

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 with held 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 Section 450 Fifth Street NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of NSCC. All submissions should refer to File No. SR-NSCC-96-05 and should be submitted by April 2, 1996.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-36930; File No. SR-NSCC-95-17]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of a Proposed Rule Change To Establish Additional Procedures for Placing Settling Members on Class A Surveillance and Collecting Clearing Fund and Other Collateral Deposits for Settling Members

March 6, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on December 20, 1995, the National Securities Clearing Corporation ("NSCC") 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 primarily by NSCC. The Commission is publishing this notice to solicit comments from interested persons.

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

The proposed rule change seeks to establish additional procedures in connection with placing NSCC members on Class A surveillance. The proposal also seeks approval of special clearing fund deposit and other collateral requirements for NSCC members placed on Class A surveillance.

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 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.²

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

Rule 15, Section 3 of NSCC's rules provides that any settling member³ shall furnish NSCC such adequate assurances of its financial responsibility and operational capability as NSCC may at any time or from time to time deem necessary or advisable in order to protect NSCC. Section 4 of rule 15 further states that such adequate assurances may include, but are not be limited to, requiring increased clearing fund deposits of settling members. Section III.B.1.o. of Addendum B to NSCC's rules permits NSCC to place any settling member on Class A surveillance status due to the presence of any condition which could materially impact the operational or financial viability of a settling member which increases or may potentially increase exposure to NSCC.

NSCC's Board of Directors has determined that settling members can materially impact their financial viability by conducting significant clearing business for over-the-counter ("OTC") market makers or by engaging in OTC market making. In turn, this could potentially increase exposure to NSCC when the market maker, either

along or acting in concert with other market makers, takes net street-side trading positions that constitute a disproportionately large percentage of the total net street-side buys or net street-side sells in any issue (*i.e.*, the market maker dominates one side of the market in the issue) and has insufficient capital or access to capital to support the positions in dominated issues.

The potential for increased exposure to NSCC becomes greater to the extent that one or more additional risk factors are present. These additional risk factors include, without limitation:

- (1) Concentrated short selling in dominated issues;
- (2) Undue concentration of inventory in the market maker(s) for dominated issues;
- (3) Dominated issues also being IPSs less than six months past initial issuance particularly when the current value of the issue is significantly different from its initial sales price or there is undue concentration of inventory in the managing underwriter(s); and
- (4) Clearing positions of market makers in dominated issues away from their primary clearing brokers.

To the extent that a market maker's net street-side trading positions in dominated issues result from legitimate customer orders, the potential adverse impact on the financial viability of a settling member and the potential for increased exposure to NSCC would be mitigated.

In light of the foregoing, NSCC has filed for approval its policy of placing settling members on Class A surveillance if they clear for or are themselves OTC market makers, and they do not have sufficient capital or access to capital to support either potential increases in market making activity in dominated issues of the type described above or if there is the presence of the additional risk factors described above in current volumes of market maker activity. At its discretion, NSCC may elect not to place settling members on Class A surveillance if it has obtained sufficient assurances of a high degree of mitigating circumstances. However, the mere fact that a market maker has a large customer base may not necessarily constitute the necessary mitigating circumstances especially if the customers are retail and/or the market maker has a history of customer complaints or other adverse regulatory or disciplinary actions.

Pursuant to Rule 15, NSCC has filed for approval its proposed interim collateralization policy which would permit NSCC, in its discretion, to require settling members placed on

² The Commission has modified the text of the summaries prepared by NSCC.

³ NSCC Rule 1 defines a "settling member" as any NSCC member or non-clearing member, and except where a contrary intent is expressed in the rules, settling member includes a special representative.

⁷ 17 CFR 200.30-3(a)(12) (1995).

¹ 15 U.S.C. 78s(b)(1) (1988).

Class A surveillance who clear for or are themselves OTC market makers to meet special collateralization requirements as follows.

(1) To the extent that the sum of the absolute values of the net unsettled trading positions of any such settling member in all the securities dominated⁵ by a market maker exceeds the market maker's excess net capital, NSCC may require the settling member to deposit the amount of the excess with NSCC at such times and in such manner as NSCC may designate, including an immediate deposit of same-day funds.⁶ In determining the size of net unsettled trading positions, NSCC may take into account offsetting, pending (*i.e.*, non-fail) institutional delivery ("ID") transactions that have been confirmed, and when NSCC deems appropriate, affirmed⁷ through the ID system of a clearing agency registered under Section 17A of the Act ("registered clearing agency").⁸ In addition, if a market maker's net unsettled trading positions in dominated issues are cleared by one or more other settling members, including any settling member on Class A surveillance, NSCC will have the discretion, for purposes of calculating the special collateral deposit, of treating those positions as if they were all cleared by a settling member on Class A surveillance.

(2) To the extent that the unsettled positions referred to in paragraph (1) above are short (*i.e.*, net sells), NSCC may in its discretion collect more than 100% of the market maker's excess net capital or may require or accept in lieu of cash collateral a book-entry delivery of securities to NSCC sufficient to cover the short position.

