

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

PTC does not believe that the proposed rule change imposes any burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

PTC has not solicited and does not intend to solicit comments on this proposed rule change. PTC has not received any unsolicited written comments from participants or other interested parties.

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 PTC 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of PTC. All submissions should refer to the file number SR-PTC-97-03 and should be submitted by July 18, 1997.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38753; File No. SR-PTC-97-02]

Self-Regulatory Organizations; Participants Trust Company; Notice of Filing of a Proposed Rule Change Relating to the Clearance and Settlement of Mortgage-Backed Securities Issued By the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association

June 20, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on April 2, 1997, the Participants Trust Company ("PTC") filed with the Securities and Exchange Commission ("Commission") and on May 6, 1997,² and June 12, 1997,³ amended the proposed rule change (File No. SR-PTC-97-02) as described in Items I, II, and III below, which items have been prepared primarily by PTC. 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 amends PTC's rules to permit PTC to process mortgage-backed securities guaranteed by the Federal Home Loan Mortgage Corporation ("FHLMC") and the Federal National Mortgage Association ("FNMA"). The proposed rule change will revise PTC's rules to include the processing of "Fed Securities," which is proposed to be defined as securities that are held on the books of a Federal Reserve Bank and which are designated as "eligible securities" pursuant to PTC's rules. FHLMC and FNMA guaranteed mortgage-backed securities will fall within the definition of Fed Securities.

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² Letter from Leopold Rassnick, Senior Vice President, General Counsel, and Secretary, PTC, (May 6, 1997).

³ Letter from Carol A. Jameson, Assistant Vice President and Assistant Counsel, PTC, (June 11, 1997).

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

In its filing with the Commission, PTC 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. PTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.⁴

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

The purpose of the proposed rule change is to amend PTC's rules to permit PTC to process Fed Securities in its book-entry system. PTC currently acts as a depository and book-entry system for securities guaranteed by the Government National Mortgage Association ("GNMA"), the Department of Veterans Affairs ("VA"), and for certain multiclass securities collateralized by GNMA securities and guaranteed by FHLMC or FNMA, all of which are issued through PTC or are deposited with PTC in certificated form and thereafter are processed through PTC's book-entry system.⁵

Fed Securities will remain in the Federal Reserve's book-entry system. PTC participants that are Federal Reserve member banks will have a choice of whether to clear and settle Fed Securities through PTC or directly through the Federal Reserve's book-entry system. Dealers and non-Federal Reserve member banks that are PTC participants will have a choice of whether to clear and settle Fed Securities through PTC or through a clearing bank.

Benefits to Participants

According to PTC, the proposed rule change was undertaken in response to participants' requests. Participants wanted to reduce overdraft and processing costs and to centralize processing of mortgage-backed securities at a single location. PTC views the expansion of its product line to include Fed Securities as an efficient

⁴ The Commission has modified the text of the summaries prepared by PTC.

⁵ Under the proposed rule change, securities which are issued through PTC or deposited at PTC in physical form and thereafter immobilized at PTC are defined under a new term, "Depository Securities." However, for convenience of reference, all such securities are referred to herein as "GNMA securities."

use of PTC's resources to utilize its infrastructure over an expanded product base of similar, mortgage-backed instruments. PTC's credit and risk management controls for securities currently cleared and settled on PTC's system, including PTC's pricing, margining, end-of-day borrowing facilities, and net debit monitoring level ("NDML") and net free equity ("NFE") controls are directly applicable to the clearance and settlement of other mortgage-backed instruments such as FHLMC and FNMA pass-throughs and REMICs.

Reduced Transaction Fees

Since its inception, PTC has anticipated that it would be expanding the types of mortgage-backed securities that are eligible for clearance and settlement at PTC. PTC's certificate of incorporation covers asset-backed securities, and its rules cover FHLMC and FNMA securities as well as GNMA's.

According to PTC, by expanding its portfolio of eligible security types, PTC would be able to process its present GNMA securities and the new Fed Securities at a lower unit cost. PTC's computer systems and much of its resources are currently geared to handle the peak processing volumes experienced on the Public Securities Association ("PSA") designated GNMA settlement dates. Because the bulk of Fed Securities settle on different dates, PTC anticipates processing the increased volume with a minimal increase in operating expenses. This is expected to reduce transaction fees for all PTC participants, including participants that utilize PTC's depository facilities for GNMA securities and elect not to use PTC as a depository for Fed Securities.

