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 at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CHX. All submissions should refer to File No. SR–CHX–97–08 and should be submitted by June 5, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[8]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–38589; International Series Release No. 1077; File No. 601–01]

Self-Regulatory Organizations; Morgan Guaranty Trust Company of New York, Brussels Office, as Operator of the Euroclear System; Notice of Filing of Application for Exemption From Registration as a Clearing Agency

May 9, 1997.

I. Introduction

On March 5, 1997, Morgan Guaranty Trust Company of New York (''MGT''), Brussels office (''MGT-Brussels), as operator of the Euroclear System [1] pursuant to a contract with Euroclear Clearance System Société Coopérative, a Belgian cooperative (''Belgian Cooperative''), filed with the Securities and Exchange Commission (''Commission'') an application on Form CA–1 [2] for exemption from registration as a clearing agency pursuant to Section 17A of the Securities Exchange Act of 1934 (''Exchange Act'') [3] and Rule 17Ab2–1 thereunder [4] to the extent it performs the functions of a clearing agency with respect to U.S. government and agency securities [5] for U.S. participants of the Euroclear System.[6] The Commission is publishing this notice to solicit comments from interested persons.[7]

II. Structure of the Euroclear System

MGT is a banking corporation organized under the laws of the State of New York. MGT-Brussels is the Brussels branch of MGT. MGT-Brussels is a division of MGT that has acted as the operator of the Euroclear System through its Euroclear Operations Centre since the creation of the Euroclear System in 1968. The Euroclear Operations Centre is a separate independent operational unit established within MGT-Brussels to operate the Euroclear System. Senior management of the Euroclear Operations Centre makes the decisions regarding the day-to-day operation of the Euroclear System.

The Euroclear System was established in 1968 by MGT-Brussels, which was then both its owner and operator. In 1972, a package of rights described as the Euroclear System was sold to Euroclear Clearance System Public Limited Company, an English limited liability company (''ECS–PLC''). The goal of the sale was to broaden the international market's participation in the formulation of general policy for the Euroclear System. MGT-Brussels was retained as operator of the Euroclear System. ECS–PLC purchased the rights to receive the revenues generated by the Euroclear System services, to approve participants, to determine eligible securities, to establish fees, and to make other similar decisions. MGT-Brussels retained all of the assets and means necessary to operate the Euroclear System and granted a license to ECS–PLC to use the Euroclear System trademarks.

The Belgian Cooperative was established in 1987 to further facilitate communication between Euroclear and the international securities industry and to encourage participation in the Euroclear System. It received a license from ECS–PLC to exercise some of ECS–PLC's rights as owner of the Euroclear System and to exercise such rights in relation to MGT-Brussels pursuant to an Operating Agreement. Neither ECS–PLC nor the Belgian Cooperative is an operating company. MGT-Brussels maintains all Euroclear System participant accounts on its own books, has established all subcustody accounts with Euroclear System subcustodians in its own name, and maintains all of the contractual relationships with Euroclear System participants and Euroclear System depositaries in its own name. It also provides all of the personnel, systems, trademarks, and operational capability used to deliver the Euroclear System services to Euroclear System participants. ECS–PLC and the Belgian Cooperative exercise their rights against MGT-Brussels through their respective Boards of Directors (collectively, ''Euroclear Boards''), which are composed of senior executives from large financial institutions. The Euroclear Boards meet four times a year to make policy decisions, such as setting admissions policy, determining categories of securities accepted, approving depositories, setting fees and

[8] 17 CFR 200.30–3(a)(12).

[1] For purposes of this notice, the term ''Euroclear'' refers to MGT-Brussels in its capacity as operator of the Euroclear System. For a complete description of the structure of the Euroclear System, *see* Section II.

[2] Copies of the application for exemption are available for inspection and copying at the Commission's Public Reference Room.

[3] 15 U.S.C. 78q–1.

[4] 17 CFR 240.17Ab2–1.

[5] For purposes of its application, Euroclear proposes to define U.S. government and agency securities to include (i) ''government securities'' as defined by Section 3(a)(42) of the Exchange Act (other than foreign-targeted U.S. government and agency securities and securities issued or guaranteed by an international organization such as the World Bank, which Euroclear classifies as internationally-traded securities that have been accepted for clearance and settlement in the Euroclear System for many years under circumstances that Euroclear believes cause its activities with respect to such securities to fall outside the scope of Section 17A of the Exchange Act and (ii) mortgage-backed securities and collateralized mortgage obligations issued or guaranteed by the Federal Home Loan Mortgage Corporation (''FHLMC''), the Federal National Mortgage Association (''FNMA''), or the Government National Mortgage Association (''GNMA'').

[6] The Commission has been advised that MGT-Brussels is permitted to seek an exemption from clearing agency registration regarding its operation of the Euroclear System and that no further authorization from the Board of Directors of the Belgian Cooperative is required. Letter from Dr. Rolf-Ernst Breuer, Chairman of the Board of the Belgian Cooperative (March 6, 1997).

MGT itself does not seek an exemption from registration as a clearing agency to the extent it performs the functions of a clearing agency with respect to U.S. government or agency securities. Sections 3(a)(23)(B) of the Exchange Act provides that a bank as defined under Section 3(a)(6) of the Exchange Act is excluded from the definition of the term clearing agency if it would be deemed to be a clearing agency solely by reason of functions performed by such institution as part of customary banking activities. MGT believes that as a bank it has the authority to perform clearing agency functions as part of its customary banking activities for U.S. government and agency securities outside the Euroclear context without registering with the Commission as a clearing agency or otherwise complying with Exchange Act provisions applicable to clearing agencies generally. Because MGT is not seeking an exemption from clearing agency registration for its activities outside the operation of the Euroclear System, the Commission is not addressing this issue.

