

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43793; File No. SR-GSCC-00-08]

### Self-Regulatory Organizations; Government Securities Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to Permitting Clearing Fund Offsets for Category 2 Dealer Netting Members and Futures Commission Merchants

January 3, 2001.

Pursuant to section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 ("Act"), notice is hereby given that on July 31, 2000, 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 would enable GSCC to provide offsets in the clearing fund calculation for Category 2 Dealer Netting Members and Category 2 Futures Commission Merchants ("FCMs") (collectively, "category 2 members") that meet all of GSCC's requirements for participating in its netting system.

#### 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>

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

GSCC has established two membership categories ("category 1" and "category 2") for dealers and FCMs that want to participate in GSCC's

netting system. GSCC established a "Category 2" membership for dealers and FCMs that meet all of GSCC's requirements for participating in the netting system but have less net worth than GSCC's category 1 members. The minimum net worth requirement for category 1 members is \$50 million, and the minimum net worth requirement for category 2 members is \$25 million.<sup>3</sup>

While category 2 members have a lower net worth threshold than category 1 members, category 2 members currently have a more stringent clearing fund requirement under GSCC Rule 4, section 2(d). Specifically, the clearing fund requirement for category 2 members is calculated (i) without the benefit of any of the offsets across opposite net settlement positions<sup>4</sup> that are permitted for category 1 members and (ii) with margin factors set at the 99 percent-of-movements confidence level<sup>5</sup> (while margin factors for a category 1 member are set at the 95 percent confidence level). In addition, if a category 2 member elects to receive credit forward margin amounts<sup>6</sup> in its daily funds-only settlements, its margin factors are set at levels that are based on the greater of: (i) the category 2 margin factors or (ii) margin factors adjusted to reflect GSCC's historical two-day price volatility data covering 95 percent of all movements.<sup>7</sup>

GSCC currently has no active category 2 members. GSCC believes that certain entities that meet the eligibility requirements for category 2 membership and who recognize the many benefits of GSCC's netting system have not applied for membership because they consider the liquidity burden associated with the current clearing fund calculation to be too onerous. In order to broaden the availability of GSCC's netting services, GSCC proposes to allow for offsets in the clearing fund calculation for category 2 members. The current prohibition of offsets for category 2

<sup>3</sup> Both categories have identical requirements for minimum excess net or liquid capital of \$10 million.

<sup>4</sup> This means that GSCC does not allow category 2 members to offset long positions versus short positions.

<sup>5</sup> This means that the category 2 margin factors are based on GSCC's historical daily price volatility data covering 99 percent of all movements.

<sup>6</sup> A credit forward margin amount refers to GSCC's daily process of computing a member's collateral by marking to market the member's transactions that will settle in the future. The result will produce a net credit or a net debit. If the member has a net credit, it can elect to have GSCC pay it the value of the net credit. If the member has a net debit, it must pay GSCC.

<sup>7</sup> A category 2 member that elects to receive credit forward margin amounts will have higher margin factors than a category 2 member that does not make that election.

members was implemented years ago as a conservative measure designed to avoid any risk arising from the creation of the category 2 level. Now, after many years of experience in conducting risk assessments, netting, and calculating margin, GSCC believes that prohibiting offsets is overly conservative and punitive. In addition, expanding the roster of GSCC netting members should also enhance the netting benefits for the existing members that currently trade with potential category 2 members.

Recognizing that category 2 members have smaller net worth bases and may therefore be deemed to pose a greater risk of default than category 1 members, the margin factors applied to category 2 members will continue to be set at the 99 percent confidence level (versus 95 percent for category 1 members). Furthermore, category 2 members will still be required to make an election regarding the receipt of forward margin. By permitting certain offsets for category 2 members and at the same time maintaining the more stringent margin factor requirements, GSCC will collect sufficient margin from duly approved category 2 members while expanding the range of netting members in a prudent manner.

