SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–38871; File No. SR–GSCC–97–03]

Self-Regulatory Organizations; Government Securities Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Eligibility of Forward-Starting Repos for Netting and Guaranteed Settlement Prior to Their Scheduled Start Date

July 24, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on May 8, 1997, the Government Securities Clearing Corporation (''GSCC'') filed with the Securities and Exchange Commission (''Commission'') and on June 13, 1997, amended the proposed rule change (File No. SR–GSCC–97–03) as described in Items I, II, and III below, which items have been prepared primarily by GSCC. 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 Purpose of the proposed rule change is to make transactions in forward-starting repurchase agreements (''repos'') eligible for netting and guaranteed settlement before they reach their scheduled start date.

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

Presently, forward-starting repos are not eligible for netting and guaranteed settlement until they reach their scheduled settlement date.[3] GSCC proposes amendments to several of its rules to make these transactions eligible for these services before they reach their scheduled start date.

1. Background

Since November 1995, GSCC has provided netting services for repo transactions. Each business day, all eligible repo transactions are netted with regular cash activity and Treasury auction purchases in the same CUSIP to establish a single net position in the security for each netting member participating in the repo netting process. For netting purposes, the settlements associated with repo close legs and reverse start legs are treated as long positions. The settlements associated with repo start legs and reverse close legs are treated as short positions. The difference between a participant's total short activity and its total long activity within a CUSIP is the participant's net position in the CUSIP.

After GSCC nets repo transactions, it interposes itself between the submitting participants for transaction settlement purposes as it does for cash transactions. In doing so, GSCC assumes contra party responsibility and guarantees settlement of all repos that enter its netting system. GSCC's guarantee for netted repose includes guaranteeing the return of repo collateral to repo participants, the return of principal (*i.e.*, repo start amount) to reverse participants, and the payment of repo interest to the full term of the repo to reverse participants.

Because forward-starting repos currently are not eligible for netting or guaranteed settlement until they reach their scheduled start date, they are not subject to clearing fund or forward margin requirements until that time. This results in two problems. One is a general management concern for GSCC arising from the possibility that a netting member that has entered into a forward-starting repo will become insolvent on the morning of the scheduled start date for the repo, after GSCC has netted, novated, and guaranteed the settlement of the repo but before the member has satisfied its funds-only settlement obligation (*i.e.*, clearing fund or forward margin requirements) with GSCC for that day. If this occurs, GSCC may have an uncovered interest rate exposure that has built up over a period of time and consequently is of a significant size.[4] The other concern is that members that enter into forward-starting repos do not have the benefit of GSCC's netting and guaranteed settlement services for those transactions until the start of the transaction.

2. Comparison of Forward-Starting Repos

The principal impediment to making forward-starting repos eligible for netting and guaranteed settlement immediately after their execution is an inability to compare certain types of forward-starting repos. Forward-starting repos may be said to be of two types: (1) ''Specific collateral'' for which the underlying CUSIP is known from the date of execution of the repo and (2) ''general collateral'' for which the specific security and par amount that will be transferred from the repo participant to the reverse participant on the start date are not known at the time of execution. Because the underlying CUSIP is not known, general collateral repo transactions cannot be compared under GSCC's current matching requirements for data submissions.

To rectify this problem, GSCC will allow repo participants submitting to GSCC data on general collateral repo transactions to use one of the seventeen generic CUSIP numbers established by the CUSIP service bureau for identifying collateral. These CUSIP numbers identify the type of Government security (*e.g.*, bill, bond, or note) and indicate the remaining length to maturity for the issue. In addition, the par amount of the underlying collateral will not be required to match. This will allow GSCC to make general collateral forward-starting repos eligible for netting upon their submission to GSCC.

In conjunction with this, GSCC will impose upon the parties to a general collateral forward-starting repo the obligation to inform GSCC when the specific CUSIPs and associated par values that will be used for settlement purposes are determined. The notification must be made to GSCC no later than by the close of business on the business day prior to the date on which the repo is scheduled to start.

The notification must be made in the same manner as that in which members inform GSCC of their intention to substitute collateral.[5] First, they must submit an ''intent to substitute'' notification providing specific collateral details to GSCC using an on-line function (*i.e.*, a screen input facility)

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[1] 15 U.S.C. 78s(b)(1).

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

[3] Forward-starting repo transactions are repo transactions which have start legs settling one or more business days in the future.

[4] If a member defaults after GSCC has guaranteed the trade, GSCC will be responsible to the counterparty for the difference between the contract repo rate and the current repo rate.

[5] See Section 4 for a description of substitution of collateral.

provided by GSCC. GSCC will then modify existing trade data in its system by canceling the ''old'' generic CUSIP data and by creating replacement data based on the specific CUSIP.

If one of the members that has submitted the data on the repo is a broker, GSCC will accept the ''intent to substitute'' notification solely from the broker without the need for a matching notification from the dealer counterparty. If neither of the members that submitted the data on the repo are brokers, GSCC will accept the ''intent to substitute'' notification from the member in the short or delivering position without the need for a matching notification from the dealer counterparty; however, GSCC will attempt to verify manually with the other member the accuracy of the details of the notification.