[7] The descriptions set forth in this notice regarding the structure and operations of the Euroclear System, MGT-Brussels, and MGT have been largely derived from information contained in MGT-Brussels' Form CA–1 application and publicly available sources.

rebates, and approving major service developments. The Euroclear Boards are not involved in the day-today operation of the Euroclear System.

MGT-Brussels, as operator of the Euroclear System, is regulated by the Belgian Banking and Finance Commission, the Board of Governors of the Federal Reserve System of the United States, and the New York State Banking Department. Examinations of MGT-Brussels may be performed by examiners from these regulatory agencies. In addition, MGT-Brussels has an external auditor that reports to the Belgian Banking and Finance Commission and the Audit Committee of MGT. In its capacity as operator of the Euroclear System, MGT-Brussels is also authorized as a service company by the Securities and Investment Board under the United Kingdom Financial Services Act, 1986.

III. Description of Euroclear System Operations

Euroclear provides several services to its participants, including securities clearance and settlement, securities lending and borrowing, and custody.[8]

A. Securities Clearance and Settlement

The Euroclear System functions as a clearance and settlement system for internationally traded securities. Securities settlement through the Euroclear system can occur with other participants in the Euroclear System (''internal settlement''), with members of Cedel Bank, société anonyme, Luxembourg (''Cedel''), the operator of the Cedel system (''Bridge settlement''), or with counterparties in certain local markets who are not members of the Euroclear System or of Cedel (''external settlement'').

The annual volume of transactions settled in the Euroclear System has grown from about US$3 trillion in 1987 to over US$34.6 trillion in 1996. The fastest growing segments of this activity have been repurchase and reverse repurchase agreements (''repos''), book-entry pledging arrangements, securities lending, and other collateral transactions[9] involving non-U.S. government securities.[10] Although the individual certificated or uncertificated government securities of these countries are immobilized or dematerialized with the central banks or central securities depositories (''CSDs'') in their home markets, book-entry positions with respect to such securities can be acquired, held, transferred, and pledged by book-entry on the records of Euroclear in any of the 35 currencies available in the Euroclear System because of the links to local custodian banks, central banks, CSDs, and national payment systems around the world.

1. Clearance and Settlement of Trades Between Participants in the Euroclear System

Transactions between Euroclear System participants in the Euroclear System can be settled against payment or free of payment. Simultaneous delivery versus payment (''DVP'') also is provided for settlements against payment between Euroclear System participants. Upon receipt of valid instructions for a settlement between participants, the Euroclear System's computer system attempts to match instructions between corresponding counterparties on a continuous basis according to a defined set of matching criteria. Matching generally is required in order for the instructions to be settled, except for certain actions specifically taken by the participant (*e.g.*, transfers between accounts maintained by a single participant). Matching of an instruction is attempted until it is either matched or cancelled.

Internal settlement of DVP transactions is accomplished by book-entry transfer and provides for simultaneous exchange of cash and securities. Settlement is final (*i.e.*, irrevocable and unconditional) at the end of each of the securities settlement processing cycles of which there are currently three per day.[11]

The overnight securities settlement process is completed early in the morning of the business day in Brussels for which settlement is intended. Daylight securities settlement processing is completed in the afternoon of each business day with settlement dated for that day. The daylight settlement cycle, which is restricted to internal settlements, permits participants to resubmit previously unmatched instructions or unsettled transactions and permits the processing of new instructions for same day settlement. All daylight instructions not settled are automatically recycled for settlement in the next overnight securities settlement cycle.

2. Clearance and Settlement of Trades Between a Participant in the Euroclear System and a Cedel Member

Participants also can send instructions authorizing receipt and delivery of securities between the Euroclear System and the Cedel system, both free of payment and against payment. Simultaneous DVP is possible for settlement of Euroclear System trades between a participant in the Euroclear System and a Cedel member because of the electronic ''bridge'' established between the two organizations.

For settlement of trades between a Euroclear System participant and a Cedel member, prematching of instructions consists of nine daily comparisons of delivery and receipt instructions. During these comparisons, each clearance system electronically transmits a file of proposed deliveries and expected receipts to the other clearance system. This exchange of information allows each clearance system to report matching results to its participants.

The bridge was enhanced in September 1993 to allow for multiple overnight transmissions of instructions between Cedel and the Euroclear System. The bridge provides finality for DVP cross-system trades occurring when the receiving clearance system confirms acceptance of a proposed delivery and that confirmation is received by the delivery clearance system.

3. Clearance and Settlement of Trades Between a Participant in the Euroclear System and a Counterparty in a Local Market

Participants also can send instructions authorizing receipt and delivery of securities free of payment and against payment between the Euroclear System and certain domestic markets' clearance and settlement

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[8] The contractual relationship between Euroclear and its participants is defined by the Terms and Conditions Governing the Use of Euroclear (''Terms and Conditions'') as supplemented by the Operating Procedures of the Euroclear System and other supplementary documents, all of which are governed by Belgian law. Among other things, the Terms and Conditions provide that Euroclear Participants agree that their rights to securities held through the Euroclear System will be defined and governed by Belgian law.

[9] Collateral transactions are designed to enable Euroclear System participants to reduce their financing costs, increase their yields on securities, reduce their credit and liquidity exposures, and manage market and operational risks. For example, a credit seeker that is long securities can reduce its financing costs by entering into a repo with a credit giver (*i.e.*, selling the securities to the credit giver subject to an agreement to repurchase the securities at a future date). A credit seeker can also reduce its financing costs or increase its borrowing capacity by pledging the securities to a credit giver.

[10] Government securities issued in the domestic markets in the following countries are currently eligible for clearance and settlement in the Euroclear System: Argentina, Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Portugal, South Africa, Spain, Sweden, Switzerland, Thailand, and the United Kingdom.

