

[Release No. 34-37996; File No. SR-GSCC-96-11]

**Self-Regulatory Organizations;
Government Securities Clearing
Corporation; Notice of Filing and Order
Granting Accelerated Approval of a
Proposed Rule Change To Extend the
Maximum Term for Next-Day and
Forward Settling Repurchase and
Reverse Repurchase Agreements**

November 27, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on October 9, 1996, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change (File No. SR-GSCC-96-11) as described in Items I and II below, which Items have been prepared primarily by GSCC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

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

GSCC proposes to amend the eligibility requirements for its netting services to include next-day and forward settling repurchase and reverse repurchase agreements ("repos") with terms that do not exceed 360 calendar days. Under GSCC's current rules, only repos with terms that do not exceed 195 calendar days are eligible for netting services.

**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.²

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

In its rule change filing implementing netting and risk management services

for repos, GSCC added a number of provisions to its Rule 11, including the requirements that a repo must meet in order to be eligible for netting services.³ One such requirement is that the number of calendar days between the scheduled settlement date for the close leg and the business day on which the data on the trade is submitted is not greater than the "maximum number of Business Days established by the Corporation for such purpose and published in a schedule made available to Members, unless the Board determines a different timeframe to be appropriate * * *."⁴

In the above mentioned filing, GSCC initially proposed that the maximum number of days between scheduled settlement and data submission should be no more than 364 calendar days.⁵ After discussion with Commission staff, GSCC revised its rule filing to limit the maximum number of days allowable between scheduled settlement and data submission to 195 calendar days.⁶ Until recently, the maximum permitted term for repos as set forth in GSCC's schedule was 180 calendar days.

In response to rising repo volumes and at the request of GSCC's members, GSCC proposes to extend the maximum allowable number of calendar days that a repo term may span and still be eligible for netting services to 360 calendar days. According to GSCC, its members will benefit from the inclusion of longer-term repos in its netting service because the inclusion of more repo transactions into the net should reduce costs as well as clearance and settlement risks.

The decision to extend the allowable repo term was made following evaluation of GSCC's risk management procedures that pertain to repo transactions. These procedures have been employed since November 1995 when repos were first included in GSCC's netting service. This period of analysis has enabled GSCC to conclude that the risk management procedures currently in place are sufficient to hedge against any exposure created by longer repo terms. Nevertheless, GSCC will

continue to monitor and evaluate all aspects of repo netting services.

GSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act⁷ and the rules and regulations promulgated thereunder because it promotes the prompt and accurate clearance and settlement of securities transactions and safeguards securities and funds in GSCC's custody or control.

**(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 Received From
Members, Participants or Others**

Written comments relating to the proposed rule change have not yet been received. Members will be notified of the rule change filing, and comments will be solicited by an important notice to members. 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**

Section 17A(b)(3)(F) of the Act⁸ requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and 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 proposed rule change is consistent with GSCC's obligations under the Act because the proposal permits GSCC to provide the benefits of centralized, automated settlement to a border segment of repo's involving government securities.

As stated in previous orders, the Commission believes that GSCC has put into place adequate risk management procedures to limit the settlement risk associated with repo transactions.⁹ The Commission believes that GSCC has adequately analyzed the application of these risk management procedures to the risks associated with longer term repo transactions and therefore will be able to adequately safeguard itself and its participants from the risks associated

³ Securities Exchange Act Release No. 36491 (November 17, 1995), 60 FR 61577 [File No. SR-GSCC-95-02] (order approving proposed rule change implementing netting services for the non-same-day-settling aspects of repo transactions).

⁴ GSCC Rule 11, Section 2(i).

⁵ Letter from Jeffrey F. Ingber, General Counsel and Secretary, GSCC, to Jerry W. Carpenter, Assistant Director, Division of Market Regulation ("Division"), Commission (July 28, 1995).

⁶ Letter from Jeffrey F. Ingber, General Counsel and Secretary, GSCC, to Christine Sibille, Special Counsel, Division, Commission (September 14, 1995).

⁷ 15 U.S.C. 78q-1 (1988).

⁸ 15 U.S.C. 78q-1(b)(3)(F) (1988).

⁹ See, e.g., Securities Exchange Act Release No. 36491, *supra* note 3.

¹ 15 U.S.C. 78s(b)(1) (1988).

² The Commission has modified the text of the summaries prepared by GSCC.

with the inclusion of longer term repo transactions in the netting system.

