Washington, DC 20549. 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 No. SR–CBOE–96–09 and should be submitted by April 2, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[4]

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[Release No. 34–36933; File No. SR–GSCC–96–01]

Self-Regulatory Organizations; Government Securities Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to the Enhancement of Risk Management Processes

March 6, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on January 5, 1996, Government Securities Clearing Corporation (''GSCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change (File No. SR–GSCC–96–01) as described in Items I, II, and III below, which items have been prepared primarily by GSCC. 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 purpose of the proposed rule change is to modify GSCC's risk management processes.

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

In its filing with the Commission, GSCC 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. GSCC 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

As a part of GSCC's continuous process of reviewing its risk management mechanism, GSCC is seeking approval to make various enhancements and revisions to that mechanism. The impetus for certain of the enhancements and revisions arose out of the design of the risk management process for GSCC's newly implemented netting service for repurchase agreements (''repos'') and as the result of recommendations made by Commission staff during their inspection of GSCC last year. Each of the proposed changes to GSCC's risk management process is described in detail below.

(1) Change in the Clearing Fund Formula: Funds Adjustment Component

A netting member's clearing fund requirement is based on a formula designed to take into account the two basic risks posed to GSCC by netting members. These risks are: (1) that a member might not pay a funds-only settlement amount due to GSCC and (2) that a member might not deliver or take delivery of securities that comprise a net settlement position. There are three components to the clearing fund deposit requirement: (1) the funds adjustment component, (2) the receive/delivery settlement component, and (3) the repo volatility component. The sum of the three components is a member's total clearing fund deposit requirement.

The first component of the clearing fund is the funds adjustment component, which addresses the potential risk that a member might not pay a funds-only settlement amount due to GSCC. Historically, this component has represented about ten percent of the total clearing fund requirement. The funds adjustment component is 125% of the average of a member's ten largest funds-only settlement amounts measured on an absolute basis during the most recent seventy-five business days.

Because GSCC did not have an historical data base, the use of the additional twenty-five percent cushion was introduced at the start of the netting system in 1989 as a conservative measure designed to ensure that GSCC's original margin process was a prudent one. GSCC now believes that this cushion is no longer necessary because the funds adjustment component recently was made more conservative with revisions to take into account the ten largest funds amounts over the most recent seventy-five business days.[3] However, under the proposed rule change GSCC will retain the right to reinstitute at its discretion all or a part of this cushion for a temporary period. For example, GSCC might reinstitute this cushion under volatile market conditions.

Moreover, GSCC believes that the use of an average of the ten largest amounts leads to an overly conservative measure of funds settlement exposure. Thus, GSCC proposes to revise the funds adjustment component to require 100% of the average of the twenty largest funds-only settlement amounts during the most recent seventy-five business days.[4]

(2) Change in the Clearing Fund Formula: Receive/Deliver Settlement Component

The second component of the clearing fund requirement is the receive/deliver settlement component, which is based on the size and nature of a member's net settlement positions. The margin collected on net settlement positions is determined by applying margin factors that are designed to estimate daily security price movements. The factors are expressed as percentages and are determined by historical daily price volatility.[5] The product of a security's settlement value and its corresponding margin factors is used as proxy for the estimated amount of loss to which GSCC is potentially exposed from price changes.

There are four potential receive/deliver contribution amounts computed each day for GSCC netting members other than Category 2 dealer or Category 2 future commission merchant members.[6] The four amounts are compared daily and the largest amount is included in a member's clearing fund

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[4] 17 CFR 200.30–3(a)(12) (1994).

[1] 15 U.S.C. 78s(b)(1) (1988).

[2] The Commission has modified the text of the summaries prepared by GSCC.

[3] Prior to the implementation of GSCC's netting service for repos, GSCC's rules required computation of the average of a member's absolute funds amounts over the prior twenty business days. Securities Exchange Act Release No. 36491 (November 17, 1995), 60 FR 61577 (order approving proposed rule change).