[11] Euroclear's internal securities processing consists of two overnight settlement cycles and one daylight settlement cycle.

structures. Where participants are expecting to receive or deliver securities outside the Euroclear System or Cedel, instructions are matched where possible in accordance with local market rules and procedures. Notification of matching in the local market is received by Euroclear from the local depositary. Instructions to deliver securities outside the Euroclear System are sent to the depositary having custody of the securities to forward the securities to the location designated by the counterparty or move the securities by book-entry transfer in the local clearance system.[12]

Euroclear has two types of relationships, direct and indirect links, with local market clearance systems. A direct link is where Euroclear has its own account with the local clearance system and holds securities and sends instructions directly in that clearance system. With an indirect link, a intermediary (*i.e.*, depositary) is used to perform Euroclear System settlement activities in the local market.[13] For different instruments in certain markets, Euroclear may have both direct and indirect links.

B. Securities Lending and Borrowing

Securities lending and borrowing is utilized to increase settlement efficiency for the borrower and to allow lenders to generate income on securities held in the Euroclear System. Lenders receive a fee for securities lending and do not incur safekeeping fees for securities lent.

With standard lending and borrowing, there is no linkage between a particular borrower and a particular lender. In effect, participants borrow securities from the lending pool.[14] With reserved lending and borrowing, there is a linkage between the borrower and the lender, but the counterparty's identities are not disclosed.[15] Consequently, with both standard and reserved lending and borrowing, borrowers' names and lenders' names are never revealed to one another.

Securities lending and borrowing is an integral part of the overnight securities settlement process. This integration permits Euroclear to determine the borrowing requirement and supply of lendable securities on a trade-by-trade basis throughout each overnight securities settlement processing. Generally, securities lending and borrowing is available only through the overnight securities settlement process.

C. Custody

Securiites held by Euroclear participants are held through a network of depositaries. Depositaries may hold securities on their premises or deposit these securities with subcustodians or with local clearance systems. Depositaries of the Euroclear System may include custodian banks, including some MGT branches, central banks, local clearance systems, and Cedel. Depositaries are selected based upon their custody capabilities, financial stability, and reputation in the financial community. All depositaries and subdepositaries are appointed with the approval of the Board of the Belgium Cooperative and are reapproved on an annual basis. This network of depositories allows linkages with domestic markets to effect external deliveries and receipts of securities, thereby facilitating cross-border securities movements.

Chase Manhattan Bank (''Chase'') currently acts as the Euroclear System's depositary in the United States for the limited purpose of holding positions in certain foreign and internationally-traded securities (*e.g.*, such as the Regulation S portion of certain global bonds issued by foreign private issuers, Yankee bonds, and book-entry debt securities issued by the World Bank) which are represented by certificates immobilized in The Depository Trust Company (''DTC'') or by electronic book-entries on the records of a Federal Reserve Bank.[16]

Securities deposited in the Euroclear System may be in either physical (bearer or registered) or dematerialized form. Securities are held on the books of a depositary in an account in the name of MGT-Brussels as operator of the Euroclear System. Where the depositary also is not the local clearing system, securities may be deposited in the local clearance system where the depositary is located.

All securities accepted by a depositary are credited to a segregated custody account in the name of MGT-Brussels as operator of the Euroclear System at the depositary or local clearance system, or to the depositary's account at the local clearance system.

Each Euroclear System participant has one or more securities clearance account(s) with associated transit accounts. Securities held by participants

[12] Securities held by participants in the Euroclear System are held by custodian banks or local clearing systems. Except where required by local law, Euroclear will not permit bank subsidiaries to serve as depositaries. All securities held by a depositary on its books for the Euroclear System are credited to a segregated custody account in the name of MGT-Brussels as operator of the Euroclear System. Depositaries receive instructions regarding the movement of Euroclear System securities directly from Euroclear. Euroclear participants do not directly deal with depositaries regarding the settlement of securities transactions within the Euroclear System or the custody of securities. *See* Section III.C *infra*.

[13] Transactions with these counterparts are performed on a book-entry basis in the local clearing system, depositary, or authorized sub-custodian, or on the basis of a physical delivery.

[14] A participant that is an automatic standard borrower is eligible to borrow securities to execute delivery instructions when there are insufficient eligible securities available in its securities clearance accounts to effect a settlement in the overnight securities settlement processing. A participant that is an opportunity standard borrower sends standard borrowing requests to Euroclear on a case-by-case basis according to expected borrowing needs.

A participant that is an automatic standard lender makes securities available to the lending pool during each overnight securities settlement processing. Subsequent to each overnight securities settlement processing, securities borrowed from the lending pool are allocated back to the lenders according to a given set of priorities. If the lendable position from automatic standard lenders for a given issue is expected to be insufficient to meet estimated borrowing demand in the next overnight securities settlement process, opportunity standard lenders may be contacted by Euroclear to make additional securities available for borrowing.

[15] A participant that wishes to reserve securities for future borrowing can do so by submitting a reserved borrowing request to Euroclear. Reserved borrowing differs from standard borrowing in that once a reserve borrower's request matches a lendable supply the lender is committed to lend the securities and the borrower is obligated to borrow them. Reserved borrowing minimizes the risk of settlement failure resulting from an inability to obtain a standard borrowing in the overnight securities settlement process due to a lack of supply in the lending pool.

An automatic reserved lender makes securities in its securities clearance accounts available on demand for reserved lending subject to the lender's selected options. When a reserved borrowing request is matched to securities automatically available for reserved lending, a reservation is initiated and the securities are blocked in the reserved lender's securities clearance account from the reservation date to the loan start date. Opportunity reserved lenders are contacted by Euroclear when the supply of lendable securities from automatic reserved lenders is not sufficient to cover reserved borrowing requests in a given issue.

