

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40288; International Series Release No. 1150; File No. SR-EMCC-98-04]

### Self-Regulatory Organizations; Emerging Markets Clearing Corporation; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change Establishing Interim Margin and Loss Allocation Procedures

July 31, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on July 13, 1998, Emerging Markets Clearing Corporation ("EMCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which items have been prepared primarily by EMCC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

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

Under the proposed rule change, EMCC will establish interim margin and loss allocation procedures for U.S. interdealer brokers and for U.S. firms whose only business with EMCC consists of clearing for interdealer brokers.

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

In its filing with the Commission, EMCC 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. EMCC 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

Most transactions in emerging markets debt are conducted on a blind brokered basis through interdealer

brokers. Currently, only one interdealer broker self-clears emerging markets debt transactions through EMCC. The remaining interdealer brokers clear such transactions through a clearing firm.

EMCC recognizes that a clearing firm has little control over its positions at EMCC because its positions are determined by dealers participating in the market. Prior to beginning operations, EMCC realized that with a limited number of members a clearing firm could be required to post a substantial amount of collateral with EMCC. EMCC now believes that with its limited number of members it may not be economical for a clearing firm to participate in EMCC under its current margin procedures. Therefore, EMCC has determined that interim margin procedures should be adopted.

Under this proposed rule change, EMCC is adopting interim margin and loss allocation procedures for a period of one year or such shorter period of time as determined by EMCC's Board.<sup>3</sup> The interim margin procedures will apply to interdealer brokers and to firms whose only business with EMCC in emerging markets instruments consists of clearing for interdealer brokers (sometimes referred to as "special members"). Interdealer brokers and clearing firms will be subject to a constant base clearing fund requirement based upon EMCC staff simulations of margin requirements. The base requirement will be equal to the staff's best estimate of the approximate probably recurring upper bound of the daily margin calculation for the firm given current market conditions and the business and market share of the firm.<sup>4</sup>

Under the interim margin procedures, EMCC will not collect daily margin calculations over the base requirement if a firm's resulting uncollateralized exposure does not exceed the lesser of: (1) ten percent of the excess net capital of the firm or (2) fifteen percent of EMCC's current aggregate clearing fund. Thus, EMCC will only collect additional margin under the interim margin procedures if the difference between the

<sup>3</sup> Should EMCC's Board decide that the use of the interim margin and loss allocation procedures should be terminated before the end of the one year period, EMCC must file a proposed rule change pursuant to Section 19(b)(2) of the Act and obtain Commission approval before terminating the interim procedures.

<sup>4</sup> EMCC expects that the instances of uncollected exposure under the interim margin procedures should be infrequent. To the extent that market share or size changes in favor of a firm such that its uncollateralized exposure calculations become frequent, the Board may increase the firm's base requirement. Conversely, if market share or size changes such that a firm's instances of uncollateralized exposure become very infrequent, the Board may reduce the firm's base requirement.

daily margin calculation and a firm's base requirement exceeds ten percent of the firm's excess net capital or fifteen percent of EMCC's current aggregate clearing fund.

Any margin call required to be paid under the interim margin procedures, other than the base requirement or any adjustments to it, will be paid by the affected firm and by EMCC's dealer members as follows. First, on each day, each special member will produce a report under methodology approved by EMCC that sets forth (a) the approximate percentage of leg-out transactions that are with dealers that have funded EMCC ("funding non-member dealer percentage") and (b) the approximate percentage of leg-out transactions that are with others ("firm percentage"). Second, the special member required to pay additional margin will post the percentage of the margin call equal to the firm percentage, and EMCC's dealer members will post the percentage of the margin call equal to the funding non-member dealer's percentage. This amount will be charged to all dealer members in proportion to their current clearing fund requirement (exclusive of any amounts charged for increased event risk).

The collateral posted by dealer members under the interim margin procedures will be considered collateral of the special member and will be applied against losses after the collateral posted by the special member itself. Any amounts not so applied will be returned to the dealer members in proportion to the amounts they deposited. However, EMCC notes that in the event of the failure of a dealer member putting up collateral for a special member's margin obligation, the collateral will be considered part of the dealer's collateral and will be applied against the dealer's losses before being returned to the dealer.

