

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. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to File No. SR-CHX-2001-09 and should be submitted by June 6, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44282; File No. SR-GSCC-2001-01]

### Self-Regulatory Organizations; Government Securities Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to the Redesign of Comparison Rules

May 8, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), notice is hereby given that on January 16, 2001, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") and on April 11, 2001,<sup>1</sup> 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 would allow GSCC to redesign its comparison rules in order to implement real-time interactive services.<sup>2</sup>

#### 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 these statements.

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

In a white paper distributed to all members in early 1997, GSCC outlined its long-range plans to provide straight-through processing and a point-of-trade guarantee to its members primarily through the implementation of real-time interactive services. Last year, GSCC announced that it would implement its interactive services in three phases. Phase 1 will introduce interactive messaging to support real-time comparison; phase 2 will introduce interactive messaging to support netting; and phase 3 will introduce support of same-day settlement of repo start legs.

During the latter part of 2000, GSCC implemented the necessary technical changes to its automated system to implement the first phase of its interactive processing service (*i.e.*, making available the interactive messaging facility to support real-time comparison). Up until this point, GSCC's processing experience has been essentially batch. Members now have the ready ability, from a technological perspective, to submit trade input on an automated basis to GSCC intraday as trades are executed. While GSCC will continue to support its existing batch

input and output facilities initially, it plans to eventually stop supporting these older formats. Members will be encouraged to make the shift from batch to interactive processing as soon as it is feasible for them to do so. At some point in time, once a sufficient nucleus of members has begun processing interactively, GSCC will implement disincentives to discourage members from continuing to submit and receive data via the old batch formats.

Concurrent with this development, GSCC has been redesigning its matching and comparison procedures to better meet the needs of its members during their transition from a batch on an interactive environment. This redesign is the subject of this rule filing. GSCC's central goal in this redesign is to provide straight-through processing by allowing for the easy identification and resolution of trades intraday to achieve 100 percent comparison. GSCC believes that interactive messaging and enhanced real-time trade matching processing are critical steps in helping to reduce risk by ensuring that more transactions are compared earlier in the day and then eventually also netted and guaranteed through GSCC so that intraday credit exposure to counterparties is minimized.

In the current environment, most trades are compared within the GSCC system as a result of bilateral comparison with the exception being certain locked-in trades, such as members' Federal Reserve auction purchases. To facilitate real-time comparison while still providing members with the flexibility to transition from batch to interactive submission according to a timeframe suitable to their own needs and resources, GSCC is proposing to: (i) Amend its rules to provide for three types of trade comparison: (a) Bilateral comparison, (b), demand comparison, and (c) locked-in comparison and (ii) make certain other related rules changes as further discussed below.

#### Bilateral Comparison

Bilateral comparison, which is the traditional method of comparison, will continue to require that the two trade counterparties (or if one or both of the counterparties are not GSCC members, the members acting on their behalf) submit trades to GSCC in which certain mandatory details either match or fall within predefined parameters to effect a match. Bilateral comparison will remain the primary comparison type for dealer-to-dealer trades and will be available in both real-time and batch. Members may elect to submit interactively regardless

<sup>5</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> Letter from Nikki M. Poulos, Vice President and Associate General Counsel, GSCC (April 10, 2001). Subsequent to filing GSCC-2001-01, GSCC filed a rule proposal (SR-GSCC-2001-02) that became immediately effective under Section 19(b)(3). The letter states that GSCC-2001-02 amends rules previously listed by GSCC-2001-01 in Exhibit A and that both rule filings are consistent with each other. The amendment does not amend any language in GSCC-2001-01 as originally filed with the Commission and as presented herein.

<sup>2</sup> A copy of the text of GSCC's proposed rule change and the attached exhibits are available at the Commission's Public Reference Section or through GSCC.

of whether their trade counterparties do so.

A new feature of bilateral comparison will be the ability for members to "DK" any trades they "do not know." The proposed rule change introduces the term "DK Notice" to GSCC's rules. If a member determines that a request for comparison is invalid or incorrect, it can send a DK notice to GSCC which will be forwarded to the original submitter. The receipt of the DK notice by GSCC will prevent the trade from comparing in GSCC's system. If a member that sent a DK notice determines that it did so erroneously, the member will be able to remove the DK and enable comparison to occur if it does so within the timeframes prescribed by GSCC for such purpose.

