

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.*

[FR Doc. 97-12883 Filed 5-15-97; 8:45 am]

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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.

activity. Rather, GSCC's approach has been to let its margining processes be the natural limit on a member's level of trading.

This approach works well because the clearing fund and forward margining processes are both dynamic ones. They are not set or capped at a specific level but are recalculated and collected daily and thus, increase or decrease daily based on (1) the level of members' overall historical and current day's net activity with respect to clearing fund and (2) the net profitability of members' overall net activity with respect to forward margin.

This inclusive approach to netting eligibility has led GSCC to allow trades into its net that have a price that differs significantly from the prevailing market price for the underlying security ("off-the-market transactions"). The large majority of the off-the-market transactions that enter the net are not independent trades per se but rather reflect exercise of options into which the parties previously entered. GSCC continuously monitors its receipt of data on off-the-market transactions. For monitoring purposes, GSCC considers trades that are greater than \$1 million in value and that traded at a price that is more than one percentage point away from GSCC's system price as off-the-market trades.

The submission by netting members to GSCC of data on an off-the-market transaction is of particular concern if done on the day before the scheduled settlement date of the transaction or if the data is submitted earlier than on the day before scheduled settlement date but is not compared until that date because it presents GSCC with exposure that it has not had the opportunity to appropriately assess and margin. As noted above, most of the off-the-market transactions submitted to GSCC are options exercises, and ordinarily, an option is settled on the business day after the day on which it is exercised.

As a partial solution to this problem, GSCC intends in the future to provide a comprehensive set of comparison, netting, settlement, and risk management services for options on Government securities. As a more immediate measure, GSCC is seeking authority to take the following two-pronged approach to the problem of off-the-market transactions.

1. *Continue to allow off-the-market trades into the net thus keeping them eligible for netting, novation, and guaranteed settlement but change the loss allocation process so as to allocate all of any loss resulting from the liquidation of the off-the-market*

*transaction to the remaining counterparty.*

This approach recognizes that allowing off-the market transactions into the net has the potential to inappropriately increase the loss that GSCC would incur should a member that has engaged in such transactions fail and have its net settlement positions liquidated. Members not involved in the off-the-market transaction should not have to share in the loss allocation that results from its liquidation.

To avoid this, GSCC is seeking the authority to amend its rules to allocate the loss arising from an off-the-market transaction done either with a netting member that subsequently is determined to be insolvent or with an executing firm that the insolvent member acts for as a submitting member directly and entirely to the insolvent member's counterparty.

2. *Not pass through to the credit side the mark-to-market amount associated with an off-the-market transaction until and unless it is paid to GSCC by the debit side.*

The revision to the loss allocation process addresses the inequity of how that process applies to a failed member that has engaged in off-the-market transactions. However, it would expose GSCC to the risk that the failed member's counterparty also defaults on its settlement obligations to GSCC after that member has received the benefit of the off-the-market transaction through the funds-settlement process. If that happens, then the allocation of loss still effectively reverts back to the other members that were not involved in the off-the-market transaction.

Thus, as a complement to the first proposed, GSCC is seeking the ability to ensure that the mark-to-market exposure on the off-the-market transaction not be inappropriately passed through to a failed member's counterparty. GSCC would do this by amending its rules and its operational procedures to provide that if the mark-to-market amount associated with an off-the-market transaction is not paid to GSCC by the debit side on the morning of the business day following the submission of the trade (*i.e.*, the debit side fails before it has satisfied its funds settlement obligation), the market amount will not be paid by GSCC to the credit side. In other words, GSCC will not pass through the profit on an off-the-market transaction until and unless it has received that profit amount.

GSCC is proposing as the definition of an off-the-market transaction any of the following:

- (1) An options exercise.
- (2) A single transaction that is:

(i) greater than \$1 million in par value and

(ii) either one percentage point higher than the highest price or one percentage point lower than the lowest price for the underlying security on the day of the submission of data on the transaction to GSCC (with such prices being obtained by GSCC from a third-party source such as Bloomberg Financial Services selected by GSCC for this purpose).