[4] This change will be made to both paragraphs (b) and (d) of Rule 4, Section 2 of GSCC's rules. Paragraph (b) applies to bank netting members, Category 1 dealer netting members, Category 1 futures commission merchant netting members, Category 2 inter-dealer broker netting members, government securities issuer netting members, insurance company netting members, and registered investment company netting members. Paragraph (d) applies to Category 2 dealer netting members and Category 2 futures commission merchant netting members.

[5] See Section 4 below for a discussion of GSCC's margin factors.

[6] GSCC's method of calculating the receive/deliver settlement component for Category 2 dealer and Category 2 futures commission merchant members is set forth below.

requirement. The potential contribution amounts are:

(i) *Post-Offset Margin Amount (''POMA''):* The POMA reflects offsets of gains against losses in liquidating a member's positions that may be expected based on historical experience. The POMA essentially is a member's total gross margin (*i.e.*, GSCC's margin factors multiplied by the dollar value of a member's current outstanding net settlement position) taking into account allowable offset percentages.[7]

(ii) *Average POMA:* The average POMA is based, in the ordinary course, on the member's ten highest POMA amounts occurring in the most recent seventy-five business days, including the current day's POMA amount.

(iii) *Adjusted POMA:* The adjusted POMA is calculated the same as the POMA with the exception of excluding all trades that are scheduled to settle on the current day. This is done based on the assumption that those trades will settle on the current day; thus, calculating POMA in this manner will more accurately reflect GSCC's settlement exposure during the current day.

(iv) *Liquidation Amount:* This is a floor amount equalling fifty percent of the total gross margin on all long and short positions without offsets.

The liquidation amount is a conservative measure designed to ensure that if the margin offsets ordinarily allowed in calculating the receive/deliver component do not reflect actual market conditions during a liquidation period, GSCC will still have a sufficient level of collateral protection. In other words, this minimum requirement protects against the risk that during a liquidation period the yield curve will be aberrational. In such a situation, collection of a minimum amount of margin based on a gross calculation ensures that GSCC will have sufficient collateral to cover liquidation losses.

GSCC believes that the percentage used to compute the liquidation amount should be lowered from fifty percent to twenty-five percent. The imposition of a fifty percent floor (*i.e.*, fifty percent of the total margin on all long and short positions without offsets) has proven to be an unduly high minimum. In particular, for a member that engages in trading activity on a fully-hedged basis, a fifty percent floor effectively negates the benefits afforded by being fully hedged. GSCC believes that a twenty-five percent floor amount is sufficient to protect GSCC from the risk that its margin offsets will not reflect actual market conditions during a liquidation period.

Moreover, GSCC believes that the use of an average of the ten largest POMA amounts in calculating the average POMA leads to an overly conservative measure of securities settlement exposure. Thus, GSCC proposes to use an average of the twenty largest POMA amounts during the most recent seventy-five business days.

GSCC also is proposing to delete sections (2)(g)(i) and (2)(g)(ii) of Rule 4 regarding alternative formulas for the receive/deliver settlement component of the required clearing fund deposit. GSCC has not found the alternative calculation under subsection (g)(i), which disregards when-issued trades that have been issued, to be useful and subsection (g)(ii) has been made obsolete by the changes approved in GSCC's filing pertaining to its repo netting service.[8]

With respect to Category 2 dealer or Category 2 futures commission merchant members, the receive/deliver settlement component is the larger of (1) the member's total gross margin without offsets, (2) the member's total gross margin without offsets and excluding positions due to settle that day, or (3) the average of the member's largest ten gross margin amounts over the most recent seventy-five business days. For the third calculation, GSCC proposes to use the average of the largest twenty gross margin amounts over the most recent seventy-five business days.

(3) Change in the Clearing Fund Formula: Repo Volatility Component

The third component of the clearing fund requirement is the repo volatility component. This component was recently added to GSCC's clearing fund formula to cover securities' settlement exposure posed by repo activity. The repo volatility component is the greater of (1) the product of the repo volatility factor and the market value of the member's repo transactions taking into account allowable offset percentages (''repo offset amount'') or (2) the average of a member's ten highest repo offset amounts over the most recent seventy-five business days. GSCC proposes to revise the second element of this calculation to take the average of a member's twenty highest repo offset amounts over the most recent seventy-five business days.

