

methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer. In this regard, the Commission believes the ISE's adoption of Supplementary Material to ISE Rule 412, to state that the ISE has the authority to impose additional margin on options positions if it determines that this is warranted, is appropriate.

Finally, the Commission believes that the reporting requirements imposed by the Exchange under ISE Rule 415(b), which will continue to require that each member or member organization that maintains a position on the same side of the market in excess of 10,000 contracts in the QQQ option, for its own account or for the account of a customer report certain information, will help protect against potential manipulation. The Exchange also requires members to report subsequent incremental increases in positions, thus assuring that positions are regularly monitored by the Exchange. In particular, information that must be reported includes, among other things, whether or not the options position is hedged, and if so, a description of the hedge. The information should help the ISE to monitor accounts and determine whether it is necessary to impose additional margin for under-hedged positions, as provided under its rules. The Commission believes that these financial requirements are sufficient to address concerns that a member or its customer may try to maintain an inordinately large unhedged position in QQQ options.

In summary, the financial and reporting requirements noted above should allow the Exchange to detect and deter trading abuses arising from the increased position and exercise limits, and will also allow the Exchange to monitor large positions in order to identify instances of potential risk and to assess additional margin and/or capital charges, if deemed necessary. These requirements coupled with the special trading characteristics of the QQQ options and the underlying QQQs noted above, warrant approval of the Exchange's proposal.<sup>16</sup>

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice of filing

<sup>16</sup> Of course, the Commission expects that ISE will take prompt action, including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in the underlying QQQ, should any unanticipated adverse market effects develop due to the increased limits.

thereof in the **Federal Register**. The Commission notes that under the current Exchange rules, the position and exercise limits applicable to QQQ options is 75,000 contracts. However, due to a 50% reduction in the value of the underlying QQQ on March 20, 2000, the limit was adjusted to 150,000 contracts. The position and exercise limits are scheduled to revert back to 75,000 contracts after the January options expiration occurring on January 18, 2002. The Commission notes that limits of 75,000 contracts for the QQQ options could reduce depth and liquidity in the QQQ market. The Commission believes for the reasons noted above that it is appropriate to approve this proposed rule change increasing the position and exercise limit to 300,000 contracts on January 18, 2002. Accordingly, the Commission finds that there is good cause, consistent with section 6(b)(5) of the Act,<sup>17</sup> to approve the proposal on an accelerated basis.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-ISE-2001-26) is hereby approved, as amended, on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45299; File No. SR-MBSCC-2001-02]

### Self-Regulatory Organizations; MBS Clearing Corporation; Notice of Filing of a Proposed Rule Change Implementing a Real-Time Trade Matching Service

January 17, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on September 19, 2001, MBS Clearing Corporation ("MBSCC") filed with the Securities and Exchange Commission ("Commission") and on September 26, 2001, amended the proposed rule change as described in Items I, II, and III below, which Items have been prepared primarily by MBSCC. The Commission is publishing this notice to

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 17 CFR 200.30-3(a)(12)

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

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 will implement a real-time trade matching service.

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

In its filing with the Commission, MBSCC 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. MBSCC 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

In furtherance of MBSCC's mission to reduce the costs and risks associated with trading in the mortgage-backed securities market, MBSCC has enhanced its services to enable its participants to submit executed trade terms and to receive comparison results from MBSCC in a more timely manner. The cornerstone of this objective is the implementation of the Real-Time Trade Matching ("RTTM") service that will replace MBSCC's current twice-daily match process with respect to trade input information. MBSCC anticipates that the RTTM service will provide more certainty, will reduce execution/market risk, and will eliminate the redundancy between the verbal checkout process (which is described below) and the current MBSCC matching process.<sup>3</sup>

MBSCC's objective in implementing the RTTM service is to match all trade input in real-time within minutes of trade execution while providing participants with the greatest flexibility and least amount of disruption in the

<sup>2</sup> The Commission has modified parts of these statements.

<sup>3</sup> One of the main objectives of the RTTM service is to significantly reduce the risks associated with a prolonged period of time between trade execution and achievement of legal and binding confirmation. The elapsed time between trade execution and verbal checkout, followed by a legal and binding confirmation, is a known and serious risk to the ultimate settlement of the trade for all trading organizations. Reducing the elapsed time between trade execution and achievement of a legal and binding confirmation increases certainty and reduces risk.

migration towards this goal. MBSCC will retire its batch trade matching process with respect to trade input information upon implementation of the RTTM service. All trade activity for all participants, regardless of the form of trade input, will be matched solely by the RTTM service upon its implementation. Therefore, participants that increase the frequency of submission and reconciliation throughout the business day will be able to realize the benefits of the RTTM service.