(3) NSCC will reserve the right at all times to accept alternative arrangements for its protection in any of the above situations. NSCC may require special collateral deposits with respect to trading positions in issues dominated by a market maker even when the value of those positions do not exceed the market maker's excess net capital. NSCC may also choose to forego collecting such special collateral even when the value of those positions exceed the

market maker's excess net capital (but do not exceed some higher threshold) as the situation may warrant depending upon, among other things, the presence or absence of additional risk factors or mitigating circumstances.

The special collateralization requirements described above are interim measures for settling members on Class A surveillance which will be in effect until NSCC has gained enough experience in surveillance of OTC market maker trading activities to impose permanent special collateralization requirements. Additionally, if there is concentrated short selling in dominated issues, NSCC will maintain its right to collect special collateral deposits from the settling members clearing the short sales without regard to their surveillance status. Special collateral collected from any settling member pursuant to the above procedures will be in addition to the settling member's clearing fund deposit computed in accordance with the formulae set forth in NSCC Procedure XV or in accordance with the alternative method set forth below.

NSCC also recognizes that settling members on Class A surveillance have been determined to present a higher than normal risk of default and insolvency. As a result, NSCC has proposed that such settling members be required to make clearing fund deposits keyed to the close-out risk presented by their unsettled positions in NSCC's systems. Therefore, pursuant to Rule 15 NSCC proposes that it shall have the discretion to compute the continuous net settlement ("CNS") clearing fund requirements for any settling member on Class A surveillance without regard to particular individual circumstances and in accordance with the following alternative method rather than as set forth in NSCC Procedure XV.

(1) NSCC may calculate on a daily or periodic basis the volatility of any such settling member's net unsettled trading positions in CNS eligible issues ("net CNS trading positions"). Such positions shall be determined after taking into account offsetting pending (*i.e.*, non-fail) ID transactions that have been confirmed, and when NSCC deems appropriate, affirmed⁹ through the ID system a registered clearing agency. Such calculation will be made in accordance with the Capital Asset Pricing Model or any other generally accepted portfolio volatility model including without limitation any margining formula employed by any other registered clearing agency provided, however, that not less than

two standard deviations' volatility shall be calculated under any model chosen. Such calculation will be made utilizing such assumptions and based on such historical data as NSCC deems reasonable and shall cover such range of historical volatility as NSCC from time to time deems appropriate. If such volatility is calculated on a periodic basis, it may be expressed as a percentage of the sum of the absolute values of the firm's net CNS trading positions. Any such calculations, whether expressed as a dollar value or percentage, may be rounded as NSCC deems appropriate.

(2) NSCC shall have the discretion to exclude from the above calculations net CNS trading positions in classes of securities whose volatility is (i) less amenable to statistical analysis, such as OTC bulletin board or pink sheet issues or issues trading below a designated dollar threshold (*e.g.*, five dollars), or (ii) amenable to generally accepted statistical analysis only in a complex manner (*e.g.*, municipal or corporate bonds). The amount of clearing fund required with respect to net CNS trading positions in such issues shall be determined by multiplying the absolute value of such positions by a percentage designated by NSCC, which percentage may vary depending on such factors as NSCC deems relevant.

(3) The amounts calculated in accordance with the immediately preceding two numbered paragraphs will be substituted for the amount calculated in accordance with paragraph (1)(c) of Sections A.I.(a), A.II.(a), and A.II.(b) of Procedure XV set forth in NSCC's rules. In addition, NSCC may in its discretion reduce or eliminate the amount calculated in accordance with paragraph (1)(a) of such sections.

(4) NSCC in its discretion also may calculate the total clearing fund requirement of any settling member on a daily basis instead of a twenty day rolling average basis and may collect deficiencies at such times and in such manner as specified by NSCC from time to time, including immediate collection of same-day funds.

Nothing in the foregoing rule proposal should be construed to limit NSCC's discretion with respect to placing settling members on Class A surveillance or requiring settling members to furnish adequate assurances of financial responsibility or operational capability as set forth in NSCC's Rules.

NSCC believes that the proposed rule change is consistent with the requirements of Section 17A(b)(3)(F)¹⁰ of the Act and the rules and regulations

⁵ Domination will be determined according to criteria specified by NSCC from time to time.

⁶ The term "same-day funds" refers to payment in funds that are immediately available and generally are transferred by electronic means.

⁷ In determining net unsettled trading positions, NSCC in its discretion under certain circumstances may elect to take into account offsetting pending confirmed ID transactions only if such transactions also have been affirmed. Moreover, NSCC may decline to consider any ID transaction if it has reason to believe that the institutional counterparty may not or cannot settle such transaction.

⁸ 15 U.S.C. § 78q-1 (1988).

⁹ *Id.*

¹⁰ 15 U.S.C. § 78q-1(b)(3)(F) (1988).

thereunder applicable to NSCC because the default or insolvency of any settling member potentially imposes burdens and costs on NSCC and all of its members and that the procedures described above are designed to reduce these burdens and costs.