(4) Providing GSCC With Discretion, within Parameters, to Lower Margin Factors

GSCC's Membership and Standards Committee (''Committee') reviews on an ongoing basis the appropriateness of its margin factors[9] by examining third-party price volatility data and GSCC's own short-term and long-term data covering ninety-five and ninety-nine percent of all price movements. However, GSCC is not allowed under its current rules to lower any of its margin factors without first obtaining Commission approval through a formal rule filing process.

GSCC believes that it needs flexibility to lower a margin factor without first completing the formal rule filing process. Thus, GSCC proposes to revise its rules to permit the Committee to lower a margin factor subject to a predefined limitation if the Committee determines it appropriate based on its review of historical price volatility data and if the GSCC Board of Directors approves such a lower margin factor. The predefined limitation would provide that GSCC could reduce a margin factor to a level that is no lower than the higher of (1) the price volatility for that remaining maturity category taking into account ninety-five percent of all movements covering the last calendar quarter or (2) the price volatility for that remaining maturity category taking into account ninety-five percent of all movements covering the last calendar year. With respect to the margin factors for Category 2 dealer members and futures commission merchant members, the limitation would provide that GSCC could reduce a margin factor to a level that is no lower than the higher of (1) the price volatility for that remaining maturity category taking into account ninety-nine percent of all movements covering the last calendar quarter or (2) the price volatility for that remaining maturity category taking into account ninety-nine percent of all movements covering the last calendar year.

(5) Revision of Certain Margin Factors for Zero-Coupon Government Securities Other Than Treasury Bills (''Zeros'')

As noted above, GSCC's margin factors are based on an assessment of historical daily price volatility data. GSCC reviews the accuracy of those

[7] Margin amounts on receive (long) and deliver (short) positions are allowed to offset each other. The extent to which an offset is allowed is determined by product and the degree of similarity in time remaining to maturity.

[8] *Supra* note 3.

[9] As defined in GSCC's rules, margin factors and Category 2 margin factors are percentages, which GSCC publishes from time to time, representing variations weighted by maturity and product type. These margin factors are used in GSCC Rule 4, Section 2 to calculate the receive/deliver settlement component of the required fund deposit for GSCC's members.

margin factors by consideration of third-party price volatility data and its own short-term and long-term data covering ninety-five and ninety-nine percent of all price movements. Zeros require different margin factors than other Treasury securities because zeros generally are subject to greater price volatility than are other Treasury securities with the same maturity.

The applicable margin percentages for zeros range from percentages that are the same as those for other Treasury securities with respect to shorter-term maturities to two-and-a-half times that applicable to other Treasury securities with respect to longer-term maturities. These differences initially were based on the differences in the amount of haircut factors between zeros and other Treasury securities found in the United States Treasury Department's liquid capital requirements for government securities brokers and dealers.

GSCC believes that its current applicable margin factors for zeros in the three longest remaining maturity classes are too high.[10] The current margin factor for zeros with a remaining maturity of seven to ten years is 1.870 percent, which is well above the price volatility that GSCC's internal data show for that category under any measure. Measured against GSCC's data at the ninety-nine percent level over the past two years, the applicable margin factor is roughly thirty-three basis points higher. Thus, GSCC proposes to lower the applicable margin factor for the seven to ten years remaining maturity category to 1.50 percent.

The margin factor for zeros with a remaining maturity of ten to fifteen years is 2.813 percent, which is well above the price volatility that GSCC's internal data show for that category under any measure. Measured against GSCC's data at the ninety-nine percent level over the past two years, the applicable margin factor is almost a point higher. Thus, GSCC proposes to lower the applicable margin factor for the ten to fifteen years remaining maturity category to 1.813 percent.

The margin factor of 3.625 percent for zeros with a remaining maturity of fifteen years or greater, the longest maturity category, also appears to be too high when compared to the price volatility that GSCC's internal data show for that category. Again, measured against GSCC's data at the ninety-nine percent level over the past two years, the applicable margin factor is eighty-nine basis points higher. Thus, GSCC proposes to lower the applicable margin factor for the fifteen years and higher remaining maturity category to 2.625 percent.

