

Category 2 interdealer broker netting members that were parties to such nonmember brokered transactions based upon the dollar value of each such broker member's trading activity with the defaulting member netted and novated on the day of default.<sup>7</sup>

An important principle in the loss allocation process is the definition of "trading activity with the defaulting member netted and novated on the day of default."<sup>8</sup> GSCC's rules define this as trading activity with a defaulting member submitted by a netting member that was compared, entered the net, and was novated on the business day on which the failure of the defaulting member to fulfill its obligations to GSCC occurred. However, if the aggregate level of such trading activity is less than the dollar value amount of the defaulting member's securities liquidated pursuant to GSCC's close out procedure, the term will encompass trading activity going back as many days as is necessary to reach a level of activity that is equal to or greater than the dollar value amount of such liquidated securities.

GSCC proposes to modify its loss allocation procedures by redefining the concept of "trading activity with the defaulting member netted and novated on the day of default" to capture a level of trading activity that is at least five times the dollar value amount of the securities of the defaulting member that are liquidated. The five-fold multiple is based on the approximate netting factor of eighty percent. Historically, the aggregate transactions processed through GSCC's netting system net down to approximately twenty percent of the aggregate transactional volume (*i.e.*, for approximately every five transactions that enter the netting process, only one needs to be settled through the movement of securities and cash).

GSCC's current approach to loss allocation focuses on the date on which a transaction is netted and novated by GSCC and this will continue to be the case. However, with the advent of netting of repurchase agreements ("repos") and the resultant increase in the number of relatively longterm transactions introduced into the netting process, GSCC has reevaluated its loss allocation process with a view toward better taking into account the duration of netted transactions.

<sup>7</sup> Category 1 interdealer brokers act exclusively as brokers and trade only with netting members and with certain grandfathered nonmember firms. Category 2 interdealer brokers are permitted to have up to ten percent of their business with nonnetting members other than grandfathered nonmembers.

<sup>8</sup> GSCC Rule 4, Section 8(a)(v).

The proposed approach does not take into account the duration of the trade (*i.e.*, the time between trade date and settlement date). Rather, GSCC seeks a balance between assessing transactions based purely on when they were entered into versus taking into account their duration by expanding the amount of trading that will be encompassed for loss allocation purposes. GSCC believes this will have the effect of establishing a greater incentive for members to assess the creditworthiness of counterparties.

GSCC believes the proposed rule change is consistent with its obligations under Section 17A of the Act<sup>9</sup> because by broadening the range of securities acceptable as clearing fund collateral and by modifying the loss allocation procedures to encompass more trades, GSCC will facilitate member transactions and will cause members to assess the creditworthiness of their counterparties based on duration of transactions. This should promote the prompt and accurate clearance and settlement of securities transactions.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

GSCC does not believe that the proposed rule change will have an impact or impose a burden on competition.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Comments on the proposed rule change have not yet been solicited or received. Members will be notified of the rule filing, and comments will be solicited by an important notice. GSCC will notify the Commission of any written comments received by GSCC.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

<sup>9</sup> 15 U.S.C. 78q-1 (1988).

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. § 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of GSCC. All submissions should refer to File No. SR-GSCC-96-05 and should be submitted by September 9, 1996.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Margaret H. McFarland,  
Deputy Secretary.

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[Release No. 34-37549; File No. SR-NSSC-96-13]

#### **Self Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to the Guarantee of When-Issued and Balance Order Trades**

August 9, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on June 21, 1996, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by NSCC. On August 1, 1996, NSCC amended the proposed rule change.<sup>2</sup> The Commission is publishing this notice to solicit

<sup>10</sup> 17 CFR 200.30-3(a)(12) (1995).

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> Letter from Julie Beyers, Associate Counsel, NSCC, to Jerry Carpenter, Assistant Director, Division of Market Regulation, Commission (August 1, 1996).

comments on the proposed rule change from interested persons.

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

NSCC proposes to modify its rules and procedures to guarantee when-issued and when-distributed (collectively "when-issued") and balance order trades as of midnight on the day the trades are reported to members as compared/recorded.

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

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.<sup>3</sup>

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

NSCC does not currently guarantee when-issued or balance order trades. The purpose of the proposed rule change is to extend NSCC's guarantee for members to these trades. NSCC proposes to guarantee when-issued and balance order trades at the same point in the clearance and settlement process as it guarantees regular-way trades in the Continuous Net Settlement ("CNS") accounting operation. Regular-way CNS trades are guaranteed as of midnight on the day the trades are reported to members as compared/recorded. The proposed guarantee of when-issued and balance order trades is intended to provide NSCC's members with greater certainty in the settlement of such trades.