3. Forward Margin and Clearing Fund Requirements

A second impediment to making forward-starting repos eligible for netting was an internal system constraint that has been resolved. GSCC now has developed the system's capability to calculate and collect clearing fund and forward margin on forward-starting repos from the time of their submission to GSCC.

Until a forward-starting repo actually starts, the forward margin and clearing fund requirements apply to it will differ from those applied at all other repos. With regard to forward margin, because a forward-starting repo that has not yet started presents only interest rate exposure and not exposure to movements in the value of the underlying collateral, only an interest rate mark-to-market will be applied.[6] This interest rate mark component will be calculated by multiplying the principal value of the repo first by a factor equal to the absolute difference between the system and contract repo rates and then by a fraction where the numerator is the number of calendar days from the scheduled start date of the repo until the scheduled close date for the repo and the denominator is 360. The interest rate mark will differ from the financing mark applied to repos that have already started in that, because the exposure presented to GSCC is a pure rate risk exposure, it can be a debit to either the short side or the long side.[7]

With regard to clearing fund, again because there is no exposure to movements in the value of the underlying collateral for a forward-starting repo that has not yet started, only the funds adjustment component of clearing fund would be affected until the scheduled start date.[8] Therefore, the clearing fund requirement for a forward-starting repo during its forward-starting period will be computed by taking the average of the twenty largest funds-only settlement amounts occurring in the most recent seventy-five business days. Only the interest rate mark, described above, would be included in these funds-only settlement amounts for any forward-starting repos entered into by the member.

4. Right to Substitute Collateral

Currently, repo participants are able to submit details of their rights of substitution to GSCC. This proposal will amend GSCC's rules to clarify that a right of substitution continues after GSCC novates the trade. The proposal also will add Section 4 to Rule 18 to clarify the method of substituting collateral. Should a repo participant want to implement a substitution, either it or its broker must submit an ''intent to substitute'' notification to GSCC using GSCC's on line collateral substitution function. The ''intent to substitute'' notification must contain information regarding the ''old'' collateral so that GSCC may begin preparing for the substitution. Additional details regarding the replacement collateral may be provided in the same notification or in a subsequent notification when known.

Upon receiving the ''intent to substitute'' notification, GSCC will prepare to process the substitution by identifying the repo and collateral being replaced. The proposal will clarify that as it currently does today with other substitute GSCC will not review the appropriateness of the substitute collateral. Once all required details have been submitted, GSCC will modify its database to reflect the substitution. For money fill substitutions, the par amount and/or CUSIP may change, and for par fill substitutions, the principal, CUSIP, and/or end money may change.

All movements associated with the substitution will be made through GSCC, and substitutions will be reported to participants as ''cancel and correct'' transactions. The reverse dealer will deliver the ''old'' collateral to GSCC, and GSCC will redeliver that collateral to the repo dealer. These deliveries will be done versus the ''old'' collateral principal amount.

Conversely, the repo dealer will deliver the replacement collateral to GSCC, and GSCC will redeliver that collateral to the reverse dealer. For par fill substitutions, these deliveries will be done versus the replacement or ''new'' collateral principal amount. For money fill substitutions, the principal amount will not change so both deliveries will be done at the same amount.

Regardless of the type of substitution, GSCC will maintain accrued interest information throughout the life of the repo across multiple collateral substitutions as required. GSCC also will reverse any previous mark-to-market and clearing fund monies calculated for the collateral being replaced. These amounts will be

[6] As a part of the morning funds-only settlement process, GSCC collects and passes through a daily basis a mark-to-market amount (''forward margin'') equivalent to its ongoing exposure on each forward net settlement position. This payment requirement reflects the daily mark-to-market obligation associated with a member's ongoing forward net settlement position in each security with a distinct CUSIP from the time of comparison and novation of the trades that underlie such position. Thus, for repos, the market value is subtracted from the repo's contract value (*i.e.*, the amount of money that was exchanged for the collateral), and a debit or credit collateral mark is established depending upon the result of the calculation and whether or not the participant is on the reverse or repo side of the transaction.

The forward margin calculation for repos differs from that for cash market trades in that there is additional financing mark component. The financing mark component reflects the fact that, if GSCC replaced the reverse side or the repo by buying securities and putting them out on repo, a financing cost would be incurred. The financing mark is debited to the reverse side and credited to the repo side.

[7] For repos for which the underlying collateral has already been exchanged, each day GSCC guarantees to the reverse repo party the interest payment on the principal amount. However, until the repos begins, GSCC only guarantees the difference between the agreed upon repo rate and the rate the party could receive in the open market.

[8] There are three components to the regular clearing fund deposit requirement, with the sum of the three being a members overall requirement:

(A) Funds Adjustment (FAD) Component: This is based on each member's average funds-only settlement amount. The relevant variable in this calculation is the size of the settlement amount; it does not matter whether the funds are to be collected from the member or paid to the member.