#### MBSCC's Current Matching Process

Currently, MBSCC participants submit details of executed trades daily to MBSCC by means of terminal or batch submissions. While participants may submit trade input to MBSCC anytime during published business hours, MBSCC performs its matching process of participant submitted data twice per day: at 10:30 a.m. ("AM Pass") and at 11:30 p.m. ("PM Pass").

Output reports/files detailing the results of the matching process are available to participants at 11:30 a.m. for the AM Pass and at 4:00 a.m., for the PM Pass. The primary outputs are the "Purchase and Sale Report" listing submitted trades that successfully compared and the "Transaction Summary Report" listing, among other things, submitted trades that did not compare. The Purchase and Sale Report serves as the sole and binding confirmation of trades and provides data for Rule 10b-10 compliance purposes as well.

Given that the majority of trades are submitted after the AM Pass, the timing limitations of a twice-daily matching/reporting process mean that participants generally are notified, at the earliest, that a trade has achieved "binding confirmation" status during the morning following submission to MBSCC. To overcome this time delay, participants engage in a process known as "verbal checkout." Shortly after execution, participants contact each other and verbally confirm executed trade details. The verbal checkout process is important to participants to ascertain, with some degree of certainty, their intraday trading positions. While generally effective, the verbal checkout process is cumbersome, error-prone, and lacks the "binding" status afforded by the two-sided matching and confirmation through MBSCC.

#### The RTTM Service and the Requisite Rules Changes

In order to provide more certainty, to reduce execution/market risk, and to eliminate the redundancy between the

verbal checkout process and MBSCC's trade input matching process, MBSCC will offer the RTTM service. As stated above, MBSCC currently processes transaction information in two batch processing passes. One segment of that processing, the matching of trade input information, will be processed by the RTTM service. The other segments of the daily processing, including the matching of clearance information, will continue to be done in either one or both of the two existing batch processing passes.

The RTTM service will provide trade input matching for dealer-to-dealer trades and inter-dealer broker trades. The RTTM service will support all of the trade types currently supported by MBSCC (settlement balance order destined, trade-for-trade, comparison only, and option) as well as the various trade functions used by participants, such as the "Don't Know" or "DK" function.

Participants will be able to submit transaction information for processing through the RTTM service using the batch file submission method that is used today, which is called "File Transmission Service." In addition, participants will also be able to use a batch file transmission method that employs SWIFT formats, the RTTM terminal service, and interactive messaging. Regardless of the input method, MBSCC will make available to participants real-time updates on all transactions entered into the system.

The following rule changes are necessary to accommodate the introduction of the RTTM service:

i. *General provisions on the RTTM service:* MBSCC is proposing to add two provisions to its rules to provide generally for the RTTM service. One of these provisions (new Section 1 or Rule 3 of Article II) will provide that MBSCC's comparison of trade input will occur in real time, and the other (new Section 1 of Rule 4 of Article II) will distinguish the RTTM processing from the current processing passes.

ii. *New reports provided by the RTTM service:* MBSCC's RTTM processing will produce output via the RTTM terminal service as well as via interactive messages. MBSCC is proposing to add a definition for the term "Report" to encompass any type of output in any form that is provided by MBSCC to its participants. As a result specifically of RTTM processing, there will be "Reports" that will indicate the transactions whose trade input has compared ("RTTM Compare Reports"),<sup>4</sup>

and "Reports" that will indicate the transactions whose trade input has not compared ("RTTM Uncompare Reports").

iii. *Changes to existing reports:* MBSCC will continue to provide the reports that are created as a result of its current two processing passes, with some modifications in one case. The Purchase and Sale Report details the results of the current batch trade processing, which includes the matching of trade input submissions, as well as the matching of clearance information. No changes are proposed to the information provided by the Purchase and Sale Report. Like the Purchase and Sale Report, the Transaction Summary Report is also provided as a result of the current twice-daily processing passes. Upon implementation of RTTM processing, the Transaction Summary Report will no longer provide details of unmatched trade terms. Unmatched trade terms will be available to participants via the RTTM Uncompare Reports (which as stated above, will be in the form of output provided by MBSCC via the RTTM terminal service as well as via interactive messages). MBSCC is proposing to modify its rules to delete references to the Transaction Summary Report as notification of unmatched trades and to provide for this notification to occur by means of the RTTM Uncompare Reports.

iv. *Sole and binding confirmation of trades:* The rules currently provide that the Purchase and Sale Report is the sole and binding confirmation of the trade. In addition, the Purchase and Sale Report currently fulfills Rule 10b-10 requirements for generation of trade confirms. As stated above, upon implementation of RTTM, the Purchase and Sale Report will continue to be purchased twice daily displaying matched trades. Participants will, however, have received notice of trade input matching prior to the production of the Purchase and Sale report by means of the RTTM Compare Reports. To enable participants to rely upon the results of the RTTM processing, MBSCC is proposing to amend its rules to confer sole and binding trade confirmation status on the RTTM Compare Reports. Since the Purchase and Sale Report covers the matching of clearing information (which is not covered by the RTTM processing and thus would not be reported in the RTTM Compare Reports), it will remain the sole and binding confirmation with respect to that information. The Purchase and Sale Report will remain the Rule 10b-10 complaint confirmation.