NSCC intends to collateralize its increased exposure from guaranteeing when-issued and balance order trades by collecting clearing fund based on market risk and liquidation risk.<sup>4</sup> With

<sup>3</sup>The Commission has modified the text of these statements.

<sup>4</sup>The market risk component of the CNS portion of the clearing fund formula requires that each NSCC member contribute to the clearing fund an amount approximately equal to the net of each day's difference between the contract price of pending, compared CNS trades, exclusive of trades reported by The Options Clearing Corporation ("OCC") which are the result of options exercises and assignments, and the current market price for all guaranteed pending CNS trades, exclusive of

respect to CNS trades, the calculation of the market risk component is based on a rolling average of the prior twenty days' mark-to-market differential. This is the method NSCC proposes to use for balance order trades. NSCC proposes to use the market risk component for when-issued trades based on the mark-to-market differential for the previous business day only. A mark-to-market differential based on the previous business day only for when-issued trades is necessary because of the typically more volatile nature of when-issued trades.

With respect to CNS trades, the calculation of the liquidation risk component is based on all pending trades and failed trades. The liquidation risk component for when-issued trades will be based only upon pending when-issued trades. The liquidation risk component for balance order trades will be based on all pending balance order trades and failed trades to the extent the contra-party to any such failed trade is a regional interface account.

Accordingly, NSCC proposes to modify Addendum M to its Rules and Procedures, Statement of Policy in Relation to the Completion of Pending CNS Trades, to delete the language that excepts when-issued trades from NSCC's policy of guaranteeing the completion of CNS trades as of midnight of the day the trades are reported to members as compared. NSCC further proposes modifying Addendum M to include a statement of its policy of guaranteeing the completion of when-issued trades as of midnight of the day trades are reported to members as compared/recorded.

NSCC also proposes to modify Addendum K to its Rules and Procedures, Interpretation of the Board of Directors—Application of Clearing Fund, to reflect that NSCC will guarantee the completion of balance order trades as of midnight of the day such trades are reported to members as compared/recorded through the close of business of T+3, regardless of whether the member could have made delivery on T+3. Addendum K will be modified further to include a statement of its policy of guaranteeing the completion of when-issued trades as of midnight of the day the trades are reported to members as compared/recorded. NSCC also proposes to modify Addendum K to state that it will consider all when-

trades reported by OCC which are the result of options exercise and assignments which have not as yet reached settlement. In addition, to protect against liquidation risk, NSCC will collect .25% of the net of all guaranteed pending CNS trades and open CNS positions. NSCC Procedure XV, Sections A.1.(a)(1)(b) AND a.1.(A)(1)(c).

issued trades of members as if the trades were CNS transactions for purposes of clearing fund calculations and surveillance regardless of the accounting operation in which the trades ultimately settle.

Because NSCC is guaranteeing three different types of transactions, Procedure XV, Clearing Fund Formula and Other Matters, is being modified to specifically include the calculations described above for when-issued and balance order trades. NSCC also proposes to modify Addendum B, Standards of Financial Responsibility—Operational Capability, to eliminate the use of the previous twenty business days' activity as a basis to determine whether additional clearing fund deposit must be collected when a member's clearing fund requirement for CNS activity exceeds the previous month-end requirement by a certain percentage threshold.

NSCC believes the proposed rule change is consistent with the requirements of Section 17A of the Act,<sup>5</sup> and the rules and regulations thereunder because it is designed to assure the safeguarding of securities and funds in the custody or control of NSCC or for which it is responsible and, in general, to protect investors and the public interest.

##### B. Self-Regulatory Organization's Statement on Burden on Competition

NSCC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

##### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments relating to the proposed rule change have been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which NSCC consents, the Commission will:

(A) By order approve such proposed rule change or

<sup>5</sup> 15 U.S.C. 78q-1 (1988).

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of NSCC. All submissions should refer to File No. SR-NSCC-96-13 and should be submitted by September 9, 1996.

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

Margaret H. McFarland,  
*Deputy Secretary.*

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[Release No. 34-37554; File Nos. SR-SCCP-96-03 and SR-Philadep-96-07]

### Self-Regulatory Organizations; Stock Clearing Corporation of Philadelphia and Philadelphia Depository Trust Company; Order Granting Temporary Approval of Proposed Rule Changes To Establish Separate Participant Categories for Inactive Accounts

August 9, 1996.

