

relevant security by GSCC's liquidity bank. Furthermore, GSCC retains the right to refuse to accept particular types of collateral for liquidity or other reasons upon action by its Board of Directors. Such refusal could arise under a variety of circumstances such as GSCC's liquidity bank's reluctance to accept a certain type of security as collateral for an extension of credit.

B. Loss Allocation

Rule 20, Section 4(c) of GSCC's rules provides that upon a member's default GSCC will close out the positions of the defaulting member. If the close out of all the defaulting member's positions results in GSCC incurring a loss, that loss will be allocated pursuant to GSCC Rule 4.

Under Section 8 of Rule 4, GSCC looks first to the defaulting member's clearing fund collateral. If the defaulting member's collateral does not fully cover GSCC's loss, GSCC determines the proportion of the remaining loss that arose in connection with non-brokered (*i.e.*, direct) transactions and the proportion that arose in connection with brokered transactions. Brokered transactions are categorized as either brokered transactions involving only GSCC members or brokered transactions involving a nonmember on one side of the trade. After the brokered and non-brokered proportions are determined, the remaining loss is allocated among participants based largely upon their trading activity with the defaulting member netted and novated on the day of default.⁷

⁷To the extent a remaining loss is determined to arise in connection with non-brokered transactions (*i.e.*, direct transactions), the loss is allocated pro rata among netting members other than interdealer brokers based on the dollar value of the trading activity of each such netting member with the defaulting member netted and novated on the day of default. If the loss is determined to arise in connection with member brokered transactions, GSCC allocates ten percent of the loss to the interdealer broker netting members on an equal basis regardless of the level of trading activity of each such broker with the defaulting member. The remainder of the loss is divided pro rata among all other netting members based upon the dollar value of each netting member's trading activity through interdealer brokers with the defaulting member netted and novated on the day of default. If the loss is determined to arise in connection with nonmember brokered transactions, GSCC allocates ten percent of the loss to the interdealer broker netting members on an equal basis regardless of the level of trading activity of each such broker with the defaulting member. The remainder of the loss is allocated pro rata among the Category 2 interdealer broker netting members that were parties to such nonmember brokered transactions based upon the dollar value of each such broker member's trading activity with the defaulting member netted and novated on the day of default. Category 1 interdealer brokers act exclusively as brokers and trade only with netting members and with certain grandfathered nonmember firms. Category 2

GSCC Rule 4, Section 8(a)(v) defines "trading activity with the defaulting member netted and novated on the day of default" as trading activity with a defaulting member submitted by a netting member that was compared, entered GSCC's net system, and was novated on the business day on which the failure of the defaulting member to fulfill its obligations to GSCC occurred. However, if the aggregate level of such trading activity was less than the dollar value amount of the defaulting member's securities liquidated pursuant to GSCC's close out procedure, the term had encompassed trading activity going back as many days as was necessary to reach a level of activity that was equal to or greater than the dollar value amount of such liquidated securities. The proposed rule change modified the concept of "trading activity with the defaulting member netted and novated on the day of default" to capture a level of trading activity that is at least five times the dollar value amount of the securities of the defaulting member that are liquidated.⁸

II. Discussion

The Commission finds that the proposed rule change is consistent with the Act, and specifically with Section 17A(b)(3)(F).⁹ Section 17A(b)(3)(F) requires 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 expansion of GSCC's acceptable clearing fund collateral will help to assure the safeguarding of securities because it should provide GSCC's members with more flexibility in meeting their clearing fund obligations with risk levels that should not be significantly higher than those present under the current clearing fund collateral definition. GSCC is limiting the potential for liquidity and price volatility risks in this regard by applying haircut percentages to each type of security accepted as clearing

interdealer brokers are permitted to have up to ten percent of their business with nonnetting members other than grandfathered nonmembers. GSCC has filed a proposal to amend certain aspects of the loss allocation provisions related to the percentage of the loss allocated to interdealer brokers. Securities Exchange Act Release No. 37565 (August 14, 1996), 61 FR 43103.