Participant Internal Savings

PTC believes that its participants should expect internal savings in the areas of reduced fees and internal centralization of mortgage-backed securities processing. Utilization of PTC's book-entry system will minimize Federal Reserve daylight overdraft fees with respect to Fed Securities transactions settled internally at PTC that would otherwise result in an overdraft on the Fedwire system. Centralizing the clearance and settlement of Fed Securities and GNMA securities at a single depository location is also expected to lead to more cost-effective internal operations for participants.

Appointment of PTC Custodian for Fed Securities

PTC has contracted with the Bank of New York ("BNY") to serve as PTC's custodian for Fed Securities, to perform custodial services for PTC, and to maintain an account at the Federal Reserve Bank of New York ("FRBNY") for the delivery and receipt of Fed Securities on behalf of PTC. Federal Reserve policy does not currently permit a limited purpose trust company such as PTC to incur an overdraft in its account at a Federal Reserve Bank. Therefore, the appointment of a custodian to maintain an account at a Federal Reserve Bank for Fed Securities maintained at PTC is necessary to enable PTC's participants to receive Fed Securities delivered versus payment through the Federal Reserve Bank's book-entry system into their accounts on PTC's book-entry system.

BNY's role as custodian for the Fed Securities program will be similar to the role of PTC's present vault custodian for GNMA certificates. PTC immobilizes GNMA's in physical form in "jumbo certificates" with book-entry interests transferred on PTC's books. Similarly, Fed Securities will be held in custody by BNY. Transfers between PTC participants will be internal movements on the books of PTC and will require no activity on the part of the custodian bank other than in some instances that require the repositioning of Fed Securities between PTC's clearing account and PTC's segregated account at BNY as discussed in more detail below.

BNY also will act as PTC's clearing bank for transactions involving the transfer of Fed Securities to or from a PTC participant and a non-PTC participant. Such external transactions will result in securities wire transfers over the Federal Reserve Bank's fedwire system using the custody bank interface. The bulk of PTC's rule changes contract provisions with BNY, and computer programming efforts are centered on the clearing aspects of the PTC-BNY and BNY-FRBNY relationships and the associated lien issues an computer interface requirements.

Receipt of Fed Securities over Fedwire

Under the proposed rule change, BNY will receive on PTC's behalf Fed Securities delivered from a non-PTC participant to a PTC participant. The incoming receive will immediately be routed to PTC through an on-line computer interface with BNY. PTC will then automatically route the incoming receive to a participant account for review prior to crediting the participant's account or associated

transfer account. Any transaction which fails PTC's NFE or NDML checks will be returned to BNY with instructions to return the securities to the originating party through the Federal Reserve's book-entry system. Receives passing PTC's NFE and NDML reviews will be posted to the participant's account (for free deliveries) or to the participant's transfer account (for deliveries versus payment).

Delivery of Fed Securities Over Fedwire

Participants that want to deliver Fed Securities to either PTC participants or non-PTC participants will instruct PTC using essentially the same data-entry procedures as are currently used for GNMA securities transactions. As is currently the case for deliveries of GNMA securities between participants, all delivery instructions will remain subject to PTC's NFE check on the participant account from which the delivery is initiated. PTC will determine from the security type and contra party address whether the delivery is internal or external. Deliveries between PTC participants will require no update of BNY's records other than repositioning between accounts on BNY's books for certain transactions, as discussed in more detail below. PTC will instruct BNY to deliver securities to non-PTC participants using the Federal Reserve's book-entry system.

Receipt of Principal and Interest ("P&I")

P&I payments received by BNY from the FRBNY will be immediately forwarded by BNY to PTC's cash account with the FRBNY. PTC expects that upon receipt from BNY the funds will be immediately available to PTC participants. There will be no need to borrow funds for P&I disbursements on Fed Securities. PTC will only disburse P&I from the P&I funds that it receives.

Intraday and End-of-Day Credit

BNY will extend credit to PTC intraday with respect to Fed Securities received versus payment from non-PTC participants, and PTC will fully collateralize any debit balance resulting from such advances. Each participant maintaining Fed Securities in a PTC account will be subject to PTC's Fed Securities NFE credit check to insure adequate collateral for its obligations to PTC. BNY's intraday debit to the FRBNY will be collateralized by BNY in accordance with its standing arrangements with the FRBNY. PTC will not retain an overnight cash balance at BNY. Any funds due to or due from BNY will be settled prior to the close of business each day. However, BNY may

choose to extend end-of-day credit if PTC cannot settle its closing debit.