<sup>4</sup> These reports will also indicate cancellations of previously compared trades.

v. *Trade input submission by inter-dealer brokers ("IDBs")*: Certain RTTM trade input formats require that an IDB submit two separate transactions linked together by a common reference number per trade. Under the current trade submission format, IDBs submit two transactions, one identifying one dealer (buyer) and one identifying the other dealer (seller), on give-up trades. The rule on IDB trade input (current Section 1 of Rule 3of Article II) speaks generally in terms of trade input and does not specify the number of submissions required. The only rule change that is proposed in this respect is a reference to MBSCC's procedures, which will describe in detail the trade input submission requirements.

vi. *Retirement of maximum match mode*: MBSCC's rules provide that each dealer must select a match mode to govern the comparison of each such dealer's MBSCC-eligible transactions involving an IDB. The rules currently provide for three match modes: the exact match mode, the net position match mode, and the maximum match mode.<sup>5</sup> Upon implementation of the RTTM service, only the exact and net position match modes will be available. MBSCC is proposing to retire the maximum match mode due to lack of participant demand for this feature. The proposed rule changes delete all references to the maximum match mode.

vii. *Review of reports by participants*: MBSCC's rules currently contain a provision that requires participants and limited purpose participants to review the reports that they receive from MBSCC. MBSCC desires to expand the provision to cover any type of communication provided to participants by MBSCC and to require participants to inform MBSCC promptly, and in no event later than ten calendar days upon receipt of the communication, if there is any error, omission, or other problem with respect to the communication. MBSCC believes that the ten-day

<sup>5</sup> The "exact match mode" means that trade input that matches in all other respects will be compared only if the par amount of the eligible securities reported to have been sold or purchased by the dealer for a particular transaction is identical to the par amount of a particular transaction reported by the broker. The "net position match mode" means that trade input that matches in all other respects will be compared only if the aggregate par amount of one or more transactions in eligible securities reported to have been sold or purchased by the dealer equals the aggregate par amount for one or more transactions reported by the broker. The "maximum match mode" means that trade input that matches in all other respects will be compared to the extent that the par amount of eligible securities reported to have been sold or purchased by the dealer does not exceed the aggregate par amount for one or more transactions reported by the broker with transactions reported by the broker in any excess par amount remaining uncompar-

timeframe will provide participants with a sufficient amount of time within which to detect problems in a communication from MBSCC.

viii. *New definitions*: MBSCC is proposing to add definitions for the following new terms: "Real Time" and "RTTM Processing" to encompass the new real-time processing concepts that will be introduced in the rules; "RTTM Compare Report" and "RTTM Uncompare Report" to specify the reports that will be available under the RTTM service; and "Report" to encompass all of the different types of output that can be provided by MBSCC to participants. The proposed amendments to existing definitions are incidental to the changes described above.

ix. *Amendment to MBSCC's Schedule of Charges for IDBs*: MBSCC is proposing to amend its Schedule of Charges to give IDBs a service-fee based incentive to move to interactive messaging. MBSCC believes that it is important to offer the incentive to its IDB participants because their early participation is critical to a successful implementation of the RTTM service. From a dealer perspective, lack of participation by one or more of the IDBs severely dilutes the benefits the dealer will gain from RTTM usage because a large percentage of the dealers' matching activity is against IDBs. The perception of reduced benefit leads to delays in dealer participation and a protracted rollout process. Therefore, MBSCC is proposing to waive, for a period of one year commencing with putting the RTTM service into production, all trade recording "Give-Up Trade Create" fees for IDBs that participate in MBSCC's testing (or "beta") phase of the RTTM service and subsequently move to production (IDBs must be interactive in order to participate in the testing phase, which is scheduled to take place during the first quarter of 2002).

The proposed rule change is consistent with the requirements of Section 17A of the Act and the rules and regulations thereunder, because they will reduce execution/market risk and eliminate the redundancy between the verbal checkout process and MBSCC's trade input matching process.

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

MBSCC does not believe that the proposed rule change will have any impact or impose any 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. MBSCC will notify the Commission of any written comments received by MBSCC.

**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 MBSCC consents, the Commission will:

(a) By order approve the 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 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 will also be available for inspection and copying at the principal office of MBSCC. All submissions should refer to file No. SR-MBSCC 2001-02 and should be submitted by February 15, 2002.

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