

[Release No. 34-37616; File Nos. SR-MBSCC-96-02; SR-GSCC-96-03, and SR-ISCC-96-04]

Self-Regulatory Organizations; MBS Clearing Corporation, Government Securities Clearing Corporation, and International Securities Clearing Corporation; Order Approving Proposed Rule Changes Seeking Authority to Enter Into Limited Cross-Guarantee Agreements

August 28, 1996.

On April 11, 1996, May 10, 1996, and May 16, 1996, the MBS Clearing Corporation ("MBSCC"), the Government Securities Clearing Corporation ("GSCC"), and the International Securities Clearing Corporation ("ISCC") (collectively referred to as the "clearing corporations"), respectively, filed with the Securities and Exchange Commission ("Commission") the proposed rule changes (File Nos. SR-MBSCC-96-02, SR-GSCC-96-03, and SR-ISCC-96-04) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ On May 13, 1996, GSCC filed an amendment to the proposed rule change to a change the specific rule numbers used in the proposed rule change.² On July 2, 1996 and on July 8, 1996, ISCC and GSCC, respectively, filed amendments to their proposed rule changes to make certain technical corrections.³ Notice of the proposed rule changes was published in the Federal Register on July 15, 1996.⁴ The Commission received no comments. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description of the Proposals

The purpose of the proposed rule change is to modify the clearing corporations' rules to enable them to enter into limited cross-guarantee agreements with other clearing agencies. Generally, limited cross-guarantee agreements contain a guarantee from one clearing agency to another clearing agency that can be invoked in the event of a default of a common member. The guarantee provides that resources of a defaulting common member remaining

after the defaulting common member's obligations to the guaranteeing clearing agency have been satisfied will be used to satisfy the obligations of the defaulting common member that remain unsatisfied at the other clearing agency. The guarantee is limited to the amount of a defaulting common member's resources remaining at the guaranteeing clearing agency.

Generally, limited cross-guarantee agreements should be beneficial to the clearing corporations because amounts available under limited cross-guarantee agreements may be applied to unpaid obligations of the defaulting participant. With regard to GSCC, these amounts may reduce possible pro rata allocations against original counterparties of the defaulting participant. Similarly, these amounts available to ISCC may reduce the possibility of pro rata charges against its clearing fund. Furthermore, even though MBSCC does not mutualize risk, these amounts may reduce allocations against and losses of the original contrasides of a defaulting participant.

The benefits generally accruing to the clearing corporations from a limited cross-guarantee agreement are illustrated by the following example:

Dealer A, a common participant of Clearing Agency X and Clearing Agency Y, declares bankruptcy. Upon insolvency, Dealer A owes Clearing Agency Y \$10 million and Clearing Agency X owes A \$7 million. In the absence of an interclearing agency limited cross-guarantee agreement, Clearing Agency X would be obligated to pay \$7 million to Dealer A's bankruptcy estate and Clearing Agency Y would have a claim for \$10 million against Dealer A's bankruptcy estate as a general creditor with no assurance as to the extent of recovery. However, an effective cross-guarantee arrangement would obligate Clearing Agency X to pay Clearing Agency Y an amount equal to Dealer A's \$7 million receivable from Clearing Agency X thereby reducing Clearing Agency Y's net exposure from to \$10 million to \$3 million. This approach would enable Clearing Agency Y to secure earlier payment and would allow Clearing Agency X to fulfill its obligations without making an actual payment to Dealer A's bankruptcy estate.

The benefits specifically accruing to MBSCC from a limited cross-guarantee agreement are illustrated by the following example:

A sells to B who sells to C. A also sells to X who sells to Y; and A also sells to Q. B and X net out, leaving obligations of A owing to C, Y, and Q. A becomes insolvent. Under MBSCC's rules, if A's participants fund contribution is not adequate to cover the aggregate of C's and Y's losses, then B, X, and Q as original contrasides would be responsible for covering such losses. However, before allocating C's and Y's aggregate loss to B, X, and Q, MBSCC may

obtain resources under a limited cross-guarantee agreement to reduce, if not eliminate, the amount of such allocations. If those resources are sufficient to satisfy C's and Y's losses, any remaining funds would also be available for the satisfaction of Q's losses.