#### Demand Comparison

Demand comparison is a new type of comparison that has been designed to provide members with flexibility and control over the comparison process for trades executed via intermediaries. Demand comparison strikes a balance between bilateral comparison, where the member is required to submit trade data in order for its trade to compare, and locked-in comparison (discussed in more detail below), where the trade has essentially been operationally compared before being submitted to GSCC.

Demand trades will be submitted by approved intermediaries (e.g., brokers) which will be called "demand trade sources." Demand trade sources must be able to communicate with GSCC interactively. In order for GSCC to accept trades from a demand trade source on a member's behalf, the member must provide GSCC with prior written authorization. The intermediary must also be approved and authorized by GSCC to be a demand trade source.

GSCC will deem a demand trade compared upon receipt of the trade data from the demand trade source. However, if a member does not know a trade submitted on its behalf by a demand trade source, the member will be able to submit a DK notice to GSCC. The receipt of a DK notice by GSCC will cause the demand trade to no longer be eligible for comparison. If a member that sent a DK notice determines that it did so erroneously, the member will be able to remove the DK and enable comparison to occur if it does so within the timeframes prescribed by GSCC for such purpose.

GSCC is making incidental rules changes to Rules 11, 16, 18, 21, 22, and 39 to take into account the introduction of demand trades.

#### Locked-In Comparison

Locked-In Comparison will be similar to that currently provided for in GSCC's rules. Locked-In Comparison presumes that a member would elect not to submit corresponding trade details to affect a match because the trade has been precompared by the trade source. An example of a trade appropriate for locked-in comparison would be one executed through a "pure" electronic trading system that is terminal-driven and that exercises no discretion over the trade.

In order to participate, the locked-in trade source must be authorized by both the members on whose behalf it will be submitting trade data and by GSCC. With the exception of some current locked-in sources, such as the Federal Reserve banks, locked-in trade sources will be expected to communicate with GSCC.

Locked-In trades will be deemed compared upon receipt by GSCC. The DK feature will also be available for locked-in trades. However, unlike in the case of demand trades, a DK of a locked-in trade will be treated by GSCC as a request for cancellation to the locked-in trade source. In order to actually cancel the trade on GSCC's system, the locked-in trade source will have to respond to the request by submitting a trade cancellation. The locked-in trade source can modify the trade in response to a DK notice in order to remove the trade's DK status.

#### Submission Methods

In order to set forth the concept of a member submitting interactively versus submitting in one of the batch modes, GSCC is proposing to add three new definitions to its rules: "interactive submission method," "multiple batch submission method," and "single batch submission method." The proposed rules changes make clear which submission type is required for each type of comparison.

In addition, GSCC is proposing to add a definition of "real time" in its rules to be used to indicate when a particular process (e.g., the enhanced comparison processes set forth in Rule 10) will be performed by GSCC in real time as opposed to at the end of day.

#### Submission of Full-Sized Trades

GSCC is also proposing to permit members to submit full-sized trades. Currently, non-GCF Repo trades are submitted in \$50 million increments. Because members' internal systems tend to reflect the full size of each trade (as opposed to the pieces that they submit to GSCC), the submission of full-sized

trades will permit members to better reconcile their trading activity. GSCC recognizes that not all members will be able to begin processing full-sized trades immediately. Therefore, GSCC will not require that members exercise this option.

#### Timing of Key Processes of GSCC

GSCC's key processes are comparison, netting, novation, and guaranty of settlement. GSCC is proposing to change the timing of two of these processes (comparison and guaranty of settlement).

With respect to the timing of comparison, GSCC's rules currently provide that it occurs when GSCC makes its comparison output available to members. The proposed rule filing provides that, while comparison will continue to occur upon issuance of the comparison message by GSCC with respect to trades submitted for bilateral comparison, it will be deemed to occur upon receipt of trade data from the authorized trade source with respect to trades submitted for demand comparison and locked-in comparison.

With respect to the timing of netting, GSCC's rules currently provide that this occurs upon issuance of the report of or output on net settlement positions by GSCC. This will continue to be the case. Similarly, GSCC's rules currently provide that novation, the process by which GSCC becomes the substituted counterparty to trades submitted to it, occurs upon the issuance of the report of or output on net settlement positions by GSCC. This will also remain unchanged.

