

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. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to file number SR-NASD-2004-038 and should be submitted by April 5, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49378; File No. SR-OCC-2003-11]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating To Clearing Member Trade Assignment Processing

March 9, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> notice is hereby given that on October 14, 2003, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") and on February 18, 2004, amended 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 by-laws and rules to update the clearing member trade assignment ("CMTA") procedures, increase OCC's initial and minimum net capital requirements, and increase OCC's minimum clearing fund requirement.

#### 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 it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.<sup>2</sup>

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

The purpose of this rule change is to amend OCC's by-laws and rules to update the description of the CTMA procedures, increase OCC's initial and minimum net capital requirements, and increase OCC's minimum clearing fund requirement for execution-only clearing members.

##### 1. Background

CMTA processing permits one clearing member ("carrying clearing member") to authorize another clearing member ("executing clearing member") to direct that exchange transactions be transferred to an account of the carrying clearing member for clearance and settlement.<sup>3</sup> The executing clearing member executes the transaction itself or guarantees the broker that executed the transaction and directs the transaction to be cleared into an account of the carrying clearing member via the options exchanges' systems for reporting matching trade information to OCC. A carrying clearing member does not have the ability to approve or reject such a direction before the transaction is entered into the exchanges' systems for reporting to OCC.

The matching trade information submitted by an exchange for a transaction that has been executed pursuant to a CMTA arrangement will identify both the carrying and executing clearing members by their assigned clearing numbers. OCC permits an executing clearing member to transfer transactions effected only on the exchange(s) designated by the carrying clearing member in a CMTA authorization filed with OCC.

<sup>2</sup> The Commission has modified the text of the summaries prepared by OCC.

<sup>3</sup> The CMTA facility was developed to permit carrying clearing members to clear and settle transactions effected on an exchange where they are either not a member or do not maintain a presence for trade execution.

Accordingly, before a transaction is transferred to an account of the carrying clearing member for clearance, OCC's system confirms that (i) there is a valid CMTA arrangement between the carrying and executing clearing member and (ii) the exchange transaction was effected on a designated exchange. The carrying clearing member is then responsible for settling the trade and maintaining the resulting position. If their arrangement permits, a carrying clearing member may transfer the position back to the executing clearing member through OCC's systems to correct the execution member's good-faith error in identifying the carrying clearing member in the submitted trade information.<sup>4</sup>

OCC's CMTA facility supports two distinct types of business. First, clearing members that execute transactions for correspondent brokers use the process to transfer transactions to the correspondent brokers' clearing firms. Second, firms that execute trades for institutional and other customers with prime brokerage arrangements use the process to transfer the trades to the prime broker clearing member.

##### 2. Discussion

##### (a) CMTA Rule Changes

Article VI, Sections 1 and 2, of OCC's by-laws and the term "authorized Exchange member" as defined in Article I, Section 1, of OCC's by-laws provide the current framework for OCC's CMTA facility. In response to clearing member requests, OCC has been working with the options exchanges and a group of clearing members that act as prime brokers to update the description of the CMTA facility in OCC's rules. In particular, the group's efforts focused on more closely defining the rights and obligations of the clearing members that are parties to a CMTA arrangement in order to remove their regulatory and legal uncertainties. Proposed Rule 403 is the result of that collaborative effort, and it would operate as follows.

Proposed Rule 403 will require clearing members that are parties to a CMTA arrangement to register and provide certain details of their arrangement with OCC. Such registration will be effective when the clearing members provide matching information regarding their arrangement.

<sup>4</sup> This commonly occurs if the executing clearing member has transposed digits of a carrying clearing member's clearing number causing the transaction to clear in an account of a wrong clearing member (assuming a valid CMTA arrangement exists between the executing and misidentified carrying clearing member).

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

Rule 403 would also establish certain checks to be performed by OCC's system to verify that a valid CMTA registration exists. Transactions that fail these checks will be transferred to a designated account or, if such designation has not been made, to the customers' account or segregated futures account of the executing clearing member, as applicable. A carrying clearing member is responsible for each transaction transferred to its account pursuant to a CMTA arrangement, subject to its right to return the resulting position for certain specified reasons (as explained below). Notwithstanding that right, the carrying clearing member is responsible to effect premium or margin settlement, as applicable, on the business day after the trade was executed for any positions carried in its accounts after nightly processing.<sup>5</sup>

