

quotes.<sup>13</sup> The CBOE believes that the LMM that provides the primary quote feed for an option class during the current expiration cycle provides a valuable service that ensures that the quotes are being updated in timely fashion to reflect the current state of the market. The LMM currently receives no participation entitlement for providing the primary quote feed for an option class, other than the entitlement it receives along with all other SMMs entitled to participate during the opening. The proposed rule change would permit the appropriate Floor Procedure Committee to establish a participation entitlement formula for the LMM providing the primary quote feed.

The CBOE is also submitting as part of the proposed rule change a draft Regulatory Circular for use by any appropriate Floor Procedure Committee to adopt the participation entitlement formula established in the circular. This Regulatory Circular establishes participation entitlements that range from 34 percent to 40 percent for the LMM providing the primary quote feed. These participation entitlements would be implemented by permitting the LMM providing the primary quote feed to log onto ROS an additional number of times as indicated in the table below:

If the total Number of appointed LMMs and SMMs is	The LMM providing the primary quote feed must log onto ROS the following Number of times	Participation right of the LMM providing the primary quote feed (percent)
3 .....	1	34
4 .....	2	40
5 .....	2	34
6 .....	3	38
7 .....	4	40
8 .....	4	36
9 .....	5	38
10 .....	6	40
11 .....	6	38
12 .....	7	39
13 .....	8	40
14 .....	8	38
15 .....	9	39
16 .....	10	40

The draft Regulatory Circular adds that in the event the total number of LMMs and SMMs appointed pursuant to CBOE Rule 8.15 is one, all ROS contracts to trade will be assigned to the appointed LMM or SMM. In the event the total number of LMMs and SMMs

appointed pursuant to Rule 8.15 is two, the circular states that the LMMs and/or SMMs will each be assigned an equal portion of ROS contracts.

## 2. Statutory Basis

The CBOE believes that the proposed rule change is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, to protect investors and the public interest, and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers, pursuant to section 6(b)(5) of the Act.<sup>14</sup> The CBOE believes that the proposed rule change protects investors and the public interest by providing incentives to the LMMs to provide the primary quote feed. The CBOE states that the LMM that provides the primary quote feed uses its own proprietary system to provide the quotes, and, in addition, must make sure that quotes are updated in a timely fashion to reflect the current quotes in the underlying Index Options.

The proposed rule change proposes to give the LMM a limited participation entitlement during the opening of an Index Option. The CBOE believes that given the service that the LMM is performing, it is within just and equitable principles of trade to grant the limited participation entitlement that is proposed. For the reasons stated, the CBOE believes that the proposed rule change is consistent with the Act and the regulations thereunder.

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

The Exchange does not believe that the proposed rule change will impose 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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

Within 35 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 90 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 Exchange consents, the Commission will:

(A) by order approve such proposed rule change, as amended, or

(B) institute proceedings to determine whether the proposed rule change, as amended, 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, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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, as amended, 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 CBOE. All submissions should refer to file number SR-CBOE-2002-10 and should be submitted by April 23, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 02-7872 Filed 4-1-02; 8:45 am]

**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45656; File No. SR-GSCC-2002-01]

## Self-Regulatory Organizations; Government Securities Clearing Corporation; Order Approving Proposed Rule Change Relating to Establishment of a Cross-Margining Program With BrokerTec Clearing Company, L.L.C.

March 27, 2002.

## I. Introduction

On January 18, 2002, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission")

<sup>13</sup> A minimum of three market-makers or market-maker groups are approved by CBOE's Index Market Performance Committee to act as LMMs and SMMs and provide a proprietary quote feed to CBOE's vendor quote system. One feed serves as the primary quote feed, and the other feeds serve as backup. In addition, Autoquote provided by RISC Systems serves as a backup.

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

proposed rule change SR-GSCC-2002-01 pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on February 21, 2002.<sup>2</sup> The Commission received two comment letters in response to the proposed rule change.<sup>3</sup> For the reasons discussed below, the Commission is approving the proposed rule change.

