18-01998-FOIA

foiapa

From: Request@ip-10-170-20-207.ec2.internal
Sent: Wednesday, May 16, 2018 8:26 AM
To: foiapa
Subject: Request for Document from Pickford, John

Mr. John C Pickford
401 City Ave
Bala Cynwyd, Pennsylvania 19004
United States

6107471904
john.pickford@sig.com
Susquehanna International Group, LLC

Request:
COMP_NAME: Chicago Board Options Exchange
DOC_DATE: December 1974 or January 1975
CTRL_NUM: 34-11146
TYPE: Other (fully describe)
COMMENTS: The approval order for the establishment of the OCC which was separate from the CBOECC
FEE_AUTHORIZED: Willing to Pay $61
FEE_WAIVER_REQUESTED: No
EXPEDITED_SERVICE_REQUESTED: No

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
STATION PLACE
100 F STREET, NE
WASHINGTON, DC 20549-2465

Office of FOIA Services

June 13, 2018

Mr. John C. Pickford
Susquehanna International Group, LLC
401 City Avenue
Bala Cynwyd, PA 19004

RE: Freedom of Information Act (FOIA), 5 U.S.C. § 552
Request No. 18-01998-FOIA

Dear Mr. Pickford:

This letter is in response to your request, dated and received in this Office on May 16, 2018, seeking the approval order for the establishment of the OCC which was separated from the CBOECC around December 1974 or January 1995.

The search for responsive records has resulted in the retrieval of 17 pages of records that may be responsive to your request. They are being provided to you with this letter.

If you have any questions, please contact me directly at andersonc@sec.gov or (202) 551-8315. You may also contact me at foiapa@sec.gov or (202) 551-7900. You also have the right to seek assistance from Ray J. McInerney as a FOIA Public Liaison or contact the Office of Government Information Services (OGIS) for dispute resolution services. OGIS can be reached at 1-877-684-6448 or Archives.gov or via e-mail at ogis@nara.gov.

Sincerely,

Clarissa Anderson

Clarissa Anderson
FOIA Research Specialist

Enclosure

herein. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

The proposal is to establish a schedule of fees varying from $.80 to $6.00 per contract, increasing with the price and decreasing with the size of the order, to be charged members for orders in Standard & Poor's 500 options that are executed through the Order Book Official ("OBO"). CBOE states that its fees are designed to defray the costs of providing OBO services. CBOE also states that they are doubling the amounts charged on equity and Standard & Poor's 100 options in order of reflect the larger contract size and corresponding liability for OBO errors. As statutory basis for the proposed rule change CBOE relies upon Section 6(b)(4) of the Act relating to equitable allocation of reasonable charges among exchange members.

The foregoing change has become effective, pursuant to Section 19(b)(3)(A) of the Act and subparagraph (e) of Rule 19b-4 under the Act. At any time with 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Interested persons are invited to submit written data, views and arguments concerning the submission within 21 days after the date of publication in the **Federal Register**. Persons desiring to make written comment should file six copies thereof with the Secretary of the Commission, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Reference should be made to File No. SR-CBOE-83-23.

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change which are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those which 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. Copies of the filing and of any subsequent amendments also will be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization.

For the Commission, by its Secretary, pursuant to delegated authority.

George A. Fitzsimmons,

Secretary.

[FR Doc. 83-26944 Filed 9-30-83; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 20222; File Nos. 600-5 and 600-19]

Registration as Clearing Agencies of Boston Stock Exchange Clearing Corp., and New England Securities Depository Trust Co.

September 23, 1983.

In accordance with Sections 17A(a)(2) and 19(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78q-1 and s (the "Act") and Rule 17Ab2-1(c)(1) (17 CFR 240.17Ab2-1(c)(1)) thereunder, the Commission granted registration as a clearing agency to the Boston Stock Exchange Clearing Corporation ("BSECC") on December 1, 1975, and to the New England Securities Depository Trust Company ("NESDTC") on September 24, 1976, for a period of eighteen months or such longer time as the Commission may provide by order. Pursuant to Rule 17Ab2-1(c)(1), these clearing agencies, among others, were exempted temporarily from satisfying a number of requirements as to which the Commission is directed to make determinations by Section 17A(b)(3)(A)-(I) of the Act (the "Requirements"). Subsequently, the Commission, by order, extended these clearing agencies' existing temporary registrations on a number of occasions, with the most recent extension to expire on September 30, 1983.[1]

In connection with both temporary registrations, the Commission instituted proceedings to determine whether to grant or deny registration to both clearing agencies.[2] Since those proceedings were instituted, both clearing agencies have periodically consented to extensions of time within which the Commission is required to conclude its registration proceedings. Recently, both clearing agencies consented to an additional twelve month extension of time for concluding the proceedings. Accordingly, this order extends until September 30, 1984, the existing registrations of the clearing agencies to enable them to remain registered during that extended period.

