

**STATEMENT OF ANN E. BERGIN
MANAGING DIRECTOR
NATIONAL SECURITIES CLEARING CORPORATION**

**BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE**

**ON
REVIEW OF CURRENT INVESTIGATIONS AND
REGULATORY ACTIONS REGARDING
THE MUTUAL FUND INDUSTRY:
FUND OPERATIONS AND GOVERNANCE**

MARCH 2, 2004

Chairman Shelby, Ranking Member Sarbanes and members of the Committee, I appreciate the opportunity to discuss the SEC proposal to amend Rule 22c-1 of the Investment Company Act of 1940. With your permission, I would like to have two documents previously provided to Committee staff included in the record: NSCC's February 6 comment letter to the SEC on the proposed amendment and a brochure that describes how our fund processing system, which is called Fund/SERV®, works.

For those of you unfamiliar with our organization, NSCC and its affiliated clearing agencies play a significant role in supporting the U.S. financial markets. We provide post-trade clearance, settlement and information services for equities, corporate and municipal bonds, mutual funds and other securities.

Current regulation allows a mutual fund order to be priced according to the time it is received by an intermediary - a broker/dealer or plan administrator, for example. Therefore, an order received by an intermediary by 4:00 p.m. is eligible for today's price, even if it is transmitted to the fund at a later time.

I have been asked to speak about that aspect of the SEC proposal providing that an order to purchase or redeem shares in a mutual fund would have to be received by a fund, its transfer agent or a registered clearing agency by 4:00 p.m. in order to receive the current day's price.

NSCC is a clearing agency, registered with the SEC under The Securities Exchange Act of 1934. As such, we are subject to comprehensive regulation and oversight by the SEC. We are currently the only registered clearing agency providing services to the mutual funds industry. In the past year we have been called upon to take an active part in several industry and regulatory initiatives involving mutual fund processing, including the NASD/Industry Task Force on Breakpoints and the NASD Omnibus Account Task Force.

NSCC is owned by our users - broker/dealers, banks, mutual fund companies and other financial service firms, and we are governed by a user-representative board of directors. The clearance, settlement and information services NSCC provides are developed at the request of our users. Our revenues are generated by the fees that are paid by our users; and, to the extent those revenues exceed our costs, the excess revenues are refunded to them.

NSCC's participation in the mutual fund industry began nearly 20 years ago, in 1986, at the request of market participants.

Our Fund/SERV system provides a standardized, automated process for distribution intermediaries to transmit purchase, redemption and exchange orders through a single process and a single communications link. Like all of NSCC's fund services, participation in Fund/SERV is optional, but it has become the industry standard for processing fund and defined contribution transactions at the wholesale level.

We estimate that today Fund/SERV processes the vast majority of these wholesale transactions. Last year, Fund/SERV handled 87 million fund transactions – roughly 350,000 a day - with a value of \$1.54 trillion. About 650 mutual fund companies and more than 430 intermediaries, offering 30,000 different funds, use Fund/SERV today.

Fund/SERV has greatly reduced operational errors, lowered the cost of processing, established standards and introduced order into the marketplace. By acting as a central conduit, Fund/SERV allows intermediaries to offer investors a much broader range of funds than before at a much lower cost.

Allow me to walk you through how a typical mutual fund trade is processed.

In my example, once an individual investor advises his broker/dealer that he wishes to purchase a particular mutual fund, the broker/dealer enters the order into its system. That system transmits order files electronically to Fund/SERV periodically throughout the day. And through Fund/SERV the orders are directed to the appropriate fund company.

The fund company either confirms or rejects the orders and then transmits that information back to the broker/dealer through Fund/SERV.

As long as the broker/dealer is in receipt of the order by 4:00 p.m., under today's rules the order is given that day's price, regardless of what time the trade is processed through Fund/SERV.

Fund/SERV receives order files over a 22-hour period each business day from 2:00 a.m. until midnight, and many of these files are received and then redirected to the fund companies between 5:00 and 8:00 p.m.

Under the proposed regulation, even if the order is received by the broker/dealer before 4:00 p.m., unless the broker/dealer is able to retransmit the order to NSCC (as the registered clearing agency), the fund or its transfer agent by 4:00 p.m., the purchase will not be made at today's price.

We anticipate that this would dramatically change the current trade flow, and result in a significant increase in the number of trades received at NSCC in the half-hour just prior to 4:00 p.m. We have done some preliminary analysis and believe that our current systems capacity is sufficient to handle the concentration of orders within that shortened timeframe.

However, we will need to make technological enhancements to some of our services. To date, we have identified three such major enhancements.

One: we would need to create a uniform methodology to record the time of receipt of each order file at NSCC. Subsequently, each order within that file would be coded with that time of receipt before transmission to the fund.

Two: our system would need to recognize the elements of a complete and valid order, so that the order is final and unalterable as of 4:00 p.m. Those elements would include the order type, that is, a purchase, redemption or exchange; the name of the fund; and either the specific number of shares, or the dollar amount of the order.

Three: we would need to build functionality to allow intermediaries to communicate additional information about a valid order after 4:00 p.m. This could include information not known prior to 4:00 p.m., as long as this information does not alter any of the essential elements of the order - for example, the breakpoint discount to which an investor is entitled or the purchase specifics of an exchange transaction.

We believe we can complete these enhancements within the one year following adoption of the amendment, as was proposed by the SEC, at an estimated cost of approximately \$5 million. This estimate is limited to NSCC's costs, which, as I indicated earlier, would be funded by our users, and does not include costs that would be directly incurred by our users in making corresponding changes to their own systems, as many of them would have to do. Some in the industry also believe that additional time would be needed to ensure rigorous testing of these changes.

NSCC does recognize that migrating the time-stamping function from the intermediary to NSCC will impose some limitations on the flexibility currently afforded to all mutual fund investors. We feel strongly, however, that applying a hard 4:00 p.m. close at NSCC is far better for investors than applying a hard 4:00 p.m. close only at the fund or its transfer agent.

In our comment letter to the SEC, we advised that the flexibility of the current system could be retained through the implementation of the alternative solution that was proposed for comment by the SEC. That solution would leave the responsibility for time-stamping at the intermediary level – with the addition of new safeguards to prevent late trading abuses.

Whatever the Commission's final determination is, NSCC is committed to working with the industry to facilitate compliance with the new regulations.

That completes my prepared remarks, and I will be pleased to answer any questions.