(3) A pattern of transactions submitted by two members that if looked at as a single transaction would constitute an off-the-market transaction.

The proposed rule changes are consistent with the requirements of Section 17A of the Act<sup>3</sup> and the rules and regulations thereunder because it would ensure that the mark-to-market exposure on the off-the-market transaction not be inappropriately passed through to a failed member's counterparty and that the liquidation of an off-the-market transaction not lead to a significant loss by GSCC.

#### *(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*

Written comments relating to the proposed rule change have not yet been solicited or received. Members will be notified of the rule change 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 organizations consents, the Commission will:

(A) by order approve rule proposed such change or

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

<sup>3</sup> 15 U.S.C. 78q-1.

#### 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 this submission, all subsequent amendments, all written statements with respects 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 provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room in Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of GSCC. All submissions should refer to the File No. SR-GSCC-97-01 and should be submitted by June 6, 1997.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38595; File No. SR-MBSCC-96-08]

#### Self-Regulatory Organizations; MBS Clearing Corporation; Order Approving a Proposed Rule Change Relating to Liens on Participants' Property

May 9, 1997.

On November 20, 1996, MBS Clearing Corporation ("MBSCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-MBSCC-96-08) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> to explicitly state that MBSCC has a lien on all property placed in its possession by its participants. On January 3, 1997, and on January 14, 1997, MBSCC filed amendments to the proposed rule change. Notice of the proposal was published in the **Federal Register** on February 26, 1997.<sup>2</sup> On April 10, 1997, MBSCC again amended the proposed

rule change.<sup>3</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### I. Description

Unlike other clearing agencies, MBSCC's rules did not contain specific language stating that MBSCC has a lien on all property placed into its possession by its participants.<sup>4</sup>

However, MBSCC has stated that it always intended to have such a lien. The proposed rule change modifies MBSCC's rules to explicitly state that MBSCC has a lien on all property placed in its possession by its participants.

The proposed rule change also revises MBSCC's rules to clarify that any cash received with respect to deposits to MBSCC's participants fund from and not yet distributed to a participant is available to MBSCC for satisfaction of participant liabilities.

#### II. Discussion

Section 17A(b)(3)(F)<sup>5</sup> of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions. The Commission believes that the proposed rule change is consistent with MBSCC's obligations under the Act because the proposed rule change adds language providing MBSCC with assurances that, in the event one of its participants fails to discharge its liabilities, MBSCC will have a lien on the participant's property in MBSCC's possession. Therefore, MBSCC can utilize the participant's cash or securities subject to the lien to cover the participant's unpaid obligations to MBSCC. As a result, MBSCC is in a better position to protect itself and its participants from a defaulting participant.

#### 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.

<sup>3</sup>The amendment was technical in nature and therefore did not require republication of the notice.

<sup>4</sup>For example, the rules of the National Securities Clearing Corporation ("NSCC") and the International Securities Clearing Corporation ("ISCC") provide NSCC and ISCC with liens on property placed in their possession by their participants. The language contained in the present proposed rule change is substantially similar to the language contained in NSCC's and ISCC's respective rules. NSCC Rule 18, Section 2(f) and ISCC Rule 18, Section 3.

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

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-MBSCC-96-08) 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. 34-38594; File No. SR-MCC-97-01]

#### Self-Regulatory Organizations; Midwest Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Return of Sponsored Account Fund Deposits

May 9, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on March 27, 1997, Midwest Clearing Corporation, ("MCC") 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 MCC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

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

The purpose of the proposed rule change is to adopt a form of indemnity agreement in accordance with Article XI, Rule 2, Section 11 of MCC's rules.

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

In its filing with the Commission, MCC 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. MCC has prepared summaries, set forth in sections A, B,

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

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

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

<sup>2</sup>Securities Exchange Act Release No. 38314 (February 19, 1997), 62 FR 8809.