EMCC's normal loss allocation rules provide that in the event of a failure of a dealer member, losses from blind brokered transactions will be borne by the entire membership in proportion to their average daily final margin calculations over the prior thirty days and losses due to direct (*i.e.*, non-brokered) transactions are borne by the actual counterparties. Losses are so allocated after the failing firm's clearing fund is applied to the losses. During the period in which the interim margin and loss allocation procedures are in effect, brokered transactions will be considered blind brokered transactions in the event of the failure of a dealer member but only to the extent that the leg-out transactions are with funding non-member dealers. For purposes of

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

<sup>2</sup> The Commission has modified the text of the summaries prepared by EMCC.

calculating the *pro rata* loss allocation, the average daily margin calculation for each member will be determined without regard to the interim margin procedures except that any daily margin calculation for a special member that exceeds the special member's base requirement shall be considered as the base requirement.

EMCC believes that 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 will facilitate the prompt and accurate clearance and settlement of securities transactions.

*(B) Self-Regulatory Organization's Statement on Burden on Competition*

EMCC 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. EMCC will notify the Commission of any written comments it receives.

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

Section 17A(b)(3)(F) of the Act<sup>6</sup> 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 the proposed rule change should provide EMCC with margin that is adequate to protect EMCC from financial exposure if an interdealer broker or clearing firm experiences financial difficulty while still providing a clearing fund framework which does not deter interdealer brokers and clearing firms from joining EMCC. Therefore, the Commission believes that the proposed rule change is consistent with EMCC's safeguarding obligations under Section 17A(b)(3)(F) of the Act.

EMCC has requested that the Commission approve the proposed rule change prior to the thirtieth day after publication of the notice of the filing. The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the publication of notice because such approval should immediately encourage

additional participation in EMCC which should in turn reduce risk to those involved in emerging market debt transactions.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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 also will be available for inspection and copying at the principal office of EMCC. All submissions should refer to File No. SR-EMCC-98-04 and should be submitted by August 27, 1998.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-EMCC-98-04) be and hereby is approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-40286; File No. SR-NASD-98-38]

**Self-Regulatory Organizations; National Association of Securities Dealers, Inc; Order Approving Proposed Rule Change Relating to NASD's Order Audit Trail System and Recordkeeping Rules**

July 31, 1998.

**I. Introduction**

On May 22, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association") through its wholly-owned subsidiary, NASD Regulation, Inc. ("NASD"), submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend NASD Books and Records Rule 3110 and NASD Order Audit Trail System ("OATS") Rules 6954 and 6957 to clarify and modify the recordkeeping requirements associated with the OATS rules.

On June 10, 1998, the proposed rule change was published for comment in the **Federal Register** and notice was given that three non-substantive, technical revisions to NASD Rules 3110 and 6957, which were concerned solely with the administration of the NASD, had become effective pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and subparagraph (e)(3) of Rule 19b-4<sup>4</sup> thereunder<sup>5</sup>. This order approves the portions of the proposal relating to substantive amendments to the OATS recordkeeping requirements.

**II. Background and Description of the Proposal**

On March 6, 1998, the Commission approved NASD OATS Rules 6950 through 6957.<sup>6</sup> The OATS rules require member firms to capture and record specific information related to the handling or execution of orders for equity securities in The Nasdaq Stock Market ("Nasdaq"). Firms must then report that information to the NASD through OATS. The rules also require members to synchronize their business

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 19b-4(e)(3).

<sup>5</sup> See Securities Exchange Act Release No. 40069 (June 4, 1998) 63 FR 31820.

<sup>6</sup> See Securities Exchange Act Release No. 39729 (March 6, 1998) 63 FR 12559 (March 13, 1998) (order approving File No. SR-NASD-97-56).

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

<sup>6</sup> 15 U.S.C. 78q-1(b)(93)(F).

<sup>7</sup> CFR 200.30-3(a)(12).