[16] Euroclear does not believe that its traditional business of clearing and settling transactions in foreign and internationally-traded securities comes within the scope of the registration requirements of Section 17A of the Exchange Act and therefore is not seeking exemptive relief with respect to such business. For this purpose, foreign and internationally-traded securities include debt and equity securities issued by foreign private and governmental issuers that trade principally in their home markets and/or internationally, (including foreign domestic debt and equity securities, Yankee bonds, securities issued by international organizations such as the World Bank, American and global depositary shares, and securities denominated or settled in a currency other than U.S. dollars), as well as Euro and globally-distributed debt securities and global depositary shares issued by U.S. issuers in a registered international offering or pursuant to provisions of the Securities Act of 1933 and the rules and regulations thereunder, including Regulation S (17 CFR 230.901), Section 4(2) (15 U.S.C. 77d(2)), Rule 144A (17 CFR 230.144A), or some other exemption (including foreign-targeted U.S. Government and agency securities). U.S. domestic debt and equity securities are not currently eligible for clearance and settlement in the Euroclear System.

in the Euroclear System are credited to the participants' securities clearance accounts or transit accounts. Euroclear System participants have the option to request the segregation of their own and client securities in separate securities clearance accounts.

Securities in the Euroclear System are held in fungible bulk. Under Belgian law and pursuant to the terms and conditions, each participant is entitled to a notional portion, represented by the amounts credited to its securities clearance account(s) and transit account(s), of the pool of securities of the same type held in the Euroclear System.

D. Banking Services

MGT–Brussels provides certain banking services to Euroclear participants, acting in its separate banking capacity and not as operator of the Euroclear System. Banking services provided include: provision of credit to Euroclear System participants, triparty repo [17] and collateral monitoring, and securities lending guarantee.

1. Provision of Credit to Euroclear Participants

MGT–Brussels offers credit facilities to Euroclear participants on an uncommitted basis under limits periodically determined by MGT. Credit decisions are made according to MGT credit guidelines. Credit facilities generally are required to be secured and are normally collateralized by participant assets within the Euroclear System. In order to secure credit, participants affirm to MGT–Brussels that they are not pledging client securities and that no other liens have been granted to third parties on such securities. In a limited number of circumstances, MGT–Brussels may agree to permit pledging of client securities, or the securities of related parties, where the participant's legal and regulatory regime permits, appropriate legal opinions are delivered, and certain other conditions are met.

The valuation of securities held in participants's pledged securities clearance accounts to secure credit extensions from MGT–Brussles is derived from the market value of the securities pledged, adjusted according to the type of instrument, currency, the rating of the issue, the issuer, and the country of the issuer. For debt securities, accrued interest is added to market value for the purpose of calculating collateral value.

2. Triparty Repo and Collateral Monitoring

MGT–Brussels also offers monitoring services whereby participants can use the Euroclear System to facilitate repo settlement/collateral posting, substitution of securities, and margin monitoring.

3. Securities Lending Guarantee

As part of the Euroclear securities lending and borrowing program, MGT guarantees securities lenders the return of securities lent or the cash equivalent if the borrower defaults on its obligation to return such securities.

E. Liens, Rights, and Obligations

In addition to any pledge of specific accounts agreed to by a participant due to extensions of credit, all assets held in the Euroclear System are subject to rights of set-off and retention. Furthermore, participants's assets held in the Euroclear System (except for assets held for customers and identified as such pursuant to the Operating Procedures or by agreement with Euroclear) are subject to a statutory lien in favor of MGT–Brussels, as operator of the Euroclear System, pursuant to Belgian law.[18] Participants also are subject to certain obligations toward Euroclear including obligations to cover any cash or securities debit balances that participants may incur.

IV. Euroclear's Request for Exemption

A. Introduction

U.S. government and agency securities are the securities of choice for cross-border collateral and other transactions. Euroclear does not currently provide participants with the means to acquire, hold, transfer, or pledge interests in U.S. government or agency securities in the Euroclear System. In its exemption request, Euroclear therefore seeks an exemption from registration as a clearing agency pursuant to Section 17A of the Exchange Act and Rule 17Ab2–1 thereunder to the extent it performs the functions of a clearing agency with respect to U.S. government and agency securities for U.S. participants of the Euroclear System.

Section 17A of the Exchange Act directs the Commission to promote Congressional objectives to facilitate the development of a national clearance and settlement system for securities transactions.[19] Registration of clearing agencies is a key element of the regulation of clearing agencies in promoting these statutory objectives. Before granting registration to a clearing agency, Section 17A(b)(3) of the Exchange Act requires that the Commission make a number of determinations with respect to the clearing agency's organization, capacity, and rules.[20] The Commission has published the standards applied by its Division of Market Regulation in evaluating applications for clearing agency registration.[21] These requirements are designed to assure the safety and soundness of the clearance and settlement system.

Section 17A(b)(1), moreover, provides that the Commission:

* * *may conditionally or unconditionally exempt any clearing agency

[17] A triparty repo arrangement generally consists of three parties, the borrower, the lender, and a collateral agent (*i.e.*, MGT–Brussels). In this arrangement, the borrower initiates a repo by ''selling'' securities to the lender in exchange for cash from the lender. Simultaneously with this transaction, the borrower agrees to repurchase these securities at a specified future date. The collateral agent maintains custody of the securities for the duration of the repo and handles all operation aspects of the transaction including distribution of income, substitutions, and mark to market securities valuations.

[18] Article 41 of the Belgian Law of April 6, 1995.

[19] 15 U.S.C. 78q–1. Section 17A(a)(1) provides:

(1) The Congress finds that—

(A) The prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors.

(B) Inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors.

(C) New data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement.

(D) The linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.

For legislative history concerning Section 17A, *See, e.g.*, Report of Senate Comm. on Housing and Urban Affairs, Securities Acts Amendments of 1975: Report to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 4 (1975); Conference Comm. Report to Accompany S. 249, Joint Explanatory Statement of Comm. of Conference, H.R. Rep. No. 229, 94th Cong., 1st Sess., 102 (1975).

[20] 15 U.S.C 78q–1(b)(3). *See also* Section 19 of the Exchange Act, 15 U.S.C. 78s, and Rule 19b–4, 17 CFR 240.19b–4, setting forth procedural requirements for registration and continuing Commission oversight of clearing agencies and other self-regulatory organizations.