(6) Introduction of a Tiered Surveillance Status Mechanism

GSCC proposes to place members that pose a heightened level of potential risk to GSCC on various levels of surveillance status in order to facilitate GSCC's ability to protect itself and its members. At the conclusion of their recent inspection of GSCC, Commission staff suggested that, in line with what many other clearing agencies have in place, GSCC establish different classes of surveillance for its members. GSCC believes this suggestion to be an appropriate one because it believes that expanding surveillance classes will enable it to appropriately categorize the degree of risk posed by a member and to react more swiftly to changes in a member's condition. Members will also have greater understanding of the specific actions GSCC may take.

GSCC's current rules require that a member be placed on surveillance status if one or more of a number of circumstances is present, including but not limited to a significant reorganization or change in control or management of the member. In addition, GSCC may place a member on surveillance status if one or more of a number of factors, such as a member experiencing a condition that could materially affect its financial or operational capability so as to potentially increase GSCC's exposure to loss or liability, is present.

GSCC proposes to use three surveillance categories. Under the proposed rule change, a member will be placed on Class 1 surveillance status if one or more of a number of factors pertaining to its financial condition is present, if it has been placed on surveillance status by another self-regulatory organization, or if it has been upgraded from Class 2 surveillance status within the past three calendar months. The financial condition factors that will result in Class 1 surveillance status include, but are not limited to (1) a member incurring recent significant net losses, (2) a member's required fund deposit obligation representing a significant portion of its net worth or net capital, and (3) a member experiencing any condition that could materially affect its financial or operational capacity. Class 1 surveillance status will result in GSCC more thoroughly monitoring a member's financial condition and activities and will provide GSCC with discretion to require a member to make more frequent financial disclosures, including interim and/or pro forma reports.

GSCC will place a netting member on proposed Class 2 surveillance status if one or more of a number of factors is present, including but not limited to (1) any element of a member's capital position falls below the minimum requirements, (2) a member has been upgraded from Class 3 surveillance status within the last three calendar months, (3) a member temporarily experiences are inability to meet its securities settlement obligations to GSCC in a timely fashion, and (4) a member's designated examining authority or appropriate regulatory agency has a pending action or investigation of the member that could call into question the member's ability to meet its obligations to GSCC. In addition to the consequences resulting from placement on Class 1 surveillance status, a member placed on Class 2 surveillance status will be required to maintain a required fund deposit in excess of the amount ordinarily required, as permitted under GSCC's rules.

A GSCC netting member will be placed on Class 3 surveillance status if GSCC is considering taking action under GSCC Rule 18 (Ceasing to Act for a Member) or GSCC Rule 20 (Insolvency of a Member).[11] A GSCC netting member on Class 3 surveillance status shall be placed on a final notification list. A netting member will remain on such final notification list until the conditions(s) that resulted in its assignment to Class 3 surveillance status have improved to an extent that GSCC deems appropriate to support reassignment of the member to Class 2 surveillance status.

(7) Simplification of the Clearing Fund Deficiency Call Mechanism

GSCC's rules currently permit GSCC to make clearing fund deficiency calls on a same day basis under the following four circumstances: (1) a member's current day's required clearing fund deposit exceeds by twenty-five percent the value of its clearing fund collateral,

[10] GSCC's margin factor schedule for zeros is contained in Exhibit B to GSCC's filing. A copy of the filing and all exhibits is available for copying and inspection in the Commission's Public Reference Room.

[11] Under Rule 18 (Cleasing to Act for a Member), GSCC may cease to act for a member upon notice to such member for such reasons as: (1) the member has failed to perform its obligations to GSCC or materially violated any GSCC rule, procedure, or agreement, (2) the member has failed to pay GSCC any payment required, (3) the member no longer meets its admissions or continuance standards, or (4) the member has been responsible for fraudulent or dishonest conduct. Under Rule 20 (Insolvency of a Member), GSCC will cease to act for a member if such member meets one of several tests of insolvency (*e.g.*, such member files a petition seeking relief under the Bankruptcy Code).