Maintenance of Clearing Account and Segregation Account

BNY will maintain two accounts on behalf of PTC: (1) A clearing account containing securities and cash which are subject to the clearing bank's lien and (2) a segregation account containing securities and cash which are free of such lien. External deliveries of securities and cash will move into or out of the clearing account from/to any other account on the books of BNY or the FRBNY. PTC may also direct BNY to transfer securities to non-PTC participants from PTC's segregation account. As required by BNY, incoming receives of Fed Securities from non-PTC participants will be posted to the clearing account. Securities may be transferred between the two accounts based on instructions from PTC.

Valuation of Collateral

A net overdraft resulting from the receipt of securities versus payment in PTC's clearing account at BNY must be fully secured at all times. BNY and PTC will use the same prices and haircuts to value securities constituting such collateral. BNY will use these prices and margins to determine the value of the collateral that secures PTC's overdraft at BNY. PTC will have a separate NFE monitor for Fed Securities and will use these prices and margins to calculate a participant's Fed Securities NFE. If the receipt of Fed Securities versus payment would cause a collateral deficiency in the clearing account, BNY may at its option return the securities to the non-participant sender or may afford PTC an opportunity to cure the deficiency. To cure the deficiency, PTC would contact its participant and use the resources of such participant.

BNY Lien on Fed Securities in the Clearing Account

Securities in participant accounts on PTC's books which are subject to a PTC lien (*i.e.*, proprietary and agency accounts) will be held in the BNY clearing account and will be subject to a BNY lien. Securities in participant accounts on PTC's books which are not subject to PTC's lien (*i.e.*, segregated, pledgee, and limited purpose accounts) will be held in the BNY segregation account and will not be subject to a BNY lien.

Securities received through BNY which a participant retransfers intraday to a lien-free account on PTC's books will be moved to the segregation account at BNY when the securities are transferred on PTC's books. If a

participant has enough Fed Securities NFE at PTC to permit the transfer, BNY will similarly have sufficient collateral securing PTC's overdraft to permit the transfer of the securities from PTC's clearing account to its segregation account on BNY's books. If the participant does not have sufficient PTC NFE, then PTC will not permit the transfer of the Fed Securities to a lien-free account on PTC's books, and a segregation instruction will not be sent to BNY. Since PTC's NFE monitor ensures that participant obligations to PTC are fully collateralized at all times, the synchronization of movements between participant accounts on PTC's books and movements between PTC's accounts on the books of BNY will ensure that PTC's obligations to BNY are also fully collateralized at all times.

BNY Lien on Additional Collateral

To secure its obligations to BNY, PTC grants BNY a first and prior lien on all securities and cash balances credited to the clearing account and to such additional property as may be mutually agreed.

The proposed rule change provides that participants may designate specific GNMA securities which are subject to liens at PTC for pledge to BNY by using PTC's Collateral Loan Facility ("CLF"). BNY will be granted a senior security interest in GNMA securities so pledged, and PTC will retain a secondary lien. The collateral value (*i.e.*, market value less haircut) of GNMA securities which have been designated by participants in this manner will be added to Fed Securities NFE and subtracted from GNMA securities NFE in the participant's account at PTC.

Release of BNY Lien

In the event of a participant default, PTC's \$2 billion committed line of credit provides a source of funds that may be applied to pay a BNY overdraft. However, the clearing agreement between PTC and BNY does provide the BNY at its option may lend PTC the amount of such shortfall secured by specific collateral designated by PTC with a value at least equal to the amount outstanding. Upon the identification of the designated collateral, BNY's lien would be released on all other collateral in the clearing account.

PTC believes the procedures in the clearing agreement covering the designation of collateral are consistent with PTC's rules which provide for the use of the collateral in a defaulting participant's accounts to cover the participant's unpaid obligations to PTC. Accordingly, the defaulting participant's collateral would be designated as

collateral to BNY thereby permitting the release of BNY's lien on the collateral of all other participants.

PTC also is authorized to designate specific collateral in the amount of an unpaid end-of-day PTC overdraft even if BNY chooses not to lend to PTC. Collateral designation in this situation could be utilized to achieve settlement under PTC's rules and would leave the securities of the defaulting participant with BNY as designated collateral. PTC's default procedures would then be applied to obtain funds equal to the remaining unpaid balance owed to PTC by the defaulting participant. A collateral designation where BNY does not lend could also be utilized in the event of a PTC insolvency in order to permit the deliveries of securities required by the participants' intraday collateral lien ("PICL") to participants with net credit balances at PTC or to participants which pay their net debit balances to PTC.