[21] Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (''Standards Release''). *See also*, Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 (omnibus order granting registration as clearing agencies to The Depository Trust Company, Stock Clearing Corporation of Philadelphia, Midwest Securities Trust Company, The Options Clearing Corporation, Midwest Clearing Corporation, Pacific Securities Depository, National Securities Clearing Corporation, and Philadelphia Depository Trust Company).

or security or any class of clearing agencies or securities from any provisions of [Section 17A] or the rules or regulations thereunder, if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of [Section 17A], including the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds.[22]

The Commission reviews every application for exemption against the standards for clearing agency registration.

Euroclear notes that the Commission previously has granted exemptions from clearing agency registration, subject to certain volume limits, reporting requirements, and other conditions, to the Clearing Corporation for Options and Securities (''CCOS'') and to Cedel.[23] The Commission also has published notice of an application by Cedel to amend its exemption from registration as a clearing agency to the extent it performs the functions of a clearing agency for U.S. domestic debt and equity securities.[24]

Euroclear believes that providing it with an exemption from clearing agency registration would produce substantial benefits to its participants, would provide U.S. investors and the U.S. national clearance and settlement system with the same level of protection against custody, clearance, and settlement risks that full registration would provide, and would otherwise satisfy the statutory requirements for an exemption.

B. Participant Benefits

Euroclear believes that the proposed exemption would promote the U.S. public interest by reducing risk to credit providers and by reducing costs to credit seekers. Euroclear believes that it is currently too costly for many international credit providers and credit seekers to use U.S. government or agency securities to reduce credit and liquidity risks in a number of international transactions.[25] As a result, credit providers currently receive lower quality collateral or remain unsecured and are subject to a higher level of credit or liquidity risks in many international transactions. Credit seekers are subject to higher credit costs and lower credit limits than they would be if they used U.S. government or agency securities as collateral.

Euroclear believes that if international credit providers suffer substantial losses or fail because of this condition, it could have repercussive effects in the United States because of the growing interdependency among the world's financial markets. Euroclear further believes that credit seekers from the United States also could face higher credit costs and lower credit limits at home and abroad because of the growing interdependency in worldwide financial markets.

Euroclear believes that allowing its system to provide clearance and settlement services for interests in U.S. government and agency securities to U.S. entities would reduce these transaction costs and therefore would reduce the costs and risks of international financial transactions.

Euroclear also believes that the proposed exemption would promote the U.S. public interest by increasing competition in the provision of clearance and settlement services for U.S. government and agency securities. Euroclear maintains that greater competition can be expected to result in lower costs and greater innovation by both U.S. and international clearing agencies.

C. Formal Registration Unnecessary or Inappropriate

Euroclear believes that formal registration would subject it to substantial additional regulatory burdens without producing any material benefits for the U.S. public related to the fundamental goal of safe and sound custody, clearance, and settlement.[26] Euroclear further believes that it would be a substantial and unnecessary burden to require it to regulate the actions of U.S. brokers and dealers, which it believes are already adequately regulated by the U.S. national securities exchanges, the NASD, and the Commission itself. Euroclear also believes that it would not have any market power over the custody, clearance, or settlement of U.S. government or agency securities and in fact would operate in a highly competitive, private sector environment. Finally, Euroclear believes that the recordkeeping, fingerprinting, and other requirements of Section 17 are effectively satisfied by the substantially similar recordkeeping, reporting, and other requirements of U.S. Federal, New York State, and Belgian banking laws.[27]

D. Safety and Soundness Protections

Sections 17A(b) (3) (A) and (F) of the Exchange Act require a clearing agency be organized and its rules be designed to facilitate the prompt and accurate clearance and settlement of securities transactions for which it is responsible and to safeguard securities and funds in its custody or control or for which it is responsible.[28]

Euroclear has represented to the Commission that its financial condition, operational safeguards, and the extent to which it is already subject to substantial U.S. regulatory oversight will provide U.S. investors and the U.S. national clearance and settlement system with the same level of protection against custody, clearance, and settlement risks that full registration would provide.

1. Financial Condition

Euroclear has advised that Commission that MGT, which ultimately is the entity fiscally responsible for operations of the Euroclear System, is a U.S. bank that it is ''well-capitalized'' and ''well-managed'' as those terms are defined under applicable U.S. Federal banking

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[22] 15 U.S.C. 78q–1(b)(1).

[23] Securities Exchange Act Release Nos. 36573 (December 12, 1995), 60 FR 65076 (CCOS) and 38328 (February 24, 1997), 62 FR 9225 (Cedel). The Commission also has granted temporary registration and partial exemptions from certain provisions of Section 17A to the Government Securities Clearing Corporation (''GSCC''), Participants Trust Company (''PTC''), MBS Clearing Corporation (''MBSCC''), Delta Clearing Corp. (''Delta''), and the International Securities Clearing Corporation (''ISCC''). Securities Exchange Act Release Nos. 37983 (November 25, 1996), 61 FR 64183 (GSCC); 38452 (March 28, 1997), 62 FR 16638 (PTC); 37372 (June 26, 1996), 61 FR 35281 (MBSCC); 38224 (January 31, 1997), 62 FR 5869 (Delta); and 37986 (November 25, 1996), 61 FR 64184 (ISCC). In granting these temporary registrations it was expected that the subject clearing agencies would eventually apply for permanent clearing agency registration.

[24] Securities Exchange Act Release No. 38329 (February 24, 1997), 62 FR 9222.

[25] Euroclear has advised the Commission in its Form CA–1 that time zone differences between where a transaction occurs for which credit support is required and the U.S. (*i.e.,* where transactions in U.S. government securities are settled) make it too costly to synchronize transactions in a way to utilize U.S. government securities to collateralize transactions that give rise to credit or liquidity risks. Furthermore, Euroclear believes that the lack of a securities intermediary with a critical mass of both securities and customers makes it too costly to have U.S. government securities in the right place at the right time to reduce such credit and liquidity risks.

