

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

Section 17A(b)(3)(F) of the Act<sup>11</sup> requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.

The Commission believes that DTC's proposed rule change is consistent with DTC's obligations under Section 17A(b)(3)(F) to facilitate the prompt and accurate clearance and settlement of securities transactions because the proposed rule change should facilitate DTC's conversion entirely to an SDFS system by eliminating provisions in DTC's rules relating to an NDFS system. The overall conversion to a SDFS system should help reduce systemic risk by, among other things, eliminating overnight credit risk. The SDFS system also should reduce risk by achieving closer conformity with the payment methods used in the derivatives markets, government securities markets, and other markets.

The Commission also believes the proposal is consistent with DTC's obligations to assure the safeguarding of securities and funds in its custody or control and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions because the proposed rule change should further reduce DTC's and NSCC's risk exposure by amending the NSCC/DTC Agreement to include cross-guarantees for transactions effected through NSCC's CNS system. The guarantees, among other things, should ensure that debits created in DTC's system will continue to be collateralized when the securities serving as collateral are delivered into the CNS system as short covers. Additionally, the guarantees also should reduce risk at NSCC by ensuring that long allocations or the approximate value of long allocations will be available to NSCC to cover certain exposures.

DTC has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing. The Commission finds good cause for so approving the proposed rule change

because the proposed rule change modifies DTC's rules and the NSCC/DTC Agreement in anticipation of DTC's conversion to an SDFS system on February 22, 1996. Accelerated approval of the proposal will allow DTC to effect the conversion and to implement the safeguards provided under the NSCC/DTC Agreement on that date.

### 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 DTC. All submissions should refer to the file number SR-DTC-96-06 and should be submitted by March 19, 1996.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-96-06) be, and hereby is, approved.

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

Margaret H. McFarland,

*Deputy Secretary.*

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[Release No. 34-36866; File No. SR-NSCC-96-03]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change to Modify NSCC's Rules and Procedures to Accommodate Same-Day Funds Settlement

February 21, 1996.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on January 16, 1996, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change (File No. SR-NSCC-96-03) as described in Items I and II below, which items have been prepared primarily by NSCC. On January 17, 1996, and January 31, 1996, NSCC filed amendments to the proposed rule change.<sup>2</sup> The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

#### 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 modify NSCC's rules and procedures and to amend the current Netting Contract and Limited Cross-Guarantee agreement between NSCC and The Depository Trust Company ("DTC") ("NSCC/DTC Agreement") to accommodate the conversion from a next-day funds settlement ("NDFS") system to a same-day funds settlement ("SDFS") system.

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

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments that it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>3</sup>

<sup>1</sup> 15 U.S.C. § 78s(b)(1) (1988).

<sup>2</sup> Letters from Julie Buyers, Associate Counsel, NSCC, to Jerry Carpenter, Esq., Associate Director, Division of Market Regulation, Commission (January 17, 1996, and January 31, 1996).

<sup>3</sup> The Commission has modified the text of the summaries submitted by NSCC.

<sup>11</sup> 15 U.S.C. § 78q-1(b)(3)(F) (1988).

<sup>12</sup> 17 CFR 200.30-3(a)(12) (1995).

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

NSCC Rule 1 ("Definitions") is being amended to add a definition for the term "refusal." The term "refusal" is defined as when a settling bank refuses to settle for one or more of its settling members or fund members.

Currently, NSCC calculates and collects clearing fund deposits from sponsored account members based on their activity at DTC.<sup>4</sup> Upon the implementation of SDFS, DTC will calculate sponsored account members' initial SDFS participants fund deposit. DTC will collect the required amount by including it in the sponsored account members' initial SDFS settlement amount at DTC. DTC will maintain the funds as part of DTC's participants fund. NSCC will not include this amount in determining the required deposit or the minimum cash requirement at NSCC for those sponsored account members. Accordingly, Rule 4 ("Clearing Fund") and Procedure XV ("Clearing Fund Formula and Other Matters") will reflect this revised policy. In addition, Rule 4 is being modified to reflect that interest paid on clearing fund deposits held at DTC will be paid at such rate or rates as DTC pays to its participants. The procedures also are being revised to require that cash deposits to the clearing fund be made by a same-day funds wire transfer.

Rule 9 ("Delivery and Receipt of Securities") and Addendum D ("Statement of Policy, Envelope Settlement Service" ["ESS"]) are being revised to address liquidity and credit risk concerns. The proposed changes restrict the use of ESS to those items which are currently eligible for delivery through ESS. This will preclude the use of ESS for any security that currently settles in same-day funds.