(B) Receive/Deliver Settlement Component: This component is based on the size and nature of net settlement positions. The margin collected on net settlement positions is determined by applying margin factors that are designed to estimate security price movements. The factors are expressed as percentages and are determined by historical daily price volatility. Multiplying security settlement values by their corresponding margin factors is a proxy for the estimated amount of loss to which GSCC is potentially exposed from price changes.

(C) Repo Volatility Component: This component reflects the interest rate exposure incurred by GSCC in guaranteeing the payment to the funds lender in a repo transaction of the full amount of interest due on the transaction. The repo volatility amount, which corresponds to the volatility of repo rates, is used to provide GSCC with protection from the portion of that fluctuation in value that represents interest exposure. A repo volatility factor essentially represents an estimate of the amount that repo market rates might change during the liquidation period for the repo transaction.

recalculated using the security information for the replacement collateral.

5. Substitution of Maturing Collateral

Finally, GSCC is making eligible for its netting system repos with underlying collateral that matures on or prior to the scheduled close date by eliminating from the list of requirements for netting-eligibility the requirement that the maturity date of the underlying securities be on or later than the scheduled settlement date of the close leg. The proposal will add Section 6 to Rule 18 to require that if a repo participant has transferred securities as underlying collateral that mature prior to the settlement date of the close leg, that participant must substitute equivalent securities with a later maturity date prior to the business day before the maturity date.

The proposed rule change is consistent with the requirements of Section 17A of the Act[9] and the rules and regulations thereunder because it will authorize GSCC to make forward-starting repos eligible for netting in a prudent fashion once they are compared by GSCC. This will allow members to enjoy the benefit of guaranteed settlement of their forward-starting repos as soon as possible.

B. Self-Regulatory Organization's Statement on Burden on Competition

GSCC does not believe that the proposed rule change would 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 solicited or received. Members will be notified of the rule change filing and comments will be solicited by an important notice. 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

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 GSCC 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 Section, 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 GSCC. All submissions should refer to the file number SR–GSCC–97–03 and should be submitted by August 20, 1997.

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

Jonathan G. Katz,

Secretary.

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[9] 15 U.S.C. 78q–1.

[10] 17 CFR 200.30–3(a) (12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–38872; File No. SR–NASD–97–26]

Self-Regulatory Organizations; Notice of Amendment to Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to an Expansion of the Pilot for the NASD's Rule Permitting Market Makers to Display Their Actual Quotation Size

July 24, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act''), 15 U.S.C. 78s(b)91), notice is hereby given that on July 17, 1997, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') an amendment[1] to the proposed rule change described below. The proposal would allow market makers to quote their actual size by reducing the minimum quotation size requirement for market makers in certain securities listed on The Nasdaq Stock Market (''Nasdaq'') to one normal unit of trading (''Actual Size Rule''). The Actual Size Rule presently applies to a group of 50 Nasdaq securities on a pilot basis.[2] The NASD has proposed to extend this pilot program to March 27, 1998, and to add an additional 100 stocks to the pilot program. The Commission has already received comments from many individual investors and other market participants on the ongoing pilot. The Commission is publishing this notice to solicit comments on the amended proposed rule change from interested persons.

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

The NASD proposes to amend NASD Rule (a)(1)(C) to allow market makers to quote their actual size by reducing the minimum quotation size requirement for market makers in certain securities listed on Nasdaq to one normal unit of trading. The text of the proposed rule change is as follows. (Additions are italicized; deletions are bracketed.)

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NASD Rule 4613 Character of Quotations

(a) Two-Sided Quotations

(1) No change.

(A)–(B) No change.

[1] See Letter from Robert E. Aber, Vice President and General Counsel, The Nasdaq Stock Market, Inc., to Katherine England, Assistant Director, Office of Market Supervision, Division of Market Regulation, Commission, dated July 17, 1997. The amendment would extend the 50 stock pilot from December 31, 1997, to March 27, 1998, and expand it to 150 stocks. This amendment corrects a technical deficiency in an earlier amendment to expand and extend the 50 stock pilot in a similar fashion that was not published for notice and comment. See Letter from Robert E. Aber, Vice President and General Counsel, The Nasdaq Stock Market, Inc., to Katherine England, Assistant Director, Office of Market Supervision, Division of Market Regulation, Commission, dated July 10, 1997.

[2] The initial approval of the 50 stock pilot program was announced in Securities Exchange Act Release No. 38156 (January 10, 1997), 62 FR 2415 (January 16, 1997). The approval of the extension was announced in Securities Exchange Act Release No. 38152 (April 15, 1997), 62 FR 19373 (April 21, 1997). On July 18, 1997, the Commission approved a proposed rule change that extended—but did not expand—the 50 stock pilot from July 18, 1997, to December 31, 1997. Securities Exchange Act Release No. 38851 (July 18, 1997), 62 FR 39565 (July 23, 1997) (File No. SR–NASD–97–49).