[26] For example, registered clearing agencies are required to assume the rights and responsibilities of a self-regulatory organization (''SRO''), including the responsibility to police the actions of U.S. brokers, dealers, and other securities intermediaries, and to submit each of its proposed rule changes to the Commission. Euroclear believes that the rights and responsibilities of an SRO were designed primarily for U.S. national securities exchanges, like the New York Stock Exchange and the American Stock Exchange, and U.S. national securities associations, like the National Association of Securities Dealers (''NASD''), and were extended to registered clearing agencies mainly because the major clearing agencies at the time Section 17A was enacted were subsidiaries of national securities exchanges or other SROs.

[27] *See e.g.,* 12 CFR Part 208 (Membership of State Banking Institutions in the Federal Reserve System [Regulation H]).

[28] 15 U.S.C. 78q–1(b) (3) (A) and (F).

regulations.[29] MGT has represented to the Commission that it has over $13.5 billion in total capital and a total capital ratio of more than 11 percent [30] and access to billions of dollars of additional liquidity in the capital markets. Its senior debt is rated AAA by Standard & Poor's [31] and its long-term debt is rated Aa–1 by Moody's Investors Services.[32]

Euroclear states that the financial condition of each of the securities intermediaries through which it would hold its positions in U.S. government and agency securities on behalf of Euroclear participants is similarly strong. It would hold its positions through an adequately-capitalized and well-managed U.S. bank, which would in turn hold matching positions through the Federal Reserve Bank of New York or PTC.

2. Operational Safeguards

Euroclear believes that it has substantially similar subcustodian, recordkeeping, and auditing policies and procedures as those utilized by registered clearing agencies. MGT-Brussels is subject to annual on-site examinations by the Federal Reserve Bank of New York and to periodic examinations by the New York State Banking Department and the Belgian Banking and Finance Commission. Euroclear also represents to the Commission that it has a leading-edge information technology division and sophisticated contingency recovery facilities and maintains substantial insurance against the loss or theft of physical securities.

3. U.S. Federal and Other Regulatory Oversight

MGT-Brussels, as operator of the Euroclear System, is a division of the foreign branch of a U.S. bank and, accordingly, is subject to the comprehensive supervision and regulation of the Board of Governors of the Federal Reserve System. As noted above, the Federal Reserve Bank of New York conducts annual on-site examinations in Brussels and otherwise regulates MGT-Brussels' operations, including its operation of the Euroclear System. MGT-Brussels, also is subject to the comprehensive supervision of the New York State Banking Department and the Belgian Banking and Finance Commission and is authorized as a Service Company by the Securities and Investment Board under the U.K. Financial Services Act, 1986.

E. Fair Representation

Section 17A(b)(3)(C) of the Exchange Act requires that the rules of a clearing agency provide for fair representation of the clearing agency's shareholders or members and participants in the selection of the clearing agency's directors and administration of the clearing agency's affairs. This section contemplates that users of a clearing agency have a significant voice in the direction of the affairs of the clearing agency.

Although Euroclear participants do not have the right to appoint MGT directors or members of the Euroclear management, they all have the right to become members of the Belgian Cooperative and can use such membership to influence the range of Euroclear services and the level of fees charged to them by Euroclear. The Board of Directors of the Belgian Cooperative consists of 23 voting members, nominated from Euroclear participant organizations representing various financial sectors and geographical regions. Euroclear's goal was to fashion a Board with a cross-functional composition in order to ensure that important strategic and policy issues are viewed with a broad market perspective. The Board meets four times a year with Euroclear management to discuss major policy and operational issues regarding the Euroclear System, including new product development and the level of fees. Moreover, Euroclear believes that its participants are some of the world's leading banks, brokers, central banks, and other professional investors who are able to analyze the risks and benefits of clearing and settling transactions in the Euroclear System and to choose competitive substitutes for settling transactions in U.S. government or agency securities if they are not satisfied with the mix of risks and benefits in the Euroclear System.

F. Participant Standards

Section 17A(b)(3)(B) of the Exchange Act enumerates certain categories of persons that a clearing agency's rules must authorize as potentially eligible for access to clearing agency membership and services. Section 17A(b)(4)(B) of the Exchange Act contemplates that a registered clearing agency have financial responsibility, operational capability, experience, and competency standards that are used to accept, deny, or condition participation of any participant or any category of participants enumerated in Section 17A(b)(3)(B), but that these criteria may not be used to unfairly discriminate among participants. In addition, the Exchange Act recognizes that a clearing agency may discriminate among persons in the admission to or the use of the clearing agency if such discrimination is based on standards of financial responsibility, operational capability, experience, and competence.

Any broker-dealer, clearing agency, investment company, bank, insurance company, or other professional investor that demonstrates it meets Euroclear's financial and operational criteria may become a Euroclear System participant. They must demonstrate that they have adequate financial resources for their intended use of the Euroclear System and the ability to maintain this financial strength on an ongoing basis. They also must demonstrate that they have both the personnel and technological infrastructure to meet the operational requirements of the Euroclear System. Furthermore, they must show that they expect to derive material benefit from direct access to Euroclear and that they are reputable firms.

V. Proposed Exemption

A. Statutory Standards

As noted above, Section 17A of the Exchange Act directs the Commission to develop a national clearance and settlement system through, among other things, the registration and regulation of clearing agencies.[33] In fostering the development of a national clearance and settlement system generally and in overseeing clearing agencies in particular, Section 17A authorizes and directs the Commission to promote and facilitate certain goals with due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and the maintenance of fair competition among brokers, dealers, clearing agencies, and transfer agents.