A position transferred pursuant to a CMTA arrangement may be returned to the executing clearing member upon notice for reasons to be specified in a standard agreement.<sup>6</sup> The reasons that are being considered include: (i) The matching trade information did not conform to the trade information supplied to the carrying clearing member by the customer on whose behalf the trade was executed (e.g., transaction was for a put option in a particular series rather than a call option); (ii) the carrying clearing member's reasonable belief that the trade involved a violation of applicable law, rule, or regulation (e.g., failure to deliver a prospectus); (iii) the carrying clearing member no longer carries the account of the customer on whose behalf the trade was executed or has restricted the customer's ability to use the CMTA process; or (iv) the carrying clearing member was misidentified in the matching trade information. Returns must be effected in accordance with specified procedures by a prescribed cutoff time before trading commences on the business day after trade date. OCC will transmit certain information regarding the reasons given for a return, but will not validate the stated reasons. A position that has been assigned,

exercised, or matured may not be transferred or returned under Rule 403 and will be dealt with in accordance with the provisions of the CMTA agreement between the clearing members.

A carrying clearing member may not effect a return after the prescribed cutoff time. Initiating a return after the applicable cutoff time might subject the carrying clearing member to disciplinary action. In the case of a position returned to an executing clearing member due to a misidentification of the carrying clearing member, the executing clearing member may retransfer the position to the correct carrying clearing member in order to correct the error.<sup>7</sup>

A registered CMTA arrangement may only be terminated as specified in Rule 403, which permits clearing members to either mutually or unilaterally terminate the arrangement.<sup>8</sup> Terminations by mutual agreement will be effective when OCC receives notice of termination from both clearing members. Unilateral terminations will be effective the next business day after notice of the termination has been given to OCC and the other clearing member. Transactions effected after the effective time of a termination will be treated as failed CMTAs and will be the responsibility of the executing clearing member.

Other rule changes relating to CMTAs include additional definitions of terms used in CMTA processing (e.g., "carrying clearing member" and "executing clearing member") and other conforming changes.

#### (b) *Increases in Net Capital and Minimum Clearing Fund Requirements*

OCC has also reassessed the risks associated with CMTA transactions. A small number of OCC's clearing members conduct an "execution only" business (i.e., their sole business is to execute transactions that are then given up to carrying clearing members for clearance and settlement). These firms' membership approval and clearing fund deposits are premised on the fact that they pose limited position risk to OCC

because they do not normally carry positions. The average net capital of these firms is substantially less than the average net capital of OCC's clearing members, although each firm's net capital is above OCC's current initial requirement and each firm maintains the minimum clearing fund deposit of \$150,000.

With the proposed increase in the number of permissible reasons for returning a position, OCC believes that there is an increased possibility that executing clearing members, including execution-only firms, will be required to make premium or margin settlement for a position before it can be closed out or otherwise managed. To address this possibility, OCC has proposed to increase its initial and minimum net capital requirements for all clearing members and to increase the minimum clearing fund deposit for execution-only firms. Initial required net capital would be increased from \$1 million to \$2.5 million, and minimum net capital would be increased from \$750,000 to \$2 million.<sup>9</sup> The minimum clearing fund deposit for execution-only firms would be increased from \$150,000 to \$150,000 plus \$15 times the firm's average daily executed volume for the preceding calendar month.

To determine the amount of the increase in net capital requirements, OCC analyzed the instances when positions were carried in the accounts of execution-only clearing members for the twelve-month period ending July 31, 2003.<sup>10</sup> Based on that analysis, OCC determined that a minimum net capital of \$2 million would have been sufficient to avoid any additional position related margin calls. Currently, minimum net capital is \$750,000. Initial net capital historically has been set above the minimum net capital amount, and OCC has determined to set the initial net capital requirement at \$2.5 million. Currently, initial net capital is \$1 million. The increases are being applied to all clearing members because over 80% of OCC's clearing members are eligible to use the CMTA facility.

The special net capital requirements for firms providing facilities management services<sup>11</sup> and stock

<sup>5</sup> Certain exchanges submit matching trade information on a real time or intermittent basis during a trading day. OCC immediately processes such submissions and makes updated position information available for clearing member review throughout the day. For transactions effected on such exchanges, clearing members may be able to effect a return before OCC closes its window for the submission of returns, in which case the executing clearing member would be responsible for any premium or margin settlement.

<sup>6</sup> The clearing members have formed an ad hoc committee under the auspices of the Securities Industry Association to collaborate on a standard form agreement. That agreement is currently in draft form.

<sup>7</sup> There is no approval process associated with position transfers between clearing members to correct clearing errors. OCC determined not to include an approval process for such transfers based on discussions with clearing members during the development of ENCORE Release 3.0. Clearing members claimed that an approval process would be inefficient from an operational and administrative perspective, would increase system overhead, and would adversely affect their ability to review position changes on a timely basis.

<sup>8</sup> OCC has retained the right to terminate all CMTA arrangements of a suspended clearing member.

