed 250% requirement.

Insurance companies will be required to submit the relevant data to NSCC on an annual basis at which time their compliance with the minimum standard will be reviewed by NSCC. In addition, any insurance company that fell below the 250% ratio during the course of the year will be required to notify NSCC immediately of this fact.

NSCC believes that the RBC standard is preferable to the existing NSCC requirements of using third-party ratings for the following reasons. First, the RBC standard should accurately

represent the financial strength of an insurer because the RBC system is based on statutorily-required financial statements and it takes into account asset risks, credit risks, underwriting and pricing risks and the risk that the return from assets are not aligned with the requirements of the company's liabilities and general business risk. Second, the RBC standard is the industry benchmark. Third, the information needed to calculate the RBC ratio is readily available in the statutorily-required financial statements, which are to be provided to NSCC annually.

### III. Discussion

Section 17A(b)(3)(F) of the Act requires among other things that the rules of a clearing agency be designed to assure the safeguarding of securities and funds in its custody or control or for which it is responsible.<sup>3</sup> The Commission finds that NSCC's proposed rule change is consistent with this requirement because it enhances NSCC's standards of financial responsibility applicable to insurance companies and therefore should help NSCC protect itself and its members from undue risk.

### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.

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<sup>3</sup> 15 U.S.C. 78q-1(b)(3)(F).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> that the proposed rule change (File No. SR-NSCC-2004-07) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

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Assistant Secretary

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<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> 17 CFR 200.30-3(a)(12).