Section 17A(b)(1) authorizes the Commission to exempt applicants from some or all of the requirements of Section 17A if it finds such exemptions are consistent with the public interest, the protection of investors, and the purposes of Section 17A, including the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds. The Commission has exercised its

[29] 12 CFR 208.33(b)(1) (definition of ''well-capitalized'') and 12 CFR 225.2(s) (definition of ''well-managed''). *See also* 12 CFR 211.2(u) (definition of ''strongly capitalized'') and (x) (definition of ''well managed'').

[30] 12 CFR Part 208, Appendix A (defining total capital as the sum of ''tier 1'' and ''tier 2'' capital and total capital ratio as total capital divided by total risk-weighted assets).

[31] Standard & Poor's, ''Morgan (J.P.) & Company Inc.,'' *Bank Ratings Analysis*, April 1997, at 1.

[32] Moody's Investor Service, ''Opinion Update: Morgan Guaranty Trust Company of New York,'' *Global Credit Research*, February 7, 1997, at 2.

[33] 15 U.S.C. 78q–1.

authority to exempt an applicant entirely from clearing agency registration on two prior occasions and has granted temporary clearing agency registrations that included exemptions from specific Section 17A statutory requirements on five previous occasions.[34]

As discussed above, applicants requesting exemption from clearing agency registration are required to meet standards substantially similar to those required of registrants under Section 17A in order to assure that the fundamental goals of Section 17A (*e.g.*, safe and sound clearance and settlement) are furthered. Therefore, the Commission invites commenters to address whether granting MGT-Brussels' application, as operator of the Euroclear System, for exemption from clearing agency registration, subject to the conditions set forth below, would further the goals of Section 17A.

B. Conditions

The Commission would expect to impose two types of conditions on the operation of the Euroclear System in conjunction with the grant of any exemption from clearing agency registration: limits on the volume of transactions in U.S. government and agency securities [35] involving a U.S. participant or its affiliate; [36] and informational requirements that will allow the Commission to monitor and control any possible adverse impact that the proposed activities of the Euroclear System could have on the safety and soundness of the U.S. national system for the clearance and settlement of eligible U.S. government securities.

1. Volume Limits

In granting Cedel and CCOS exemptions from clearing agency registration, the Commission placed a limit on the transactions in eligible U.S. government securities conducted by U.S. participants or their affiliates that can be processed through those systems.[37] Euroclear similarly proposes to limit the average daily volume of transactions in U.S. government or agency securities involving U.S. participants [38] or their affiliates that are settled through the Euroclear System to five percent of the average daily volume of total worldwide transactions in U.S. government and agency securities. Although Euroclear has proposed this volume limit, it has requested that due to its relatively strong capital position, its operational safeguards, and its comprehensive regulation by U.S. Federal and state authorities, this volume limit be transitional in nature. Accordingly, Euroclear also requests that the Director of the Division be granted delegated authority from the Commission to increase or eliminate the volume limit if the Division deems such action appropriate.

The Commission preliminarily believes the proposed volume limit appears to be appropriate in that it is large enough to allow Euroclear to commence operations in clearing and settling eligible U.S. Government securities transactions involving U.S. participants and to allow the Commission to observe the effects of the Euroclear System's activities on the U.S. securities market. Likewise, the Commission preliminarily believes that the proposed volume limit is sufficiently narrow in scope so that the safety and soundness of the U.S. markets would not be compromised if Euroclear or MGT experiences financial or operational difficulties.

2. Informational Requirements

To facilitate the monitoring of compliance with the proposed volume limits under the proposed exemption, Euroclear would be required to provide information on a monthly basis regarding aggregate volume for all Euroclear System participants for transactions in eligible U.S. Government securities. Euroclear also would be required to notify the Commission if there is a material adverse change in any Euroclear System account maintained by MGT-Brussels for Euroclear System participants that also are members of affiliates of members of a U.S. registered clearing agency.[39] Euroclear also would be required to respond to any Commission request for information about a U.S. participant or its affiliate about whom the Commission has concerns.

Euroclear specifically has agreed to promptly provide the Division with the following documents when made available to Euroclear System participants:

(1) Any amendments to or revised editions of (a) the Terms and Conditions, (b) the Supplementary Terms and Conditions Governing the Lending and Borrowing of Securities through Euroclear, and (c) the Operating Procedures of the Euroclear System;

(2) The annual report to shareholders of the Belgian Cooperative; and

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[34] *Supra* note 23 and accompanying text.

[35] The Commission proposes that the U.S. government and agency securities eligible for Euroclear processing will be the same as those securities permitted to be processed by Cedel. Accordingly, eligible securities will include (i) Fedwire-eligible U.S. government securities, (ii) mortgage backed pass-through securities that are guaranteed by the Government National Mortgage Association (''GNMAs''), and (iii) any collateralized mortgage obligation whose underlying securities are Fedwire-eligible U.S. government securities or GNMA guaranteed mortgage-backed pass through securities and which are depository eligible securities (collectively, ''eligible U.S. government securities''). The Commission is of the view that this definition should not include those U.S. government or agency securities currently processed by Euroclear that are foreign targeted securities and/or guaranteed by an international organization.

[36] The Commission is proposing that ''U.S. entity'' should include (i) any entity organized under the laws of the United States or any state or subdivision thereof that is registered or regulated pursuant to state or federal banking laws or state or federal securities laws and should include, without limitation, U.S. registered broker-dealers, U.S. banks (as defined by Section 3(a)(6) of the Exchange Act), and (ii) foreign branches of U.S. banks or U.S. registered broker-dealers.

Additionally, the Commission is proposing that the term ''affiliate'' should be defined as any Euroclear System participant having a relationship with a U.S. entity where the U.S. entity has an arrangement on file at Euroclear to prevent a settlement default or credit default with respect to the Euroclear System participant or where Euroclear knows that the U.S. entity has an arrangement to prevent a settlement default or credit default with respect to the Euroclear System participant.