## II. Description<sup>4</sup>

On August 19, 1999, the Commission approved GSCC's rule filing to establish a cross-margining program with other clearing organizations and to begin its program with the New York Clearing Corporation ("NYCC").<sup>5</sup> Subsequently, the Commission approved GSCC's rule filing to establish similar cross-margining programs with the Chicago Mercantile Exchange ("CME")<sup>6</sup> and with the Board of Trade Clearing Corporation ("BOTCC").<sup>7</sup> GSCC is now seeking to establish a similar cross-margining program with BCC.

BCC is the affiliated clearing organization for the BrokerTec Futures Exchange, L.L.C. ("BTEX"). On June 18, 2001, the Commodity Futures Trading Commission approved the application of BTEX for contract market designation and granted registration of BCC as a derivatives clearing organization. BCC clears the futures contracts on U.S. Treasury securities traded on BTEX.<sup>8</sup>

### A. GSCC's Cross-Margining Program

GSCC believes that the most efficient and appropriate approach for establishing cross-margining links for fixed-income and other interest rate products is to do so on a multilateral basis with GSCC as the "hub." Each clearing organization that participates in a cross-margining program with GSCC ("Participating CO") enters into a separate cross-margining agreement between itself and GSCC, as in the case of NYCC, CME, BOTCC, and now BCC. Each of the agreements do and will continue to have similar terms, and no preference will be given by GSCC to one Participating CO over another. Under GSCC's arrangement, cross-margining occurs between GSCC and each Participating CO and not between Participating COs.

Cross-margining is available to any GSCC netting member (with the exception of inter-dealer broker netting members) that is or that has an affiliate that is a member of a Participating CO.<sup>9</sup> Any such member (or pair of affiliated members) may elect to have its margin requirements at both clearing organizations calculated based upon the net risk of its cash and repo positions at GSCC and its offsetting and correlated positions in certain futures contracts carried at the Participating CO. Cross-margining is intended to lower the cross-margining member's (or pair of affiliated members') overall margin requirement, as intermarket hedges are taken into consideration in the margining process. The GSCC member (and its affiliate, if applicable) sign an agreement under which it (or they) agree to be bound by the cross-margining agreement between GSCC and the Participating CO and which allows GSCC or the Participating CO to apply the member's (or its affiliate's) margin collateral to satisfy any obligation of GSCC to the Participating CO or the Participating CO to GSCC that results from a default of the member (or its affiliate).

Margining based on the combined net risk of correlated positions is based on an arrangement under which GSCC and each Participating CO agree to accept the offsetting correlated positions in lieu of supporting collateral. Under this arrangement, each clearing organization holds and manages its own positions and collateral and independently determines the amount of margin that it will collect from its member and that it

will make available for cross-margining. This available margin is referred to as the "residual margin amount."<sup>10</sup>

GSCC computes the amount by which the cross-margining member's margin requirement can be reduced at each clearing organization by comparing the member's positions and the related margin requirements at GSCC against those submitted to GSCC by each Participating CO. This reduction amount is referred to as the "cross margin reduction." GSCC offsets each cross-margining member's residual margin amount (based on related positions) at GSCC against the offsetting residual margin amounts of the member (or its affiliate) at each Participating CO. If, within a given pair of offset classes, the margin that GSCC has available for a participant is greater than the combined margin submitted by the Participating COs, GSCC will allocate a portion of its margin equal to the combined margin at the Participating COs. If, within a given pair of offset classes, the combined margin submitted by the Participating COs is greater than the margin that GSCC has available for that member, GSCC will first allocate its margin to the Participating CO with the most highly correlated position. If, within a given pair of offset classes, the positions are equally correlated, GSCC will allocate pro rata based upon the residual margin amount submitted by each Participating CO. GSCC and each Participating CO may then reduce the amount of collateral that they collect to reflect the offsets between the cross-margining member's positions at GSCC and its (or its affiliate's) positions at the Participating CO(s).<sup>11</sup> In the event of the default and liquidation of a cross-margining participant, the loss sharing between GSCC and each of the Participating COs will be based upon the foregoing allocations and the cross-margin reduction.

GSCC will guarantee the cross-margining member's (or its affiliate's) performance to each Participating CO up to a specified maximum amount based on the loss sharing formula contained in the Cross-Margining Agreement. Each Participating CO will provide the same guaranty to GSCC. The amount of the guarantee is the lowest of:

<sup>10</sup> The residual margin amount is the long margin amount or the short margin amount in each offset class that is available for cross-margining after all internal offsets are conducted within and between offset classes at a particular clearing organization.