Limitation on BNY Lien

The only PTC liability that will be secured by a BNY lien on participant securities and collateral is PTC's overdraft indebtedness to BNY caused by the receipt of Fed Securities versus payment through BNY. Fees and other BNY charges will be charged to a separate PTC cash charge account at BNY and are not secured by BNY's lien on Fed Securities or other collateral. The release of funds and securities from the clearing account is dependent solely upon the satisfaction by PTC of its overdraft indebtedness to BNY, except as otherwise provided with respect to the designation of collateral to secure such overdraft indebtedness.

Overdraft Fees

PTC's arrangement with BNY requires that PTC pay overdraft fees when an overdraft exists in its account. Each participant will be allocated its pro rata share of BNY's overdraft charge to PTC based upon that participant's outstanding PTC debit balance associated with Fed Securities processing as a percentage of PTC's outstanding overdraft balance at the custody bank.

Securities and cash in the segregation account will not be subject to BNY's lien. However, for purposes of calculating daylight overdraft fees, any cash credit balance in the segregation account will be used to reduce the amount of any FRBNY daylight overdraft obligation incurred by BNY on behalf of PTC.

Clearing Bank Default to PTC

PTC may have a credit balance in its cash account at BNY arising from external deliveries of Fed Securities and prefunding deposits. If BNY defaulted on its payment of PTC's credit balance at BNY, PTC would be an unsecured creditor of BNY. Such a result would be basically the same as exists in the present structure of the marketplace where each securities dealer would also be an unsecured creditor of its clearing bank. PTC believes that its selection of a strong, money-center bank, such as BNY, to act as PTC's clearing bank reduces the potential for the clearing bank's default.

Under the proposed rule change, in the event that BNY defaulted in its capacity as clearing bank and created a shortfall in the funds needed by PTC to pay participant credit balances at settlement, PTC would adjust participant Fed Securities cash balances by deducting the amount of the shortfall from participant cash balances as follows: first, pro rata from the cash balances of participants with net credits with respect to external deliveries and receives of Fed Securities with a maximum adjustment equal to the value of such net credits and second, pro rata from the cash balances of participants with remaining Fed Securities credit balances.

Participant Default

In the event of a participant default, PTC would follow the procedures described in its current rules where the collateral of the defaulting participant is used to secure an advance from PTC or to borrow funds. The NFE computation should ensure that sufficient collateral value is available in the defaulting participant's account.

If the default remedies in PTC's rules are insufficient to enable PTC to satisfy its overdraft indebtedness to BNY, PTC would require participants to settle separate cash balances for GNMA securities and Fed Securities. As a result of the separate settlements, some participants which had paid debit balances or have net credit balances would subsequently be required to remit payment to PTC for a debit balance with respect to either GNMA securities or Fed Securities (i.e., participants whose account cash balance reflected a debit balance with respect to Fed Securities and a credit balance with respect to GNMA Securities or vice versa). Failure to pay a debit balance with respect to

either GNMA securities or Fed Securities resulting from the separate settlement would be a default to which the general default provisions of PTC's rules would apply. However, borrowings from participants which delivered to the defaulting participant would be applied to deliveries of GNMA securities or Fed Securities, as applicable, to reduce the debit balance.

After the deadline set by PTC for participant payment of debit balances resulting from separate settlements, PTC would remit all Fed Securities debit balance payments to BNY. If a deficiency remained, PTC would designate the collateral of the participant which defaulted in payment of its Fed Securities debit balance to BNY in accordance with the clearing agreement between PTC and BNY thereby causing the release of BNY's lien on the remaining collateral belonging to other PTC participants.

Once BNY's interest in participant collateral is released, PTC would proceed with the default remedies in PTC's rules which provides for loans from participants which delivered securities to a defaulting participant collateralized by securities of the defaulting participant. PTC would then settle the securities of participants with credit balances or which have paid their debit balances.

PTC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act⁶ and the rules and regulations thereunder in that it will assure the safeguarding of securities and funds which are in the custody or control of PTC or for which it is responsible, remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.

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

Margaret H. McFarland,
Deputy Secretary.

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⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁷ 17 CFR 200.30-3(a)(12).