[37] The CCOS exemptive order contained volume limitations of US$6 billion net daily settlement for U.S. government securities and US$24 billion for repurchase agreements and reverse repurchase agreements transactions in U.S. government securities. These limits are calculated on an average daily basis over a ninety day period. At that time, the CCOS volume limits were designed to limit CCOS's activity to approximately five percent of the average daily dollar value of transactions in U.S. government securities and in repurchase agreements and reverse repurchase agreements involving U.S. government securities. In the Cedel exemptive order, the Commission determined that a percentage-based formula was more appropriate. Accordingly, Cedel may not process more than 5% of the total average daily value of the aggregate volume in eligible U.S. government securities. The total average daily dollar value of eligible U.S. government securities volume is derived from the total daily value of securities activity through Fedwire, GSCC, MBSCC, PTC, and any other source that the Division deems appropriate to reflect the aggregate volume in eligible U.S. government securities. Cedel's average daily volume is derived from the value of eligible U.S. government securities that are processed through Cedel involving a U.S. counterparty or its affiliate. Based upon December 31, 1996, information, this computation yields an average daily volume limit of approximately US$49 billion.

[38] For this purpose Euroclear proposes that ''U.S. participant'' would mean any participant of the Euroclear System having a U.S. residence (based on location of its executive office or principal place of business), including any foreign branch of such participant.

[39] For purposes of the exemption, the Commission preliminarily believes that the term ''material adverse change'' would include defaults in settlement for credit reasons in a Euroclear System account, liquidation of collateral posted by a participant in that participant's Euroclear System account, or the limitation on the extensions of credit to a participant through the Euroclear System.

(3) The annual report on the internal controls, policies and procedures of the Euroclear System (''SAS–70 Report'').[40]

Euroclear also has agreed to provide the Division with prompt notice upon the occurrence of any of the following events;

(1) The termination of any Euroclear System participant;

(2) The liquidation of any securities collateral pledged by a participant to secure an extension of credit made through the Euroclear System;

(3) The institution of any proceedings to have any Euroclear System participant declared insolvent or bankrupt; or

(4) The disruption or failure in the operations of the Euroclear System in whole or in part from its regular operating location or its contingency center.

Finally, Euroclear also has agreed to provide the Commission with quarterly reports, calculated on a twelve-month rolling basis, of the following:

(1) The average daily volume of transactions in eligible U.S. Government securities for U.S. participants and their affiliates that are subject to the volume limit described in IV.B.1 above; and

(2) The average daily volume of transactions in eligible U.S. Government securities for all participants, whether or not subject to the volume limit described in Section IV.B.1 above.

The Commission seeks comment on these proposed volume limits and the informational requirements. Specifically, commenters are requested to address the structure and the appropriate size of such limits. Commenters also are requested to address the types of information which should be provided to the Commission to help maintain the safety and soundness of the U.S. clearance and settlement systems and the U.S. securities markets. Finally, commenters are invited to comment on the specific information that Euroclear has agreed to provide to the Commission and on the occurrence of events for which Euroclear must notify the Commission.

C. Fair Competition

Section 17A of the Exchange Act requires the Commission, in exercising its authority under that section, to have due regard for the maintenance of fair competition among clearing agencies.[41] Therefore, the Commission must consider an applicant's likely effect on competition and on the U.S. securities markets in its review of any application for registration or exemption from registration as a clearing agency.

Consistent with this approach, the Commission invites commenters to address whether granting Euroclear an exemption from registration would result in increased competition, including greater access to the U.S. securities market by foreign broker-dealers, banks, and clearing agencies. Such competition may result in the development of improved systems capabilities, new services, and perhaps lower costs to market participants. The Commission also invites commenters to address whether the proposal would impose any burden on competition that is inappropriate under the Exchange Act.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing application by June 16, 1997. Such written data, views, and arguments will be considered by the Commission in deciding whether to grant Euroclear's request for exemption from registration. Persons desiring to make written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Reference should be made to File No. 601–01. Copies of the application and all written comments will be available for inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[42]

Margaret H. McFarland,

Deputy Secretary.

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[40] In addition, the Division will review the annual reports on Form 10–K and the quarterly reports on Form 10–Q for J.P. Morgan & Co. Incorporated, MGT's parent, which are already provided to the Commission.

[41] 15 U.S.C. 78q–1(a)(2).

[42] 17 CFR 200.30–3(a)(16).

SECURITIES AND EXCHANGES COMMISSION

[Release No. 34–38585; File No. SR–NASD–97–05]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change Relating to the Transfer of Limited Partnership Securities

May 8, 1997.

I. Introduction

On January 29, 1997, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') submitted to the Securities and Exchange Commission (''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 expand the current exemptions concerning the use of the Limited Partnership Transfer Forms and to require that these forms be utilized by members when transferring customer accounts containing limited partnership securities.

The proposed rule change was published for comment in the **Federal Register** on March 24, 1997.[3] No comments were received on the proposal. This order approves the proposal.

II. Description

On January 29, 1996, the Commission approved new NASD Rule 11580 to the NASD's Uniform Practice Code.[4] It requires members to use the Standardized Transfer Forms (''Forms'') when transferring limited partnership securities. NASD Regulation is proposing two amendments related to the use of the Forms. The first is an amendment to NASD Rule 11580 to expand the current exceptions to include limited partnerships that trade in the non-Nasdaq over-the-counter (''OTC'') market that are in a depository. The second is an amendment to NASD Rule 11870 to require members to use the Standardized Transfer Forms when transferring customer accounts that contain limited partnerships.

A. Amendment to NASD Rule 11580

Limited partnership securities that are listed on an national securities exchange or the Nasdaq Stock Market are not required to use the Forms. NASD

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

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 38398 (Mar. 13, 1997), 62 FR 13921 (Mar. 24, 1997).

[4] Securities Exchange Act Release No. 36783 (Jan. 29, 1996), 61 FR 3955 (Feb. 2, 1996).