GSCC has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of the filing. The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of the filing because accelerated approval will allow GSCC to immediately expand its netting services to include repos with terms between 196 and 360 calendar days. This will permit more participants that conduct repo transactions to benefit from the positive effects of netting. Furthermore, the Commission has not received any comment letters and does not expect to receive any comment letters on the proposal.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submission should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington D.C. 20549. Copies of the submissions, 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, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filings will also be available for inspection and copying at the principal office of GSCC. All submissions should refer to the file number SR-GSCC-96-11 and should be submitted by December 27, 1996.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (File No. SR-GSCC-96-11) be, and hereby is, approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37995; File No. SR-GSCC-96-07]

Self-Regulatory Organization's; Government Securities Clearing Corporation; Order Approving Proposed Rule Change Modifying the Rights and Responsibilities of Interdealer Broker Netting Members

November 27, 1996.

On July 2, 1996, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-GSCC-96-07) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ to modify the rights and responsibilities of interdealer broker ("IDB") netting members. GSCC amended the filing on July 23, 1996.² Notice of the proposed rule change, as amended, was published in the Federal Register on August 20, 1996.³ On August 16, 1996, and on August 21, 1996, GSCC filed amendments No. 2 and No. 3 to the filing.⁴ Because the amendments were substantive in nature, notice of the proposed amendments was published in the Federal Register on September 12, 1996.⁵ No comment letters were received regarding the proposed rule change or proposed amendments. For the reasons discussed below, the Commission is approving the proposed rule change, as amended.

I. Description

This rule change modifies GSCC's loss allocation and clearing fund requirements for IDBs.⁶ The percentage allocated collectively to IDBs from losses arising from member brokered transactions is raised to fifty percent with a dollar cap on each IDB's potential liability, as discussed below. Each IDB's individual share of the collective broker allocation will be

¹ 15 U.S.C. 78s(b)(1) (1988).

² Letter from Karen Walraven, Vice President and Associate Counsel, GSCC, to Jerry W. Carpenter, Assistant Director, Division of Market Regulation ("Division"), Commission (July 18, 1996).

³ Securities Exchange Act Release No. 37565 (August 14, 1996), 61 FR 43103.

⁴ Letter from Karen Walraven, Vice President and Associate Counsel, GSCC, to Jerry W. Carpenter, Division, Commission (August 12, 1996, and August 15, 1996).

⁵ Securities Exchange Act Release No. 37658 (September 6, 1996), 61 FR 48190.

⁶ Unless otherwise indicated, the term IDB refers to both Category 1 and Category 2 IDBs. Under current rules, Category 1 IDBs act exclusively as brokers, trade exclusively with GSCC netting members and certain grandfathered nonmember firms, and must maintain \$10 million in net or liquid capital. Category 2 IDBs may transact up to 10% of their trading volume with nonmembers and must maintain \$25 million in net worth and \$10 million in excess net or liquid capital.

allocated pro rata based on the dollar value of its trading activity with the defaulting member. By implementing this change, the IDB will no longer be subject to an allocation of a portion of a loss arising from the default of a firm with which the IDB never traded. Because only Category 2 IDBs may enter into brokered transactions with nonmembers,⁷ the entire loss from such a transaction will be allocated among Category 2 IDBs pro rata based on the level of their trading activity with the defaulting member.

Currently, the loss amount allocated to each IDB is capped at \$1.6 million per calendar year for losses attributable to brokered transactions with members. The proposed rule change raises the maximum amount of loss that can be allocated to each IDB to \$5 million per loss allocation event as opposed to a calendar year maximum.⁸

GSCC is raising the clearing fund requirement for Category 1 IDBs from a fixed \$1.6 million to a fixed \$5 million and raising the minimum clearing fund requirement for Category 2 IDBs from \$1.6 million to \$5 million. Under the proposed rule change, at least thirty percent of a Category 1 IDB's clearing fund deposit must consist of cash or eligible netting securities, and no more than seventy percent of the clearing fund deposit may be met by pledging eligible letters of credit. Category 2 IDBs will be subject to the same clearing fund deposit composition requirement as other non-Category 1 IDB netting members, which is ten percent of the required fund deposit (\$500,000) must be in cash, and no more than seventy percent of the total may consist of eligible letters of credit.

Category 1 IDBs are now subject to all of the surveillance requirements of Section 3 of GSCC Rule 4, including GSCC's authority to increase the amount of clearing fund deposit for any IDB on surveillance status. Category 1 IDBs are now required to participate in the daily funds-only settlement process. In addition, the proposed rule change eliminates the exception in Section 3 of GSCC Rule 11 that permitted IDBs to exclude trades from GSCC's netting system if the inclusion of such trade would have resulted in the IDB having a net settlement position other than zero. GSCC Rule 11, Section 3 will continue to permit netting members to exclude repo transactions from the

⁷ A nonmember brokered transaction is a brokered transaction where either the buy-side or sell-side counterparty to the IDB is a nonmember.

⁸ As noted above, Category 2 IDBs are subject to an unlimited loss allocation, based on trading volume, for losses related to brokered transactions with nonmembers.

¹⁰ 15 U.S.C. 78s(b)(2) (1988).

¹¹ 17 CFR 200.30-3(a)(12) (1996).