With respect to the timing of GSCC's guaranty of settlement, GSCC's current rules provide that GSCC guarantees the settlement of a netting-eligible trade upon issuance of the report/output that sets forth the member's net settlement position. The exception to this rule is GSCC's policy of guaranteeing blind brokered repos entered into in good faith upon trade execution.<sup>3</sup>

The proposed rule changes will move the timing of GSCC's guaranty to the point of comparison. This means that a netting-eligible trade submitted for bilateral comparison will be guaranteed upon issuance of the comparison message by GSCC and that a netting-eligible trade submitted for demand or

<sup>3</sup> GSCC adopted its policy of guaranteeing blind brokered repos entered into in good faith upon trade execution in order to comfort dealers that have intraday credit exposure to brokers through whom they execute such transactions. The policy only applies to such transactions that are entered into in good faith, which means, for example, that GSCC would not honor it in the event that a dealer entered into a transaction knowing that the counterparty was insolvent.

locked-in comparison will be guaranteed upon receipt of trade data from the authorized trade source. If a trade is DKed (and with respect to a locked-in trade, canceled by the locked-in trade source), GSCC's guaranty will no longer be in effect with respect to that trade. As a transition measure that recognizes that members may need some time to switch to interactive processing, GSCC is proposing that it maintain its policy of guaranteeing blind brokered repo trades entered into in good faith upon trade execution through the year 2001.

#### General Responsibilities of Members

GSCC's comparison rule contains a provision that requires members to review documents that they receive from GSCC.<sup>4</sup> GSCC desires to expand the provision to cover any type of communication provided to members by GSCC and require members to inform GSCC promptly, but in no event later than ten calendar days after receipt of the communication, if there is any error, omission or other problem with respect to the communication.<sup>5</sup> GSCC's netting rule contains a similar provision with respect to which GSCC has proposed to add the ten-day requirement.<sup>6</sup> GSCC believes that the ten-day timeframe will provide members with a sufficient amount of time within which to detect problems in a communication from GSCC.

#### Amendments to Schedules

GSCC is proposing incidental changes to certain of its Schedules for clarification purposes and to bring them into conformity with the proposed rules changes discussed above. Specifically,

<sup>4</sup> GSCC proposed revised Rule 5, Section 5 will state: "Each Member shall promptly review each Report it receives from the Corporation pursuant to this Rule. Any errors, omissions, or similar problems noted by a Member with respect to a Report must be promptly reported to the Corporation, but such reporting to the Corporation shall be made no later than ten calendar days after the receipt of the Report."

<sup>5</sup> In its rules, GSCC requires its members to review reports received from GSCC. In its Rule 1, "Definitions," GSCC defines the term "report" as follows: "The term Report means any document, record, or other output prepared by the Corporation and made available to a Member in any format (including, but not limited to, machine-readable and print-image formats) or medium (including, but not limited to, print copy, magnetic tape, video display terminal, and CPU-to-CPU interface formats) that provides information to such Member with regard to the services provided by, or the operations of, the Corporation."

<sup>6</sup> GSCC proposed revised Rule 11, Section 12 will state: "The Netting member shall inform the Corporation after the occurrence of any event specified above; provided however, that the Netting Member shall inform the Corporation no later than ten calendar days after receiving a Report described in subsection (b) above."

GSCC is expanding the output time slot in its "Schedule of Timeframes" from "midnight to 2 a.m." to "8 to 2 a.m." This change reflects the fact that GSCC may be able to provide certain output earlier given the implementation of real-time trade matching and also the recent shift to the 8 p.m. trade submission deadline.

GSCC is also proposing additional amendments to the Schedule of Timeframes in order to update it to reflect actual practice. Specifically, funds-only settlement payments are due to GSCC at 10 a.m. (currently at 9 a.m.) and funds-only settlement payments are due from GSCC at 11 a.m.). GSCC has proposed clarifying language to indicate that the 10:30 a.m. deadline for satisfaction of a clearing fund deficiency call is approximate because members have two hours after a call is made to fulfill their obligation.

GSCC is also updating its "Schedule of Required Match Data," "Schedule of Required Data Submission Items," and its "Schedule of Required Data Submission Items for a Right of Substitution" to make clear that the only locked-in trades to which those schedules do not apply are Treasury/Federal Reserve auction purchases and GCF repo transactions.

GSCC is also amending its fee structure to set fees for demand trades which will be the same as those currently imposed on locked-in trades.

The proposed rules changes are consistent with the requirements of the Act and rules and regulations thereunder because they will help to eliminate risk by promoting a higher rate of comparison and ensuring that more transactions are compared on a more timely basis, and then eventually netted and guaranteed through GSCC.

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

GSCC does not believe that the proposed rules changes 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 changes 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 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 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 GSCC. All submissions should refer to File No. SR-GSCC-2001-01 and should be submitted by June 6, 2001.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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