⁸The five-fold multiple is based on the approximate netting factor of eighty percent. Historically, the aggregate transactions processed through GSCC's netting system net down to approximately twenty percent of the aggregate transactional volume (*i.e.*, for approximately every five transactions that enter the netting process, only one needs to be settled through the movement of securities and cash).

⁹ 15 U.S.C § 78q-1(b)(3)(F) (1988).

fund collateral. GSCC also will retain the right to refuse to accept particular types of collateral for liquidity or other reasons.

The Commission believes that GSCC's modifications to its loss allocation procedures also will help to assure the safeguarding of securities or funds in its control or for which it is responsible. Expanding the amount of trading that will be encompassed for loss allocation purposes should spread out the loss among a greater number of participants and thus decrease the likelihood that any one participant will be disproportionately affected. As a result, GSCC should be in a better position to collect such funds should the need ever arise. Because the rule change also results in participants having potential liability for trades entered into with a failing participant over a greater time period, it should encourage participants to assess the creditworthiness of their counterparties more carefully. As a result, the level of risk of the trades submitted to GSCC should be reduced, and GSCC's ability to safeguard securities and funds should be enhanced.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with Section 17A of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-GSCC-96-05) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37829; File No. SR-NSCC-96-13]

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving a Proposed Rule Change Relating to the Guarantee of When-Issued and Balance Order Trades

October 16, 1996.

On June 21, 1996, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-

¹⁰ 17 CFR 200.30-3(a)(12) (1996).

NSCC-96-13) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ to modify its rules and procedures to guarantee when-issued and when-distributed (collectively, "when-issued"), and balance order trades. On August 2, 1996, NSCC amended the proposal ("Amendment No. 1").² Notice of the proposal was published on August 19, 1996, in the Federal Register to solicit comments on the proposed rule change.³ On August 6 and August 9, NSCC amended the filing to clarify certain terms ("Amendment No. 2" and "Amendment No. 3"),⁴ and on August 14, 1996, NSCC submitted an amendment replacing Exhibit A to the original filing as amended by Amendment No. 1.⁵ No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

NSCC's proposed rule change modifies NSCC's rules and procedures to guarantee when-issued⁶ and balance order trades at the same point in the clearance and settlement process as it guarantees regular-way trades in the Continuous Net Settlement ("CNS") accounting operation.⁷ NSCC will collateralize its increased exposure resulting from the modification of its guarantee of when-issued and balance order trades by collecting clearing fund based on market risk and liquidation risk.⁸ Generally, with respect to CNS

trades, the calculation of the market risk component is based on a rolling average of the prior twenty days market-to-market differential. This is the method NSCC will use for calculating market risk for balance order trades. For when-issued, NSCC will base its calculation of market risk on the market-to-market differential for the previous business day only. A market-to-market differential based on the previous business day only for when-issued trades is necessary because of the typically more volatile nature of when-issued trades.

The calculation of the liquidation risk component for CNS trades is based on all pending trades and failed trades. For when-issued trades, NSCC will base its calculation of the liquidation risk component only upon pending when-issued trades. For balance order trades, NSCC will base its calculation of the liquidation risk component on all pending balance order trades and failed trades to the extent the contra-party to any such failed trade is a regional interface account.

Accordingly, NSCC is modifying Addendum M to its Rules and Procedures, Statement of Policy in Relation to the Completion of Pending CNS Trades, to delete the language that excepts when-issued trades from NSCC's policy of guaranteeing the completion of CNS trades as of midnight of the day the trades are reported to members as compared. NSCC further is modifying Addendum M to include a statement of its policy of guaranteeing the completion of when-issued trades as of midnight of the day trades are reported to members as compared/recorded.

NSCC is modifying Addendum K to its Rules and Procedures, Interpretation of the Board of Directors—Application of Clearing Fund, to reflect that NSCC will guarantee the completion of balance order trades as of midnight of the day such trades are reported to members as compared/recorded through the close of business of T+3 regardless of whether the member could have made delivery on T+3. Addendum K

will be modified further to include a statement of its policy of guaranteeing the completion of when-issued trades as of midnight of the day the trades are reported to members as compared/recorded. NSCC also is modifying Addendum K to state that it will consider all when-issued trades of members as if the trades were CNS transactions for purposes of clearing fund calculations and surveillance regardless of the accounting operation in which the trades ultimately settle.