<sup>9</sup> These new capital standards are consistent with the capital requirements of other clearing organizations. For example, the Chicago Mercantile Exchange's initial net capital requirement is \$2 million, while the Board of Trade Clearing Corporation is \$2.5 million.

<sup>10</sup> The instances in which positions were carried in execution-only clearing members' accounts was relatively low with the greatest rate of "returned" positions for such firms was 4.11%.

<sup>11</sup> Proposed OCC Rule 309A [File No. SR-OCC-2003-09].

settlement services<sup>12</sup> are being increased proportionately. A firm providing such services will be required to have a minimum net capital of \$4 million plus \$200,000 times the number of firms over four that it services.

The proposed increases in OCC's net capital requirements will not be unduly burdensome. Only two OCC clearing members (one of which is an execution-only firm) maintain net capital below the proposed minimum of \$2 million. (No firm that provides facilities management services or stock settlement services will be affected by the proposed increase for those firms.) Although clearing members will be given a one-year grace period from October 1, 2003, to achieve compliance with the new requirements, OCC's membership/margin committee shall have the discretion to extend that deadline to a date no later than October 1, 2006, for clearing members admitted to membership after the date that this proposed rule change is approved by the Commission, provided that such clearing members undertake not to engage in a CMTA execution business during the period of such extension.

Execution-only clearing members pose a special risk because they do not ordinarily carry position overnight and therefore do not ordinarily deposit margin with OCC. This means that if a position is returned to an execution-only member and if the execution-only member fails to make settlement, the only asset of the member that OCC can draw upon to liquidate the position is the member's clearing fund deposit. Today, execution-only members maintain the minimum clearing fund deposit of \$150,000 because OCC's clearing fund requirements are based on positions maintained during the preceding month, and execution-only firms ordinarily do not maintain positions. To determine a new minimum clearing fund requirement for execution-only members, OCC analyzed executed trade activity for the four execution-only clearing members over a period where total volume was deemed to be within normal ranges and assessed the net price change risk (through simulation) of the contracts executed by the firms relative to average daily executed volume. Dividing net price change risk by average daily executed volume resulted in net risk per contract of \$15.85. OCC proposes to increase the minimum clearing fund requirement for execution-only members to \$150,000 plus \$15 times average daily executed volume for the preceding month.

Execution-only firms will also be given the one-year grace period described above to comply with this new minimum.

OCC also proposed to make conforming changes to the definitional provisions of its by-laws, qualification standards for admission, various financial responsibility rules, and the rule defining monthly contributions to the clearing fund.

OCC believes that the proposed rule change is consistent with Section 17A of the Act because it fosters the prompt and accurate clearance and settlement of securities transactions, the safeguarding of funds and securities, and the protection of investors and the persons facilitating transactions by and acting on behalf of investors.

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

OCC does not believe that the proposed rule change would impose any burden on competition.

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

OCC has not solicited or received written comments with respect to the proposed rule change.

### **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 the self-regulatory organization consents, the Commission will:

- (a) By order approve the 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, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549-0069. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No.

SR-OCC-2003-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, comments should be sent in either hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the rule filing that are filed with the Commission, and all written communications relating to the rule filing between the Commission and any person, other than those that may be withheld from the public in accordance with provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room in Washington, DC. Copies of such filing will also be available for inspection and copying at OCC's principal office and on OCC's Web site at [http://www.optionsclearing.com/publications/rules/proposed\\_changes/proposed\\_changes.jsp](http://www.optionsclearing.com/publications/rules/proposed_changes/proposed_changes.jsp). All submissions should refer to File No. SR-OCC-2003-11 and should be submitted by April 5, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## **SMALL BUSINESS ADMINISTRATION**

### **Small Business Size Standards: Waiver of the Nonmanufacturer Rule**

**AGENCY:** Small Business Administration.

**ACTION:** Notice of waiver of the Nonmanufacturer Rule for General Aviation Turboprop Aircraft.

**SUMMARY:** The U. S. Small Business Administration (SBA) is granting a waiver of the Nonmanufacturer Rule for General Aviation Turboprop Aircraft. The basis for the waiver is that no small business manufacturers are supplying this class of products to the Federal government. The effect of a waiver would be to allow otherwise qualified regular dealers to supply the products of any domestic manufacturer on a Federal contract set aside for small businesses or awarded through the SBA 8(a) Business Development Program.

**DATES:** This waiver is effective on March 30, 2004.

**FOR FURTHER INFORMATION CONTACT:** Edith Butler, Program Analyst, by telephone at (202) 619-0422; by FAX at

<sup>12</sup> Proposed OCC Rule 309A [File No. SR-OCC-2003-09].

<sup>13</sup> 17 CFR 200.30-3(a)(12).