<sup>11</sup> GSCC and each Participating CO unilaterally have the right not to reduce a member's margin requirement by the cross-margin reduction or to reduce it by less than the cross-margin reduction. However, the clearing organizations may not reduce a participant's margin requirement by more than the cross-margin reduction.

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

<sup>2</sup> Securities Exchange Act Release No. 45438 (February 13, 2002), 67 FR 8048.

<sup>3</sup> Letters from Douglas E. Harris, General Counsel, BrokerTec Clearing Company, L.L.C. ("BCC") (January 28, 2002) and Henry D. Mlynarski, President, BCC (March 4, 2002).

<sup>4</sup> The description of GSCC's cross-margining program is drawn largely from representations made by GSCC.

<sup>5</sup> Securities Exchange Act Release No. 41766 (August 19, 1999), 64 FR 46737 (August 26, 1999) [File No. SR-GSCC-98-04]. The requisite rule changes necessary for GSCC to engage in cross-margining programs with other clearing organizations were made in the NYCC cross-margining rule filing.

<sup>6</sup> Securities Exchange Act Release No. 44301 (May 11, 2001), 66 FR 28207 (May 22, 2001) [File No. SR-GSCC-00-13]. In addition to approving GSCC's cross-margining program with the CME, the order granted approval to change GSCC Rule 22, Section 4, to clarify that before GSCC credits an insolvent member for any profit realized on the liquidation of the member's final net settlement positions, GSCC will fulfill its obligations with respect to that member under cross-margining agreements.

<sup>7</sup> Securities Exchange Act Release No. 45335 (January 25, 2002), 67 FR 4768 (January 31, 2001) [File No. SR-GSCC-2001-03].

<sup>8</sup> Currently, BTEX offers trading in futures contracts on the 5-year Note, 10-year Note, and 30-year Bond. It is expected that, in the future, BTEX will offer trading in other U.S. fixed-income futures contracts and options on futures contracts traded on BTEX. BCC will provide clearing services for these products.

<sup>9</sup> The GSCC-BCC cross-margining agreement requires ownership of 50 percent or more of the common stock of an entity to be deemed "control" of that entity for purposes of the definition of "affiliate."

(1) The cross-margin loss of the worse off party; (2) the higher of the cross-margin reduction or the cross-margin gain of the better off party; (3) the amount required to equalize the parties' cross-margin results; or (4) the amount by which the cross-margining reduction exceeds the better off party's cross-margin loss if both parties have cross-margin losses.

#### *B. Information Specific to the Current Agreement Between GSCC and BCC*

1. *Participation in the cross-margining program:* Any netting member of GSCC other than an inter-dealer broker will be eligible to participate.<sup>12</sup> Any clearing member of BCC will be eligible to participate.

2. *Products subject to cross-margining:* The products that will be eligible for the GSCC-BCC cross-margining program are the Treasury and non-mortgage-backed Agency securities of certain remaining maturities that fall into GSCC's Offset Classes C, E, F, and G and e and f as defined in the cross-margining agreement that are cleared by GSCC and the 5-year Note, 10-year Note, and the 30-year Bond futures contracts cleared by BCC.<sup>13</sup> In addition, it is anticipated that the GSCC products specified above will be cross-margining with the 5-year and 10-year Agency futures and options on futures when these products are traded on the BTEX and cleared by BCC.<sup>14</sup> All eligible positions maintained by a cross-margining member in its account at GSCC and in its (or its affiliate's) proprietary account at BCC will be eligible for cross-margining.<sup>15</sup> An appropriate disallowance factor<sup>16</sup> based

on correlation studies and a minimum margin factor<sup>17</sup> will be applied.<sup>18</sup>

3. *Margin Rates:* Margin reductions in the GSCC-BCC cross-margining program will always be computed based on the lower of GSCC's and BCC's margin rates. This methodology results in potentially less benefits to the members but ensures a more conservative result (*i.e.*, more collateral held at the clearing organization) for both GSCC and the Participating COs.

