

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38592; File No. SR-GSCC-96-14]

### Self-Regulatory Organizations; Government Securities Clearing Corporation; Order Approving a Proposed Rule Change to Eliminate Grandfather Privileges

May 9, 1997.

On December 19, 1996, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-GSCC-96-14) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on February 25, 1997.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### I. Description

Effective June 30, 1997, the proposed rule change eliminates the list of grandfather non-members. GSCC established the grandfather list in May 1993, when GSCC created category 1 IDBs and category 2 interdealer broker netting members ("IDB") and placed limitations on their trading activity with firms that were not members of GSCC's netting system.<sup>3</sup> GSCC restricted category 1 IDBs to trading only with GSCC netting members and limited to ten percent the trading activity of category 2 IDBs with nonmember firms.

At that time, GSCC decided to allow IDBs to continue to trade with certain nonmember firms ("grandfather nonmembers") that historically have had access to the IDB's screens and that GSCC has identified on its grandfather list.<sup>4</sup> Accordingly, category 1 IDBs would continue to trade with the grandfather nonmembers and trades between category 2 IDBs and grandfathered firms did not count

toward category 2 IDBs' ten percent limit.

Currently, all grandfather nonmembers are eligible for GSCC membership or could have their trades submitted to GSCC's netting system through an affiliated netting member. The proposed rule change eliminates the grandfather list. As a result, category 2 IDBs, which do virtually all of the brokered transactions with the current grandfathered nonmembers, will have to trade with the formerly grandfathered firms that do not join GSCC's netting system under the category 2 IDB's authority to engage in ten percent of its trading activity with nonmember firms. Category 1 IDBs will be prohibited from doing any netting eligible activity with a formerly grandfathered firm that does not join GSCC's netting system.

#### II. Discussion

Section 17A(b)(3)(F)<sup>5</sup> of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible. The Commission believes that GSCC's proposed rule change is consistent with GSCC's obligations under the Act because eliminating the grandfather list ends the additional exposure to GSCC that the trading by the IDBs with grandfather nonmembers creates.

Specifically, these trades expose GSCC to greater risks than trades between an IDB and a netting member because trades with a grandfather nonmember are not eligible for netting by GSCC. As a result, when an IDB has offsetting trades with a netting member and with a grandfather nonmember, only the trade with the netting member will be netted thereby leaving the IDB instead of a grandfathered firm with a position. The traditional role of IDBs is to net out of every transaction. GSCC's system reflects this role. (For example, IDBs have lower net capital requirements.) As a result, an IDB with a position presents a greater risk to GSCC. By reducing the risks to GSCC, the proposed rule change enables GSCC to better assure the safeguarding of securities and funds which are in its custody or control.

#### III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act

and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-GSCC-96-14) be and hereby is approved.

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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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38603; File No. SR-GSCC-96-12]

### Self-Regulatory Organizations; Government Securities Clearing Corporation; Order Approving a Proposed Rule Change Relating to Interdealer Broker Repurchase Agreement Transactions

May 9, 1997.

On November 21, 1996, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-GSCC-96-12) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> On December 3, 1996, GSCC filed with the Commission an amendment to the proposed rule change. Notice of the proposal was published in the **Federal Register** on February 20, 1997.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### I. Description

Generally, interdealer brokered ("IDB") submit data to GSCC on corresponding repo transactions entered into with two non-IDB counterparties with the intent of maintaining a flat position (*i.e.*, the IDB's deliver obligations are equal to its receive obligations). Thus, the IDB does not have margin or clearing fund consequences from the trades at GSCC. However, when one non-IDB counterparty fails to submit in a timely or accurate fashion data related to the transaction, the IDB's trade with the non-submitting counterparty will not compare and will not enter GSCC's

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

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

<sup>2</sup> Securities Exchange Act Release No. 38287 (February 13, 1997), 62 FR 8068.

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

<sup>2</sup> Securities Exchange Act Release No. 38302 (February 18, 1997), 62 FR 8475.

<sup>3</sup> Securities Exchange Act Release No. 32722 (August 5, 1993), 58 FR 42993 (order approving establishment of new membership categories).