GSCC believes that the proposed rule change is consistent with section 17A(b)(3)(F)<sup>8</sup> of the Act and the rules and regulations thereunder because it will (i) permit new entities to join GSCC and realize the benefits of participating in its netting system and (ii) enhance the netting benefits of existing members that currently trade with the potential members.

#### 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 From Members, Participants or Others

Written comments relating to the proposed rule change have not yet been solicited or received.<sup>9</sup> 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**

<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>9</sup> Members will be notified of the rule change filing, and comments will be solicited by an Important Notice.

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

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

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.

#### 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 20549-0609. 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 Room in Washington, DC. Copies of such filing will also be available for inspection and copying at GSCC's principal office. All submissions should refer to File No. SR-GSCC-00-08 and should be submitted by February 1, 2001.

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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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43794; File No. SR-GSCC-00-10]

### Self-Regulatory Organizations; Government Securities Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to the Submission of Repo Collateral Substitutions

January 3, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on September 11, 2000, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change and on November 20, 2000, amended the proposed rule change as described in Items I, II and III below, which items have been prepared primarily by GSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The proposed rule change amends GSCC's rules relating to repo collateral substitutions processes and the fees associated with such substitutions.

#### 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 section A, B, and C below, of the most significant aspects of these statements.<sup>2</sup>

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

Support of repo collateral substitutions has been an integral part of GSCC's array of services for blind-brokered repo markets since its introduction in 1996. Over the past two years, however, GSCC members have at times engaged in certain practices in

connection with the repo collateral substitution process that present risk to GSCC and its members by placing an inordinate level of stress on the operational infrastructures of GSCC and its inter-dealer broker members, and by causing undue fail-financing expenses for other members. GSCC desires to prohibit these practices and to impose an additional risk management measure on the repo substitution process.

#### 1. Late Notifications

Over the past two years, there have been an increasing number of occasions where GSCC experienced dramatic increases in the number of substitutions requests.<sup>3</sup> In addition, many members have not followed The Bond Market Association's ("TBMA") published deadlines for substitution requests applicable to dealers and brokers which has resulted in GSCC receiving the substitution requests late in the day.<sup>4</sup> Specifically, some dealers are not complying with the substitution deadlines and some brokers, in turn, are not able to submit the requisite notifications to GSCC in a timely manner. The combination of the increased volume and the late submissions has, on certain occasions, placed an inordinate amount of stress on both GSCC's and the brokers' infrastructures. In addition, because "new" collateral is often delivered at or too near the close of the securities Fedwire to be redelivered by GSCC, GSCC is forced in many instances to obtain overnight financing, the cost of which is passed on to the netting members.<sup>5</sup>

GSCC has requested a number of times over the past two years that industry participants voluntarily comply with TBMA deadlines for

<sup>3</sup> These spikes in substitution requests occur most often at month-end and quarter-end.

<sup>4</sup> Update 98-3 of the TBMA's Repo Trading Practices Guidelines (August 1996) (hereinafter "TBMA's Guidelines") states:

Unless the parties to a trade otherwise agree, in all trades executed through brokers, dealers should notify the brokers of any substitution of collateral *no later than 9:55 a.m. (New York Time)*. In turn the broker should notify the counterparty dealer of the substitution by *10:00 a.m. (New York time)*. Substitution notifications received after the relevant deadline will be accommodated on a "best efforts" basis. Additionally, dealers should provide brokers with the description of the substituted collateral by *11:00 a.m. (New York time)*. (Emphasis in original.)

<sup>5</sup> GSCC's Rule 12 provides that the costs or expenses incurred by GSCC in obtaining financing under such circumstances are generally allocated pro rata among all netting members based upon usage of GSCC's services. Rule 12 also provide that if the GSCC Board determines that a netting member has on a frequent basis and without good cause caused GSCC to incur financing costs, the member can become obligated to pay for or reimburse GSCC for the entire amount of the financing costs.

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

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

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