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

NSCC does not believe that the proposed rule will have an 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 relating to the rule filing have been solicited or received. NSCC will notify the Commission of any written comments received.

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 NSCC consents, the Commission will:

- (a) By order approve such proposed rule change or
- (b) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submission should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington D.C. 20549. Copies of the submissions, 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 filings will also be available for inspection and copying at the principal office of NSCC. All submissions should

refer to the file number SR-NSCC-95-17 and should be submitted by April 2, 1996.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 96-5844 Filed 3-11-96; 8:45 am]

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[Release No. 34-36927; File No. SR-NYSE-95-45]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Additions to "List of Exchange Rule Violations and Fines Applicable Thereto Pursuant to Rule 476A"

March 5, 1996.

On December 28, 1995, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to revise the List of Exchange Rule Violations and Fines Applicable Thereto Pursuant to Rule 476A ("476A List") to include NYSE Rule 476(a)(10) and certain provisions of NYSE Rule 95 and NYSE Rule 127. The NYSE also requested approval, under Rule 19d-1(c)(2), to amend its Rule 19d-1 Minor Rule Violation Enforcement and Reporting Plan ("MRVP") to include the items proposed for addition to the 476A List.³

The proposed rule change was published for comment in Securities Exchange Act Release No. 36756 (Jan. 22, 1996), 61 FR 2856 (Jan. 29, 1996). No comments were received on the proposal.

In 1984, the Commission adopted amendments to Rule 19d-1(c) to allow SROs to submit, for Commission approval, plans for the abbreviated reporting of minor rule violations.⁴ The

Commission, in adopting Rule 19d-1, attempted to balance the informational needs of the Commission against the reporting burdens of the SROs,⁵ and with paragraph (c) of Rule 19d-1 the Commission further attempted to reduce those reporting burdens by permitting, where immediate reporting was unnecessary, quarterly reporting of minor rule violations. Rule 19d-1(c), however, was intended to be limited to rules that can be adjudicated quickly and objectively.

In 1985, the Commission approved a NYSE plan for the abbreviated reporting of minor rule violations pursuant to Rule 19d-1(c). The NYSE MRVP, as embodied in NYSE Rule 476A, provides that the Exchange may designate violations of certain rules as minor rule violations. The Exchange may impose a fine, not to exceed \$5,000, on any member, member organization, allied member, approved person, or registered or non-registered employee of a member or member organization for a violation of the delineated rules by issuing a citation with a specific penalty.⁶ Such person can either accept the penalty or request a full disciplinary hearing on the matter.⁷ The Exchange also retains the option of bringing violations of rules subject to NYSE Rule 476A to full disciplinary proceedings, and the Commission expects the Exchange to do so for egregious or repeated violations.

The NYSE currently is adding to the 476A List and MRVP: (1) misstatements or omissions of fact on any submission filed with the Exchange as provided in NYSE Rule 476(a)(10); (2) failure to comply with the requirements of NYSE Rule 95 with respect to its order identification requirements or prohibition of transactions by members on the Floor involving discretion; and

be considered "final" for purposes of Section 19(d)(1) of the Act if the sanction imposed consists of a fine not exceeding \$2,500 and the sanctioned person has not sought an adjudication, including a hearing, or otherwise exhausted his or her administrative remedies. By deeming unadjudicated minor violations as not final, the Commission permits the SRO to report violations on a periodic, rather than on an immediate, basis.

⁵ See Securities Exchange Act Release No. 13762 (July 8, 1977), 42 FR 35411 (July 14, 1977).

⁶ The List is contained in Supplementary Material to NYSE Rule 476A. As discussed *supra*, note 4, only those fines imposed that are not in excess of \$2,500 are subject to periodic reporting. Fines imposed pursuant to Rule 476A in excess of \$2,500 are deemed final and therefore must be reported immediately to the Commission consistent with the reporting requirements of Section 19(d)(1) of the Act.

⁷ As discussed *supra*, note 4, any sanction for which a full disciplinary hearing was requested or administrative remedies otherwise have been exhausted is considered final and must be reported immediately to the Commission consistent with the reporting requirements of Section 19(d)(1) of the Act.

¹¹ 17 CFR 200.30-3(a)(12) (1994).

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Daniel Parker Odell, Assistant Secretary, NYSE, to Glen Barrentine, Team Leader, Division of Market Regulation, SEC, dated December 27, 1995.

⁴ See Securities Exchange Act Release No. 21013 (June 1, 1984), 49 FR 23828 (June 8, 1984). Pursuant to paragraph (c)(1) of Rule 19d-1, an SRO is required to file promptly with the Commission notice of any final disciplinary action taken by the SRO. Pursuant to paragraph (c)(2) of Rule 19d-1, any disciplinary action taken by an SRO for a violation of an SRO rule that has been designated a minor rule violation pursuant to the Plan shall not