<sup>4</sup> The grandfather list includes the following firms:

Aubrey G. Lanston & Co., Inc.  
The Nikko Securities Co., Ltd. (Tokyo)  
Nikko Europe PLC (London)  
Nomura International Inc. (Tokyo)  
Nomura Securities Co., Ltd. (Tokyo)  
Nomura International PLC (London)  
Daiwa Europe Ltd. (London)

<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(F).

netting system. If the corresponding repo submission compares and enters the net, the IDB will have a net settlement position and may incur clearing fund and funds-only settlement assessments.<sup>3</sup>

The proposed rule change amends Rule 19, which sets forth special provisions for brokers repo transactions, by adding Section 3. Section 3 reaffirms the obligation of a non-IDB netting member to submit in a timely and accurate manner to GSCC or to another registered or exempted clearing agency data on all of its brokered repo transactions.<sup>4</sup> Section 3 also provides that if a non-IDB member fails without good cause to submit data on a brokered repo transaction in a timely or accurate manner, GSCC may treat the transaction as compared based on the data submission received from the counterparty IDB for purposes of assessing clearing fund deposits and funds-only settlement payments. Prior to GSCC's assessing clearing fund and funds-only settlement consequence to a non-IDB netting member that has failed to submit such trade data in a timely and accurate manner, GSCC would attempt to contact (e.g., by telephone) as promptly as possible such non-IDB netting member in order to confirm the accuracy of the data submitted by its IDB netting member counterparty. If the lack of comparison arose because of operational or other problems on the part of the IDB party and the non-IDB netting member therefore does not know the trade, GSCC would not assess margin consequences against the non-IDB netting member.

## II. Discussion

Section 17A(b)(3)(F)<sup>5</sup> of the Act provides that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds in the custody or control of

the clearing agency or for which it is responsible. Without this amendment, a non-IDB that has failed to submit trade data as required by GSCC rules would not be required to pay the related clearing fund and funds-only settlement obligations. Instead, these obligations would fall upon the IDB. Because of their traditional role, IDBs tend to have fewer financial resources to pay these obligations. The amendment is an effort to place the financial obligations associated with a trade on the proper party. By collecting funds from the party that represents the real settlement risk (i.e., the non-IDB party), the proposal helps to safeguard the securities and funds in the custody or control of GSCC.

In addition, without this proposal, non-IDBs do not have an incentive to submit data in a timely fashion because failure to submit data results in clearing fund and funds-only settlement obligations not being assessed to them. By ensuring that the non-IDBs will be required to collateralize their risks whether or not they submit data, the amendment removes any incentive to fail to fulfill data submission obligations. Thus, the proposal promotes the prompt and accurate clearance and settlement of securities transactions.

## III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of Section 17A(b)(3)(F) of the Act and the rules and regulations thereunder. *It is therefore ordered*, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR-GSCC-96-12) be, and hereby is approved.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38601; File No. SR-GSCC-97-01]

### Self-Regulatory Organizations; Government Securities Clearing Corporation; Notice of Filing of Proposed Rule Change Regarding Off-Market Transactions

May 9, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the

“Act”),<sup>1</sup> notice is hereby given that on March 11, 1997, the Government Securities Clearing Corporation (“GSCC”) 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 by GSCC. The Commission is publishing this notice to solicit 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

The proposed rule change consists of modifications to GSCC's rules to allow the mitigation of risk arising from the netting and guaranteed settlement of off-the-market transactions.

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

In its filing with the Commission, GSCC 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. GSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

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

GSCC's fulfillment of its basic mission, which is to ensure that the overall settlement process for the Government securities industry never fails, has been based on the belief that it is best to be as inclusive as possible with regard to the transactions entered into by its members. This makes it less likely that the failure of an industry participant will have a chain reaction effect and lead to the failure of other participants and the settlement process in general.

Because of this philosophy, GSCC has avoided to the extent possible establishing barriers to the inclusion of members' trades in the netting process. Thus, absent the potential for a member to fail to fulfill its settlement obligations to GSCC and have GSCC cease to act for it, GSCC's rules do not provide for limitations on a member's ability to submit trading activity based on its financial status or its level of overall

<sup>3</sup>The funds-only settlement assessment is designed to collateralize a member's net cash payment obligations to GSCC.

<sup>4</sup>GSCC rules currently require that repo netting members submit in a timely manner data on all eligible repo transactions either to GSCC or to another registered clearing agency or a clearing agency that has been exempted from registration as a clearing agency by the Commission. Currently, only one other registered clearing agency, Delta Clearing Corp., clears and settles repo transactions in government securities. Typically, dealers enter into a brokered transaction with the understanding that such trade will be cleared and settled through a specified clearing agency. Therefore, if the counterparties to a repo transaction have selected GSCC as the clearing agency to be used, failure to submit the relevant data may be a violation of GSCC's rules.

<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(F).

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

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

<sup>2</sup> The Commission has modified the text of these summaries.