4. *Daily Procedures:* On each business day, it is expected that BCC will inform GSCC of the residual margin amounts it is making available for cross-margining by approximately 10:30 p.m. New York time. GSCC will inform BCC by approximately 12:30 a.m. New York time of how much of these residual margin amounts it will use (*i.e.*, the cross-margining reduction). The actual reductions which may be no greater than the cross-margining reduction, will be reflected in the daily clearing fund calculation.

#### *C. Benefits of Cross-Margining*

GSCC believes that its cross-margining program enhances the safety and soundness of the settlement process for the Government securities marketplace by: (1) Providing clearing organizations with more data concerning members' intermarket positions (which is especially valuable during stressed market conditions) to enable them to make more accurate decisions regarding the true risk of such positions to the clearing organizations; (2) allowing for enhanced sharing of collateral resources; and (3) encouraging coordinated liquidation processes for a joint member, or a member and its affiliate, in the event of an insolvency. GSCC further believes that cross-margining benefits participating clearing members by providing members with the opportunity to more efficiently use their collateral. More important from a regulatory perspective, however, is that cross-margining programs have long been recognized as enhancing the safety and soundness of the clearing system itself. Studies of the October 1987 market break gave support to the

concept of cross-margining. For example, The Report of the President's Task Force on Market Mechanisms (January 1988) noted that the absence of a cross-margining system for futures and securities options markets contributed to payment strains in October 1987. The Interim Report of the President's Working Group on Financial Markets (May 1988) also recommended that the SEC and CFTC facilitate cross-margining programs among clearing organizations. This resulted in the first cross-margining arrangement between clearing organizations which was approved in 1988.<sup>19</sup>

#### **III. Comment Letters**

The Commission received two comment letters in response to the proposed rule change.<sup>20</sup> Both letters from BCC were strongly in support of the proposed cross-margining program between GSCC and BCC. The January BCC comment letter stated that BCC has filed amendments to its rules and bylaws with the Commodity Futures Trading Commission to allow BCC to implement the cross-margining program with GSCC and that the program is similar in all major respects to GSCC's cross-margining programs with other U.S. futures clearing organizations that have been reviewed and approved by the Commission. Finally, the letter requested that the Commission act as quickly as possible on approval of the rule change.

The second BCC comment letter, which reiterated the comments in the January BCC letter, urged the Commission to approve promptly the proposed rule change because it will improve collateral and risk management. The second letter also stated that the amendments to BCC's rules and bylaws to allow it to implement the cross-margining program became effective on January 30, 2002.

#### **IV. Discussion**

Section 19(b) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. In section 17A(a)(2)(A)(ii) of the Act, Congress directs the Commission having due regard for, among other things, the

<sup>12</sup> Because inter-dealer brokers should not and generally do not have positions at GSCC at the end of the day, they should have no margin requirement to be reduced.

<sup>13</sup> GCF Repo products will not be included in the program.

<sup>14</sup> GSCC will notify the Commission when additional securities and futures are made eligible for the cross-margining program.

<sup>15</sup> The GSCC-BCC cross-margining program will be applicable, on the futures side, only to positions in a proprietary account of a cross-margining member (or its affiliate) at BCC. Positions in a customer account at BCC that would be subject to segregation requirements under the Commodity Exchange Act will not be included in the program. This is also the case with respect to the arrangements with NYCC, CME, and BOTCC.

<sup>16</sup> The disallowance factor is the haircut reflective of the correlation analysis done by GSCC for each offset class.

<sup>17</sup> The minimum margin factor is the contractually agreed upon cap on the amount of the margin reduction that the clearing organizations will allow. (In some of the documents submitted by GSCC, the minimum margin factor is referred to as the minimum disallowance factor.) Initially, the GSCC-BCC cross-margining program will employ a 25% minimum margin factor. Should GSCC decide to change the minimum margin factor, it will submit a proposed rule filing under Section 19(b) of the Act.

<sup>18</sup> GSCC will review the cross-margining parameters on a yearly basis unless market events dictate the need for more frequent reviews.

<sup>19</sup> Securities Exchange Act Release No. 26153 (October 3, 1988), 53 FR 39567 (October 7, 1988) [File No. SR-OCC-86-17] (order approving cross-margining program between OCC and The Intermarket Clearing Corporation).