Because NSCC is guaranteeing three different types of transactions, Procedure XV, Clearing Fund Formula and Other Matters, is being modified to specifically include the calculations described above for when-issued and balance order trades. NSCC also is modifying Addendum B, Standards of Financial Responsibility-Operational Capability. NSCC is adding language to Procedure XV, Clearing Fund Formula and Other Matters, to clarify that unless it determines otherwise, the mark-to-market component of the clearing fund formula for when-issued and when-distributed transactions is the daily market differential while CNS and balance order trades use a rolling twenty day average of such mark-to-market differential.

II. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder and particularly with the requirements of Sections 17A(b)(3) (A) and (F).⁹ Sections 17A(b)(3) (A) and (F) require that the rules of a clearing agency be designed to safeguard securities and funds in its custody or control or for which it is responsible.

The Commission believes that by guaranteeing when-issued trades and balance order trades, NSCC is providing its members with greater certainty in the settlement of such trades. Furthermore, NSCC is collateralizing the increased exposure of guaranteeing when-issued and balance order trades as of midnight on the day trades are reported to members as compared by collecting clearing fund on those trades based on market and liquidation risk. The Commission believes that the collection of clearing fund for these trades will reduce the risk to NSCC and its participants with regard to member default thereby assuring the safeguarding of securities and funds in the custody or control of NSCC or for which it is responsible.

¹ 15 U.S.C. § 78s(b)(1) (1988).

² Letter from Julie Beyers, Associate Counsel, NSCC, to Jerry Carpenter, Commission (August 1, 1996).

³ Securities Exchange Act Release No. 37549 (August 9, 1996), 61 FR 92927.

⁴ Letters from Julie Beyers, Associate Counsel, to Peggy Blake, Commission (August 6, 1996, and August 9, 1996). The Commission did not notice the amendments for comment because they were technical in nature and not substantive.

⁵ Letter from Julie Beyers, Associate Counsel, NSCC, to Jerry Carpenter, Assistant Director, Division of Risk Management and Control, Commission (August 13, 1996).

⁶ NSCC Amendment No. 3 defines a when-issued transaction as a transaction in a security which has occurred prior to the issuance of such security and is determined to be a when-issued transaction by the marketplace or exchange on which it trades.

⁷ NSCC Amendment No. 3 defines a when-distributed transaction as a transaction in a security which has occurred prior to the initial distribution of such security and is determined to be a when-distributed transaction by the marketplace or exchange on which it trades.

⁸ Regular-way CNS trades are guaranteed as of midnight on the day the trades are reported to members as compared/recorded.

⁹ In File No. SR-NSCC-96-11, NSCC amended Procedure XV, Clearing Fund Formula and Other Matters, to define the market risk component of the CNS portion of the clearing fund formula as requiring each NSCC member to contribute to the clearing fund an amount approximately equal to the net of each day's difference between the contract price of pending compared CNS trades which have

not as yet reached settlement and the current market price for such trades provided that they will exclude any trades for which under a clearing agency cross-guarantee agreement NSCC has either obtained coverage for such difference or undertaken an obligation to provide coverage for such difference. In addition to protect against liquidation risk, NSCC will collect .25% of the net of all compared pending CNS trades and open CNS positions. Securities Exchange Act Release No. 37731 (September 26, 1996), 61 FR 51731 (Order approving proposed rule change relating to an amended restated options exercise settlement agreement between The Options Clearing Corporation and NSCC). See also current NSCC Procedure XV, Sections A.1.(a)(1)(b) and A.1.(a)(1)(c).

⁹ 15 U.S.C. §§ 78q-1(b)(3) (A) and (F) (1988).

