

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 differs 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 The clearing fund requirement for a forward-starting repo during its forward-starting period will be based solely on the interest rate mark.

In addition to the changes relating to forward-starting repos, the proposal clarifies that a right of substitution continues after GSCC novates the trade. Section 4 to Rule 18 specifies 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. For money fill substitutions, the par amount and/or CUSIP may change, and for par fill substitutions, the principal, CSUIP, and/or end money may change. GSCC does not review the appropriateness of the substitute collateral. All movements associated with the substitution will be made through GSCC.

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 replace. These amounts will be recalculated using the security information for the replacement collateral.

Finally, the proposal makes eligible for GSCC's 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. Section 6 of Rule 18 requires 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.

II. Discussion

Section 17A(b)(3)(F) requires that the rules of the clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and to ensure the safeguarding of securities and funds which are in the custody and control of the clearing agency or for which it is responsible.⁸ The Commission believes that proposal will enhance GSCC's ability to clear and to settle forward-starting repos. GSCC will be better able to evaluate participants' true positions by including more of participants' pending positions in the margin and clearing fund calculations. By collecting funds based on a more accurate reflection of a participant's actual risk, the proposal assists GSCC in safeguarding securities and funds. By guaranteeing forward-starting repos earlier in the process, the proposal increases the likelihood that these trades will eventually settle.

Furthermore, by making forward-starting repos eligible for netting and guaranteed settlement, the proposal should increase the number of repos that will be cleared and settled through GSCC and should increase the utility of GSCC's clearance system. By enhancing the settlement process, GSCC's proposal is consistent with the prompt and accurate clearance and settlement of securities.

III. Conclusion

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

of section 17A 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-GSCC-97-03) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39063; File No. SR-NASD-97-64]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Small Order Execution System Tier Size Classifications

September 12, 1997.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on September 4, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. 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 NASD is submitting this filing to effectuate The Nasdaq Stock Market, Inc.'s ("Nasdaq") periodic reclassification of Nasdaq National Market ("NNM") securities into appropriate tier sizes for purposes of determining the maximum size order for a particular security eligible for execution through Nasdaq's Small Order Execution System ("SOES"). Specifically, under the proposal, 537 NNM securities will be reclassified into a different SOES tier size effective October 1, 1997. Since the NASD's proposal is an interpretation of existing NASD rules, there are no language changes.

⁶ As a part of the morning funds-only settlement process, GSCC collects and passes through on a daily basis forward margin based on its ongoing exposure on each forward net settlement position. 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 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 an additional financing mark component. The financing mark component reflects the fact that, if GSCC replaced the reverse side of 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 repo begins, GSCC only guarantees the difference between the agreed upon repo rate and the rate the party could receive in the open market.

⁸ 15 U.S.C. 78q-1(b)(3)(F).

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

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 NASD 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. The NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

The purpose of the rule change is to effectuate Nasdaq's periodic reclassification of NNM securities into appropriate tier sizes for purposes of determining the maximum size order for a particular security eligible for execution through SOES. Nasdaq periodically reviews the SOES tier size applicable to each NNM security to determine if the trading characteristics of the issue have changed so as to warrant a tier size adjustment. Such a review was conducted using data as of June 30, 1997, pursuant to the following established criteria:²

NNM securities with an average daily non-block volume of 3,000 shares or more a day, a bid price less than or equal to \$100, and three or more market makers are subject to a minimum quotation size requirement of 1,000 shares and a maximum SOES order size of 1,000 shares;

NNM securities with an average daily non-block volume of 1,000 shares or more a day, a bid price less than or equal to \$150, and two or more market makers are subject to a minimum quotation size requirement of 500 shares and a maximum SOES order size of 500 shares; and

NNM securities with an average daily non-block volume of less than 1,000 shares a day, a bid price less than or equal to \$250, and less than two market makers are subject to a minimum quotation size requirement of 200 shares and a maximum SOES order size of 200 shares.

Pursuant to the application of this classification criteria, 537 NNM securities will be reclassified effective October 1, 1997. These 537 NNM securities are set out in the NASD's *Notice To Members 97-61* (September, 1997).

In ranking NNM securities pursuant to the established classification criteria,

Nasdaq followed the changes dictated by the criteria with three exceptions. First, an issue was not moved more than one tier size level. For example, if an issue was previously categorized in the 1,000-share tier size, it would not be permitted to move to the 200-share tier even if the reclassification criteria showed that such a move was warranted. In adopting this policy, Nasdaq was attempting to maintain adequate public investor access to the market for issues in which the tier size level decreased and help ensure the ongoing participation of market makers in SOES for issues in which the tier size level increased. Second, for securities priced below \$1 where the reranking called for a reduction in tier size, the tier size was not reduced. Third, for the top 50 Nasdaq securities based on market capitalization, the SOES tier sizes were not reduced regardless of whether the reranking called for a tier-size reduction.

The NASD believes that the proposed rule change is consistent with section 15A(b)(6) of the Act. Section 15A(b)(6) requires, among other things, that the rules of the NASD governing the operation of The Nasdaq Stock Market be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market. The NASD believes that the reassignment of NNM securities within SOES tier size levels will further these ends by providing an efficient mechanism for small, retail investors to execute their orders on Nasdaq and by providing investors with the assurance that they can effect trades up to a certain size at the best prices quoted on Nasdaq.

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

The NASD believes that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The proposed rule change has become effective immediately pursuant to section 19(b)(3)(A)(i) of the Act and subparagraph (e) of Securities Exchange Act Rule 19b-4 because the reranking of NNM securities into appropriate SOES tier sizes was done pursuant to the NASD's stated policy and practice with respect to the administration and enforcement of an existing NASD rule. Further, in the SOES Tier Size Order, the Commission requested that the NASD provide this information as an interpretation of an existing NASD rule under section 19(b)(3)(A) of the Act.

At any time within 60 days of the filing of a rule change pursuant to section 19(b)(3)(A) of the Act, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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, NW., Washington, DC 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 at 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 No. SR-NASD-97-64 and should be submitted by October 10, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³

Margaret H. McFarland,
Deputy Secretary.

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² The classification criteria is set forth in NASD Rule 4613(a)(2) and the footnote to NASD Rule 4710(g).

³ 17 CFR 200.30-3(a)(12).