<sup>20</sup> Letters from Douglas E. Harris and Henry D. Mlynarski, *supra* note 3.

public interest, the protection of investors, the safeguarding of securities and funds, to use its authority under the Act to facilitate the establishment of linked or coordinated facilities for clearance and settlement of transactions in securities, securities options, contracts of sale for future delivery and options thereon, and commodity options.<sup>21</sup> Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency for which it is responsible.<sup>22</sup> The Commission finds that the approval of GSCC's proposed rule change is consistent with these Sections.

First, the Commission's approval of GSCC's proposed rule change to establish a cross-margining arrangement with BCC and to extend its hub and spoke approach to cross-margining to include BCC along with BOTCC, CME, and NYCC is in line with the Congressional directive to the Commission to facilitate linked and coordinated facilities for the clearance and settlement of securities and futures.<sup>23</sup> Second, approval of GSCC's proposal should result in increased and better information sharing between GSCC and Participating COs regarding the portfolios and financial conditions of participating joint and affiliated members. As a result, GSCC and participating COs will be in a better position to monitor and assess the potential risks of participating joint or affiliated members and will be in a better position to handle the potential losses presented by the insolvency of any joint or affiliated member. Therefore, GSCC's proposal should help GSCC better safeguard the securities and funds in its possession or control or for which it is responsible.

## V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular 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-2002-01) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>24</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-7903 Filed 4-1-02; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45634; File No. SR-PCX-2002-13]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Relating to the Priority of Bids and Offers on the Options Floor and the Manner in Which Orders Must Be Allocated in Connection With Options Transactions

March 22, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 19, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On March 21, 2002, the PCX submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The PCX proposes to adopt new rules and to amend existing rules on the priority of bids and offers on the Options Floor and the manner in which orders must be allocated in connection with options transactions on the Exchange.

Below is the text of the proposed rule change. Deleted language is in brackets. Proposed new language is italicized.

\* \* \* \* \*

#### Obligations of Market Makers

Rule 6.37(a)-(c)—No change.

(d)—No Change.

(e) Prohibited Practices and Procedures.

<sup>24</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Michael D. Pierson, Vice President, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 21, 2002. The changes made by Amendment No. 1 have been incorporated into this notice.

(1)—No Change.

(2) *Any practice or procedure whereby Market Makers trading any particular option issue determine by agreement the allocation of orders that may be executed in that issue is prohibited.*

#### Priority of Bids and Offers

Rule 6.75

No change.

(a)-(b)—No change.

#### Simultaneous Bids and Offers

(c) *Except as otherwise provided, if the bids (or offers) of two or more members are made simultaneously, or if it is impossible to determine clearly the order of time in which they were made, such bids (or offers) will be deemed to be on parity and priority will be afforded to them, insofar as practicable, on an equal basis.*

(d)-(e) [(c)-(d)]

#### Order Allocation Procedures

(f) *Determination of Time Priority Sequence.*

(1) *Floor Brokers. A Floor Broker is responsible for determining the sequence in which bids or offers are vocalized on the Trading Floor in response to the Floor Broker's bid, offer or call for a market. Any disputes regarding a Floor Broker's determination of time priority sequence will be resolved by the Order Book Official, provided that such determinations of the Order Book Official are subject to further review by two Floor Officials, pursuant to Rule 6.77.*

(2) *When a Floor Broker's bid or offer has been accepted by more than one member, that Floor Broker must designate the members who were first, second, third and so forth. Except as provided below, the member with first priority is entitled to buy or sell as many contracts as the Floor Broker may have available to trade. If there are any contracts remaining, the member with second priority will be entitled to buy or sell as many contracts as there are remaining in the Floor Broker's order, and so on, until the Floor Broker's order has been filled entirely.*

(3) *Market Makers and Order Book Officials. A Market Maker is responsible for determining the sequence in which bids and offers are vocalized on the Trading Floor in response to that Market Maker's bid, offer or call for a market. Likewise, an Order Book Official is responsible for determining the sequence in which bids and offers are vocalized on the Trading Floor in response to the Order Book Official's bid, offer or call for a market. The order allocation procedures for Market Makers*

<sup>21</sup> 15 U.S.C. 78q-1(a)(2)(A)(ii).

<sup>22</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>23</sup> 15 U.S.C. 78q-1(a)(2)(A)(ii).