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with Sections 17A(b)(3) (A) and (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 change (File No. SR-NSCC-96-13) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37824; File No. SR-ODD-96-1]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Supplement to Options Disclosure Document Regarding Flexible Exchange Options ("FLEX Options")

October 15, 1996.

On October 4, 1996, The Options Clearing Corporation ("OCC") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Rule 9b-1 under the Securities Exchange Act of 1934 ("Act"),¹ five definitive copies of a Supplement to its options disclosure document ("ODD"), which describes, among other things, the risks and characteristics of trading in flexibly structured options overlying individual stocks ("FLEX Equity Options").

The ODD currently contains general disclosures on the characteristics and risks of trading flexibly structured options ("FLEX Options"). At the time the FLEX Options disclosure was approved,² the Commission had approved Exchange proposals to trade FLEX Options overlying particular indexes ("FLEX Index Options"). Since that time, the Commission has approved Exchange proposals to trade FLEX Equity Options.³ OCC now proposes

this Supplement, which is to be read in conjunction with the more general ODD entitled "Characteristics and Risks of Standardized Options," that provides disclosures to specifically accommodate the introduction of FLEX Equity Options and to reflect current rules of the options markets on which FLEX Equity Options are traded.⁴ Pursuant to Rule 9b-1, the Supplement will have to be provided to investors in FLEX Equity Options before their accounts are approved for FLEX Equity Options transactions or their orders for FLEX Equity Options are accepted.

The Commission has reviewed the ODD Supplement and finds that it complies with Rule 9b-1 under the Act. The Supplement is intended to be read in conjunction with the ODD, which discusses the characteristics and risks of options, including FLEX Options, generally. The Supplement provides additional information regarding FLEX Equity Options sufficient to further describe the special characteristics and risks of these products.

Rule 9b-1 provides that an options market must file five preliminary copies of an amended ODD with the Commission at least 30 days prior to the date definitive copies of the ODD are furnished to customers, unless the Commission determines otherwise, having due regard to the adequacy of information disclosed and the protection of investors.⁵ The Commission has reviewed the Supplement, and finds that it is consistent with the protection of investors and in the public interest to allow the distribution of the Supplement as of the date of this order.

It is therefore ordered, pursuant to Rule 9b-1 under the Act,⁶ that the proposed Supplement regarding FLEX Equity Options is approved, on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

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pursuant to Rule 9b-1 under the Act. *See also* Securities Exchange Act Release No. 37630 (September 3, 1996) (File No. SR-OCC-96-03).

⁴ *See e.g.*, Securities Exchange Act Release No. 37726 (September 25, 1996) (File Nos. SR-Amex-96-29, SR-CBOE-96-56, and SR-PSE-96-31) (order approving proposals to restrict the available exercise prices for FLEX equity call options).

⁵ This provision is intended to permit the Commission either to accelerate or extend the time period in which definitive copies of a disclosure document may be distributed to the public.

⁶ 17 CFR 240.9b-1.

⁷ 17 CFR 200.30-3(a)(39).

[Release No. 34-37838; File No. SR-PHLX-96-42]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Limiting Time for Submission of Settlement Offers

October 17, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on September 27, 1996, the Philadelphia Stock Exchange, Inc. ("PHLX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. 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

Currently, PHLX Rule 960.7, "Offers of Settlement," allows a respondent in any proceeding under the PHLX's disciplinary rules to submit a written settlement offer to the Exchange's Business Conduct Committee ("BCC") at any time during the course of the proceeding. The PHLX proposes to amend PHLX Rule 960.7 to limit the time when a respondent may submit a written settlement offer to the BCC to within 120 calendar days immediately following the date of service of the statement of charges upon the respondent. Under the proposal, the Exchange may schedule a hearing during the 120-day period immediately following the date of service of the statement of charges or as soon as practicable thereafter. The BCC may consider a settlement offer submitted after the 120-day period as long as consideration of the offer does not delay the hearing in the matter.

The text of the proposed rule change is available at the Office of the Secretary, PHLX, and at the Commission.

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

In its filing with the Commission, the self-regulatory organization 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.