Rule 12 ("Settlement") and Procedure VIII ("Money Settlement Service") are being revised to accommodate the conversion from an NDFS system to an SDFS system. Under the proposed rule change, settling members and fund members must settle through a settling bank by a federal funds wire transfer. The proposed rule change also specifies that a settling member or a fund member is deemed to have failed to settle when

NSCC receives a refusal from the participant's settling bank or when a participant's settling bank has failed to pay its net debit obligation. In addition, changes are being made to incorporate into participant's settlement statements, which reflect a participant's net debit and/or credit obligations for each business day, net settlement debits or credits arising through NSCC's cross-guaranty agreement.<sup>5</sup>

NSCC's ability to fine a member currently is found in Rule 26 ("Bills Rendered") which governs NSCC's billing policy. Because NSCC may fine members on a daily basis rather than a monthly basis, the fine procedures will be moved from Rule 26 to new Rule 17 ("Fine Payments") to permit NSCC to impose fines on members, including settling bank only members, at such frequency as determined by NSCC from time to time. In addition, a new Addendum P ("SDFS Failure-to-Settle Fines") sets forth the fine schedule for an SDFS system failure to settle.

NSCC Rules 32, 33, 36 and 37 are being modified to accommodate the addition of settling bank only members.<sup>6</sup> Rule 39 ("Special Representatives/Index Receipt Agent") is being amended to delete the duplicative language in the second paragraph regarding the form of an instruction on which NSCC may rely from a special representative or an index receipt agent. The forms of instructions from a special representative or an index receipt agent are the same forms as those on which NSCC may rely when it receives instructions directly from a participant; therefore, NSCC moved the reference to special representatives and index receipt agents into the same paragraph governing forms of instructions received from participants.

Rule 41 ("Funds Only Settlement Service" ["FOSS"]) is being amended to explicitly state that settlement of money payments arising out of FOSS are to be made in accordance with Rule 12 regarding settlement of money payments.

Rule 52 ("Mutual Fund Services") is being amended to clarify that settlement with respect to mutual fund services is governed by Rule 12 and to delete conflicting language. Currently, fund members have an earlier payment deadline with respect to their mutual

fund services payment obligations. Concurrently with the implementation of SDFS, NSCC is establishing a uniform payment deadline for all members, including fund members, so that settling banks will not have to bifurcate their payment obligations.

Rule 54 ("Settling Bank Only Members") is being modified to permit a bank that meets the financial requirements established by NSCC to become a settling bank if it is either a member of the Federal Reserve System or it has direct access to the Federal Reserve System.

Rule 55 ("Settling Banks") is being amended to clarify that in the event of the insolvency of a settling bank which has failed to pay its net-net debit obligation, members that are represented by such insolvent bank will be charged pro rata for amounts owed by the insolvent bank.

NSCC Procedure IX ("Special Services") is being revised to indicate that even though SDFS is being implemented, NSCC will retain the right to effect payments on a direct clearing member's behalf, other than for NSCC money settlement, either through the use of checks or by initiating wire transfer instructions.

Addendum B ("Standards of Financial Responsibility and Operational Capability") is being revised to clarify that the criteria set forth therein with respect to bank applicants do not apply to applicants for settling bank only membership. Settling bank only members are required to meet the operational and financial requirements set forth in Addendum B(I)(A) and other requirements established by NSCC.<sup>7</sup>

NSCC believes that its short term funding resources are adequate and that it is extraordinarily unlikely that it would need to implement any liquidity contingency plan. Nevertheless, the rule change includes a revised Addendum F ("Statement of Policy in Relation to Same Day Funds Settlement") which sets forth a liquidity contingency plan to be employed in the event that funding resources are insufficient. The statement permits NSCC to reverse debits and credits arising from non-guaranteed services to the extent necessary to

<sup>4</sup> Pursuant to its Procedure IX(B), NSCC makes available to participants that do not maintain a direct membership in a qualified securities depository the facilities of a qualified securities depository through the use of a sponsored account. The account is under the jurisdiction of NSCC, and NSCC is solely responsible for all liabilities arising from the use of the account including the payment of fees to the qualified securities depository.

<sup>5</sup> *Infra* note 8 and accompanying text.

<sup>6</sup> Rule 32 governs the use of facsimile signatures by NSCC participants; Rule 33 provides NSCC's Board of Directors or its delegates the authority to prescribe NSCC procedures; Rule 36 relates to proposed rule changes and notification of proposed rule changes; and Rule 37 provides procedures by which hearings are requested and conducted.

<sup>7</sup> NSCC requires settling bank only members to have a short-term obligation rating of at least A-2 by Standard and Poor's Corporation or P-2 by Moody's Investors Services Incorporated. For a further description of the financial responsibility and operational capability requirements for settling bank only members, refer to Securities Exchange Act Release No. 36714 (January 16, 1996), 61 FR 1807 [File No. SR-NSCC-95-13] (order approving proposed rule change enabling members settling mutual fund transactions in same-day funds to settle through a settling bank).

eliminate the liquidity problem, as determined by NSCC. It also permits NSCC to spread its obligations to make payments over such period of time as is necessary to eliminate the liquidity crisis. If the liquidity problem arises as a result of CNS deliveries, the policy statement permits NSCC to return CNS deliveries to the delivering member until such time as NSCC is able to pay for the deliveries. NSCC will reimburse members whose securities are returned for the financing costs incurred during the intervening period.