The limited cross-guarantee agreements are designed to preserve substantial flexibility to the counterparty clearing corporation. The agreements will provide a list of all the limited cross-guarantee agreements to which the clearing agencies are a party, including the counterparties to those agreements. The agreements will set forth the clearing agency's priority structure with respect to the order in which it will make guarantee payments to its counterparty clearing agencies (if more than one exist) in the event of a defaulting common participant. GSCC intends to prioritize its counterparty clearing agencies in the following manner: (1) pro rata to those counterparty clearing agencies with a transactional nexus to GSCC; (2) the National Securities Clearing Corporation; and (3) pro rata to all other counterparty clearing agencies.⁵

An additional source of flexibility in a limited cross-guarantee agreement is the length of time within which a demand for payment must be made. This period is negotiated and agreed to by the counterparty clearing agencies. GSCC believes that an appropriated time period for this purpose is six months.⁶ During this six month period, the limited cross-guarantee agreement would permit recalculations of each clearing agency's available resources and losses.

Accordingly, GSCC's proposed rule change modifies GSCC's rules to establish GSCC to enter into one or more limited cross-guarantee agreements. Proposed GSCC Rule 41 governing limited cross-guarantee agreements provides that a participant is obligated to GSCC for any guarantee payment that GSCC is required to make to a clearing agency pursuant to the terms of any limited cross-guarantee agreement. GSCC's Rule 41 and the proposed modifications to Rule 4, Section 8 provide that amounts received by GSCC under any limited cross-guarantee agreement will be applied to the common participant's unpaid obligations to GSCC and will reduce assessments against original counterparties of the defaulting

¹ 15 U.S.C. § 78s(b)(1) (1988).

² Letter from Karen Walraven, Vice President and Associate Counsel, GSCC, to Jerry Carpenter, Assistant Director, Division of Market Regulation ("Division"), Commission (May 13, 1996).

³ Letter from Julie Beyers, ISCC, to Peter Geraghty, Special Counsel, Division, Commission (July 1, 1996) and letter from Karen Walraven, Vice President and Associate Counsel, GSCC, to Peter Geraghty, Special Counsel, Division, Commission (July 2, 1996).

⁴ Securities Exchange Act Release No. 37413 (July 9, 1996), 61 FR 1199.

⁵ At this time, MBSCC and ISCC have not determined the priority structures of their limited cross-guarantee agreements.

⁶ At this time, MBSCC and ISCC have not determined a specific recovery period for their limited cross-guarantee agreements.

participant. The proposed rule change also modifies GSCC's Rule 1 to add definitions of the terms "common member," "cross-guarantee obligation," "cross-guarantee party," "defaulting common member," "defaulting member," and "limited cross-guarantee agreement." GSCC also is proposing to amend Rule 4, Section 6 to clarify that liabilities of GSCC include limited cross-guarantee payments made to a counterparty clearing agency pursuant to a limited cross-guarantee agreement.⁷

MBSCC's proposed rule change will add new Rule 4 to Article III of MBSCC's rules. The new rule will enable MBSCC to enter into one or more limited cross-guarantee agreements. The new rule provides that a former participant⁸ is obligated to MBSCC for any guarantee payment MBSCC is required to make to a clearing agency pursuant to the terms of any limited cross-guarantee agreement. The new rule also provides that amounts received by MBSCC under any limited cross-guarantee agreement will be applied to unpaid obligations of the former participant to MBSCC and to reduce assessments against and losses of original contraside participants. A technical modification will be made to renumber current Rule 4 of Article III as Rule 5. MBSCC's proposed rule change also modifies Rule 1 of Article I of MBSCC's rules to add definitions of the terms "limited cross-guarantee agreement," "cross-guarantee obligation," and "cross-guarantee party." MBSCC's proposed rule change also modifies Chapter VI of MBSCC's procedures relating to application of the participants fund to reflect that amounts received by MBSCC under any limited cross-guarantee agreement will be applied to unpaid obligations of a former participant of MBSCC and to reduce assessments against and losses of original contraside participants.⁹