On May 8, 1996, the Stock Clearing Corporation of Philadelphia ("SCCP") and the Philadelphia Depository Trust Company ("Philadep") filed with the Securities and Exchange Commission ("Commission") proposed rule changes (File Nos. SR-SCCP-96-03 and SR-Philadep-96-07) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposals were published in the Federal Register

on May 31, 1996.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule changes through December 31, 1996.

#### I. Description of the Proposals

SCCP and Philadep are establishing separate participant categories for inactive accounts and are amending their respective participants fund formulas with respect to such inactive accounts. Pursuant to the rule changes, SCCP and Philadep are defining in their rules "inactive account(s)" as an account in which a participant conducts de minimis activity, which will be established as twenty or fewer trades per month for SCCP participants and less than \$100 in monthly billing activities for Philadep participants. SCCP and Philadep propose to decrease the required contribution to the participants fund for inactive accounts from \$10,000 to \$5,000. SCCP and Philadep believe that inactive accounts pose virtually no risk to the clearing corporation or the depository as long as they remain inactive.

SCCP and Philadep have established procedures to detect a change in the status of a participant's account from inactive to active and to immediately collect additional required participants fund contributions at such time. Following the admission of a participant, SCCP and Philadep monitor participants' account activities to assure that the proper participants fund contribution is being collected.

With respect to inactive accounts, SCCP's and Philadep's Finance and Administration Departments will identify for SCCP and Philadep the specific accounts that are currently inactive. Thereafter, SCCP's Operations Department will monitor on a daily basis purchase and sale blotters for each inactive account. Trade activity detected from inactive accounts will be compiled on a separate report identifying cumulative activity in each inactive account during a monthly billing cycle.<sup>3</sup> In the event that activity in an inactive account exceeds ten trades but is fewer than twenty-one trades for a particular month, SCCP's Operations Department will immediately notify SCCP's Finance and Administrative Department and SCCP's compliance officer.

Similarly, Philadep's Operations Department will monitor daily deposit, transfer, and miscellaneous deliver

<sup>2</sup> Securities Exchange Act Releases No. 37244 (May 24, 1996), 61 FR 27377 and 37245 (May 24, 1996), 61 FR 27379.

<sup>3</sup> This report will be distributed on a daily basis to SCCP management and SCCP's compliance officer.

order ("MDO") activity of each inactive account. The Operations Department will generate a report that maintains a cumulative total of deposits, transfers, and MDOs occurring in each inactive account for each monthly billing cycle.<sup>4</sup> If the cumulative total exceeds forty transfers, deposits, and MDOs but is less than seventy-five for any inactive account in any given month, Philadep's Operations Department will immediately notify Philadep's Finance and Administration Department and Philadep's compliance officer.<sup>5</sup>

Once a SCCP or Philadep inactive participant exceeds the respective thresholds described above, the respective Finance and Administration Departments will verify the activity, immediately call the participant, and send a letter to the participant requesting that the participant wire additional funds to meet the new required participants fund contribution associated with an active account. In order for the participant to conduct further account activity, the required funds must be wired to SCCP or Philadep (depending on whether the inactive account is at SCCP or Philadep) by the next business day. If the participant does not wire the required participants fund contributions by the next business day, the participant's account will be suspended on the business day after the additional contribution was due to prevent any further activity in the account. A participant's failure to timely wire the required participants fund contributions also will subject the participant to a \$500 fine for the first offense and a \$2,000 fine for the second offense during a calendar year.<sup>6</sup>

When an inactive account becomes active, the account will be subject to the normal monthly review and update process, and the respective Finance and Administration Departments will recalculate each participant's required deposit using the applicable participants fund formulas.

#### II. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing

<sup>4</sup> This report will be distributed on a daily basis to Philadep management and Philadep's compliance officer.

<sup>5</sup> The seventy-five transaction threshold serves as a reliable proxy to determine when a participant's account has incurred \$100 of billing activity. Pursuant to Philadep's fee schedule, the most expensive activity among deposits, transfers, and MDOs multiplied by 75 typically generates less than \$100 in monthly billings.

<sup>6</sup> An offense refers to the number of times that the account was suspended from conducting any further business for failure to furnish SCCP or Philadep with the required participants fund contribution.

<sup>6</sup> 17 CFR 200.30-3(a)(12) (1995).

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).