NSCC recognizes that its requirement that each member appoint a settling bank may impose an undue burden on fund members or mutual fund services members, which members use only non-guaranteed services. Therefore, Addendum F includes a provision which allows NSCC on a case by case basis to waive the requirement that a member appoint a settling bank to the extent that this requirement creates an undue burden on such a member.

The conversion to SDFS also requires NSCC to make certain amendments to the current NSCC/DTC Agreement.<sup>8</sup> The current NSCC/DTC Agreement provides that with respect to participants common to both entities ("common members"), DTC and NSCC agree to net daily a common member's final net settlement debit or credit at one entity with the common member's final net settlement credit or debit at the other entity. In most instances, the result will be either one net debit obligation payable to either DTC or NSCC or one net credit receivable from either DTC or NSCC.<sup>9</sup> In the event of a default of a common member, the current NSCC/DTC Agreement also provides that any resources remaining after the failed common member's obligations to the guaranteeing clearing agency have been satisfied will be made available to the other clearing agency. The guaranty is not absolute but rather is limited to the extent of the resources relative to the failed member remaining at the guaranteeing clearing agency. The principal resources will be the failed member's settlement net credit balances and its deposits to the clearing agencies' clearing funds.

The proposed rule change amends the current NSCC/DTC Agreement to

include cross-guaranties of NSCC and DTC arising from transactions effected through NSCC's continuous net settlement ("CNS") system. NSCC's CNS system continually nets all trades due to settle the next day against each other and against prior days' unsettled long and short positions in the same securities. NSCC is the counterparty to each CNS transaction. Thus, NSCC participants obligated to deliver securities deliver the securities to NSCC as free, book-entry movements at DTC ("short covers"). NSCC participants obligated to receive securities will receive the securities from NSCC as free, book-entry movements at DTC ("long allocation").

Certain cross-guarantees between NSCC and DTC are being established to permit transactions to flow smoothly between DTC's system and the CNS system in a collateralized SDFS environment. Under the amended NSCC/DTC Agreement, DTC will provide a guarantee to NSCC of all long allocations, and NSCC will provide a guarantee to DTC for all short covers. These guarantees will ensure, among other things, that debits created in DTC's system continue to be collateralized when the securities serving as collateral are delivered into the CNS system as short covers and will reduce risk at NSCC by ensuring that long allocations or the approximate value of long allocations will be made available to NSCC to cover certain exposures.

When securities received versus payment in DTC's system are turned into CNS short covers, NSCC will provide a guarantee to DTC equal to the prior day's closing price of the securities.<sup>10</sup> If CNS short covers are satisfied from securities that were not received versus payment in DTC's system, NSCC will provide a guarantee to DTC equal to the prior day's closing market value less an applicable haircut. DTC will take this guarantee into account for collateral monitor purposes.

When long allocations to participants are redelivered in DTC's system, DTC will provide a guarantee to NSCC equal to the prior day's closing price of the long allocations less an applicable haircut. The guarantee will serve as a collateral substitute for long allocations and only will be called on to the extent a participant fails to settle due to insolvency and NSCC's own internal close-out procedures result in a net loss to NSCC. DTC will apply its normal collateralization controls to the value of its guarantee to NSCC to ensure that it

has sufficient collateral to cover potential guarantee obligations to NSCC as the result of a participant redelivering CNS long allocations in DTC's system.

It is the industry's intention that the conversion SDFS take effect on February 22, 1996; therefore, NSCC is seeking approval of these changes to coincide with this date.

NSCC believes the proposed rule change is consistent with the requirements of Section 17A of the Act and the rules and regulations thereunder because the rule proposal will promote the prompt and accurate clearance and settlement of securities transactions.

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

NSCC does not believe that the proposed rule change will impact or impose a burden on competition.

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

No written comments have been solicited or received. NSCC will notify the Commission of any written comments received by NSCC.

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

Section 17A(b)(3)(F) of the Act<sup>11</sup> requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.

The Commission believes that NSCC's proposed rule change is consistent with NSCC's obligations under Section 17A(b)(3)(F) to facilitate the prompt and accurate clearance and settlement of securities transactions because the proposed rule change should facilitate NSCC's conversion to an entirely SDFS system by including provisions in NSCC's rules relating to an SDFS system. The conversion to a SDFS system should help reduce systemic risk by eliminating overnight credit risk. The SDFS system also should reduce risk by achieving closer conformity with the payment methods used in the derivatives markets, government securities markets, and other markets.