ISCC's proposed rule change will add new Rule 13 to ISCC's rules. The new rule provides that an ISCC member is obligated to ISCC for any guarantee payment ISCC is required to make to a

clearing agency pursuant to the terms of any limited cross-guarantee agreement. ISCC's proposed rule change also modifies ISCC's rules to indicate that amounts available to satisfy aggregate losses will include amounts available under limited cross-guarantee agreements. ISCC's proposal also modifies ISCC's Rule 1 to add definitions of the terms "limited cross-guaranty agreement," "cross-guaranty obligation," and "cross-guaranty party."¹⁰

II. Discussion

Section 17A(b)(3)(F) of the Act¹¹ requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions. The Commission believes the proposals are consistent with each clearing corporation's obligation to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible because cross-guarantee agreements among clearing agencies are a method of reducing clearing agencies' risk of loss due to a common member's default. Furthermore, the Commission has encouraged the use of cross-guarantee agreements and other similar arrangements among clearing agencies.¹² Consequently, cross-guarantee agreements should assist clearing agencies in assuring the safeguarding of securities and funds in their custody or control.

The Commission also believes the proposals are consistent with each clearing corporation's obligation to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions. The Commission believes that by entering into such cross-guarantee agreements, clearing corporations can mitigate the systemic risks posed to an individual clearing corporation and to the national clearance and settlement system as a result of a defaulting common member.

⁷ The definitions of the terms described above as well as the specific changes to GSCC's rules and procedures are attached as Exhibit A to GSCC's proposed rule change which is available through GSCC or through the Commission's public reference room.

⁸ Under Section 10 of Rule 3 of Article III of MBSCC's rules, the term "former participant" is defined as a participant for whom MBSCC has ceased to act pursuant to Sections 1 and 2 of Rule 3 of Article III.

⁹ The definitions of the terms described above as well as the specific changes to MBSCC's rules and procedures are attached as Exhibit A to MBSCC's proposed rule change which is available through MBSCC or through the Commission's public reference room.

¹⁰ The definitions of the terms described above as well as the specific changes to ISCC's rules and procedures are attached as Exhibit A to ISCC's proposed rule change which is available through ISCC or through the Commission's public reference room.

¹¹ 15 U.S.C. § 78q-1(b)(3)(F) (1988).

¹² E.g., Securities Exchange Act Release Nos. 36431 (October 27, 1995), 60 FR 55749 [File No. SR-GSCC-95-03] and 36597 (December 15, 1995), 60 FR 66570 [File No. SR-MBSCC-95-05] (orders approving proposed rule changes authorizing the release of clearing data relating to participants).

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposals are consistent with the requirements of the Act, and in particular with 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 changes (File Nos. SR-MBSCC-96-02, SR-GSCC-96-03, and SR-ISCC-96-04) be, and hereby are, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37622; File No. SR-OCC-96-10]

Self-Regulatory Organizations; the Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to a Laptop Version of the Enhanced Clearing Member Interface Platform

August 29, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on July 18, 1996, The Options Clearing Corporation ("OCC") 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 OCC. 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 amend OCC's rules and schedule of fees to provide a laptop version of the Enhanced Clearing Member Interface ("ECMI") platform.

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

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments that it received on the proposed rule change. The text of these

¹³ 17 CFR 200.30-3 (a)(12) (1995).

¹ 15 U.S.C. 78s(b)(1) (1988).