(2) a member's current day's required clearing fund deposit level exceeds by more than $250,000 the value of its clearing fund collateral, (3) a member is on surveillance status and its required clearing fund deposit as of the current day exceeds the value of its clearing fund collateral, or (4) a member's ''clearing fund funds-only settlement amount,'' which excludes clearance difference, invoice amount, and other miscellaneous amounts, for the current day exceeds by more than twenty-five percent its average daily clearing fund funds-only settlement amount over the most recent twenty business days.[12]

Over the years, the fourth circumstance, a twenty-five percent jump in the member's clearing fund funds-only settlement amount, which could represent a relatively small dollar amount, has not proven to be necessary and has become obsolete as a practical matter. At the conclusion of their recent inspection of GSCC, Commission staff suggested that GSCC should either monitor the funds-only deficiency call requirements or file with the Commission a proposed rule change eliminating it. GSCC believes that the funds-only deficiency call aspect of the clearing fund is unnecessary and should be eliminated.

Moreover, because GSCC is proposing the tiered surveillance status mechanism, GSCC believes that a clearing fund deficiency call, pursuant to which GSCC calls for any amount of deficiency, that is based on a member being on surveillance status should be invoked only if a member is on Class 2 or Class 3 surveillance status. Finally, since 1989 when the netting system was implemented, GSCC's rules have provided that GSCC automatically may make a clearing fund deficiency call at the beginning of each month. Given the adequacy of the same day deficiency call mechanism outlined above, GSCC believes that this monthly deficiency call mechanism is no longer appropriate and is therefore proposing to delete this provision.

(8) Elimination of the Noon Deadline for Satisfaction of Clearing Fund Deficiency Calls

GSCC issues by telephone call followed by telefax notices calls for additional clearing fund deposits by 9:00 a.m. The exact time that each telephone call is made is recorded. Under GSCC's current rules, a member has until the later of two hours after the receipt of a clearing fund deficiency call or noon to satisfy the call.

Receipt of clearing fund margin as early in the day as possible is a fundamental principle behind optimal risk management. GSCC's long term goal is to develop an automated mechanism pursuant to which it will be in receipt of clearing fund collateral by the time that the securities Fedwire opens in the morning, which is currently at 8:30 a.m.

As an interim step toward achieving this goal, GSCC is proposing to eliminate the 12:00 p.m. alternative deadline for satisfaction of a clearing fund deficiency call and to require a member to satisfy a deficiency call within two hours after it is received. The practical effect of this change is that, in the ordinary course, a member will have to satisfy a deficiency call by approximately 11:00 a.m. In order to ensure that the elimination of the noon deadline does not produce an unduly harsh effect on members, GSCC also is proposing that a clearing fund deficiency call does not need to be satisfied before 10:00 a.m. regardless of when the call actually is made.

GSCC believes the proposed rule change will enhance GSCC's risk management processes in a prudent manner that is consistent with minimizing operational burdens on GSCC netting members and with maximizing the members' liquidity. Thus, GSCC believes the proposed rule change is consistent with the Section 17A of the Act and the rules and regulations thereunder applicable to a self-regulatory organization.[13]

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

GSCC does not believe that the proposed rule will have an impact on 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

Comments on the proposed rule change have not yet been solicited. GSCC members will be notified of the rule filing and comments will be solicited by an important notice. GSCC will notify the Commission of any written comments received by GSCC.

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

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(a) by order approve 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 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 in the Commission's Public Reference Section, 450 Fifth Street NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of GSCC. All submissions should refer to the file number SR–GSCC–96–01 and should be submitted by April 2, 1996.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[14]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–5845 Filed 3–11–96; 8:45 am]

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[Release No. 34–36932; File No. SR–NASD–96–7]

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

March 6, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] Notice is hereby given that on March 1, 1996, the National Association

[12] The clearance difference is the dollar difference between GSCC's system price for a settlement obligation and the actual value at which the settlement obligation was settled. The invoice amount means all fees that a member owes GSCC.

[13] 15 U.S.C. 78q–1 (1988).

[14] 17 CFR 200.30–3(a)(12) (1995).

[1] 15 U.S.C. 78s(b)(1) (1988).