<sup>8</sup>For a complete description of DTC's and NSCC's current agreement, refer to Securities Exchange Act Release No. 33548 (January 31, 1994), 59 FR 5638 [File Nos. SR-DTC-93-08 and SR-NSCC-93-07] (order approving proposed rule change).

<sup>9</sup>If a common member has either a net settlement debit at both DTC and NSCC or a net settlement credit at both DTC and NSCC, the common member will make payments to both DTC and NSCC or receive payments from both DTC and NSCC.

<sup>10</sup>The guarantee from NSCC to DTC is calculated on a per share basis.

<sup>11</sup>15 U.S.C. § 78q-1(b)(3)(F) (1988).

The Commission also believes the proposal is consistent with NSCC's obligations to assure the safeguarding of securities and funds in its custody or control and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions because the proposed rule change should further reduce NSCC's and DTC's risk exposure by amending the NSCC/DTC Agreement to include cross-guaranties for transactions effected through NSCC's CNS system. The guaranties should, among other things, ensure that debits created in DTC's system continue to be collateralized when the securities serving as collateral are delivered into the CNS system as short covers.

Additionally, the guaranties also should reduce risk at NSCC by ensuring that long allocations or the appropriate value of long allocations will be available to NSCC to cover certain exposures.

NSCC has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing. The Commission finds good cause for so approving the proposed rule change because the proposed rule change modifies NSCC's rules and the NSCC/DTC Agreement in anticipation of NSCC's and the securities industry's conversion to SDFS on February 22, 1996. Accelerated approval of the proposal will allow NSCC to effect the conversion and to implement the safeguards provided under the NSCC/DTC Agreement on that date.

#### 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 NSCC. All submissions should

refer to the file number SR-96-03 and should be submitted by March 19, 1996.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NSCC-96-03) be, and hereby is, approved.

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

Margaret H. McFarland,

*Deputy Secretary.*

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[Release No. 34-36860; File No. SR-OCC-96-02]

#### **Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Accelerated Approval of a Proposed Rule Change to Modify the Stock Loan/Hedge Program to Accommodate Same-Day Funds Settlement**

February 20, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on January 16, 1996, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change (File No. SR-OCC-96-02) as described in Items I and II below, which items have been prepared primarily by OCC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

##### **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 modify OCC's rules relating to its Stock Loan/Hedge Program ("Hedge Program")<sup>2</sup> to reflect the conversion of the equity securities processing operations of The Depository Trust Company ("DTC") to a same-day funds settlement ("SDFS") system.

##### **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

<sup>12</sup> 17 CFR 200.30-3(a)(12) (1995).

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> For a description of OCC's Stock Loan/Hedge Program, refer to Securities Exchange Act Release No. 32638 (July 15, 1993), 58 FR 39264 [File No. SR-OCC-92-34] (order granting permanent approval of the Stock Loan/Hedge Program).

the purpose of and basis for the proposed rule change and discussed any comments that 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>3</sup>

##### **(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 make technical modifications to OCC's rules governing its Hedge Program to accommodate the conversion by DTC of its equity securities processing operations to an SDFS system. DTC is scheduled to convert to an SDFS system on February 22, 1996.

Stock loans under the Hedge Program are effected by a book-entry transfer on the books of a correspondent depository (*i.e.*, a securities depository at which OCC has an account and which provides services to OCC in connection with the Hedge Program). The Midwest Securities Trust Company ("MSTC") had acted as the only correspondent depository since the Hedge Program was established. However, MSTC has withdrawn from the securities depository business,<sup>4</sup> and OCC has made arrangements for DTC to act as a correspondent depository for the Hedge Program.

Under OCC's rules governing the Hedge Program, after two participating clearing members have agreed to the terms of a stock loan, the lending clearing member transfers the stock that is the subject of the loan by book-entry into OCC's account at a correspondent depository. The lending clearing member's transfer instructions identify the borrowing clearing member and specify the amount of cash to be received as collateral by the lending clearing member. Once the stock is delivered into OCC's account, OCC instructs the correspondent depository to redeliver the stock to the account of the borrowing clearing member against payment of the required collateral. The cash payments also are effected through

<sup>3</sup> The Commission has modified the text of the summaries submitted by OCC.

<sup>4</sup> Securities Exchange Act Release No. 36684 (January 5, 1996), 61 FR 1195 (January 17, 1996) [File Nos. SR-CHX-95-27, SR-DTC-95-22, SR-MCC-95-04, SR-MSTC-95-10, and SR-NSCC-95-15] (order approving arrangements relating to a decision by the Chicago Stock Exchange, Inc. to withdraw from the clearance and settlement, securities depository, and branch receives business).