During the last two years, BSECC has altered significantly its operations and procedures and currently is revising its rules, by-laws, and procedures to reflect these changes. BSECC has requested an extension of temporary registration to afford it time to complete and submit proposed rule changes to the Commission, pursuant to Rule 19b-4 (17 CFR 240.19b-4). In turn, NESDTC has indicated that it has ceased doing any business as a clearing agency and has requested that its registration be cancelled pursuant to Section 19(a)(3) of the Act. At this time, however, the Commission has not determined whether to grant deregistration to NESDTC. Instead, at the Commission staff's request, NESDTC has agreed to an extension of its temporary registration to afford the Commission time to review the nature and extent of residual activities and obligations, if any, and to determine whether additional steps or undertakings must be made by NESDTC or the Boston Stock Exchange, Inc., before granting deregistration.

It is, therefore, ordered that BSECC's and NESDTC's temporary registrations be, and they hereby are, extended until September 30, 1984.

By the Commission.

George A. Fitzsimmons,

Secretary.

[FR Doc. 83-26942 Filed 9-30-83; 8:45 am]

BILLING CODE 8010-01-M

[1] Securities Exchange Act Release No. 18584 (March 22, 1982), 47 FR 13266 (March 29, 1982).

[2] Proceedings were instituted by the Commission on September 1, 1976, regarding BSECC and on June 23, 1977, regarding NESDTC

[Release No. 20221; File No. 600-1, et al.]

Depository Trust Co., et al.; Order

September 23, 1983.

In the matter of the full registration as clearing agencies of: The Depository Trust Company (File No. 600-1); Stock Clearing Corporation of Philadelphia (File No. 600-4); Midwest Securities Trust Company (File No. 600-7); The Options Clearing Corporation (File No. 600-8); Midwest Clearing Corporation (File No. 600-9); Pacific Securities Depository Trust Company (File No. 600-10); Pacific Clearing Corporation (File No. 600-11); National Securities Clearing Corporation (File No. 600-15); and Philadelphia Depository Trust Company (File No. 600-19).

Introduction

This Order concerns the registration of nine clearing agencies [1] pursuant to

[1] The Commission today is granting full registration to the Depository Trust Company ("DTC"); Stock Clearing Corporation of Philadelphia ("SCCP"); Midwest Securities Trust Company ("MSTC"); Options Clearing Corporation ("OCC"); Midwest Clearing Corporation ("MCC"); Pacific Securities Depository Trust Company ("PSDTC");

Continued

Section 17A of the Securities Exchange Act of 1934 (the "Act"),[2] and Rule 17Ab2-1.[3] The full registration of these clearing agencies constitutes an important step in the Commission's efforts to facilitate the development of a national system for the prompt and accurate clearance and settlement of securities transactions ("National System") under Section 17A of the Act. Granting these nine applications for clearing agency registration culminates eight years of cooperative efforts by the securities industry and the Commission to put in place central portions of the National System. Through the issuance of this Order, the Commission recognizes the significant steps that have been taken by various segments of the financial community toward achieving the goals established by Congress in Section 17A(a)(1) of the Act.

The remainder of this Order is organized as follows:

I. Background

A. The Paperwork Crisis and Resulting Legislation

During the late 1960's, the securities industry experienced a paperwork crisis that nearly brought the industry to a standstill and directly or indirectly caused the failure of a large number of broker-dealers. This crisis resulted from sharply increased trading volumes and historic industry inattention to securities processing, as illustrated by inefficient, duplicative and extensively manual clearance and settlement systems, poor records, insufficient controls over funds and securities, and use of untrained personnel to perform processing functions.[4] In the aftermath of the paperwork crisis, the securities industry, the Commission, and the Congress directed concerted attention to securities processing. Among other things, the Commission actively encouraged expanded participation in clearing corporations and securities depositories by all qualified broker-dealers and other financial intermediaries. Congress held extensive hearings to investigate the paperwork problems[5] and ultimately enacted the Securities Acts Amendments of 1975 (the "1975 Amendments").[6]

In Section 17A(a)(1) of the act, as amended, Congress found that:

(A) The prompt and accurate clearance and settment 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 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.[7]

Accordingly, in Section 17A(a)(2) of the Act, Congress directed the Commission to facilitate the development of the National System consistent with those findings. At the same time, Congress instructed the Commission to administer Section 17A 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 and dealers, clearing agencies, and transfer agents.

B. Full Registration Proceedings

Although Section 17A(b)(1) of the Act required that all clearing agencies be registered with the Commission by December 1, 1975,[8] Congress provided that the Commission could not grant registration to clearing agencies unless they exhibited certain organizational characteristics and capabilities (the "Requirements")[9] or were otherwise exempted by the Commission.[10] Pursuant to this authority, on November 3, 1975,[11] the Commission adopted Rule 17Ab2-1[12] and Form CA-1[13] for the registration of clearing agencies. In accordance with Rule 17Ab2-1(c)(1),[14] thirteen clearing agencies applied for registration. The Commission granted temporary registration to all thirteen clearing agencies [15] after finding that each clearing agency (1) was organized to have, and had, the capacity to safeguard securities and funds in its custody or control or for which it was responsible; [16] (2) had rules that assured the safeguarding of securities or funds that were in its custody or control or for which it was responsible; [17] and (3) had rules that did not impose any schedule of prices, or fix rates or other fees, for services rendered by participants.[18] The Commission also instituted proceedings to determine whether the clearing agencies satisfied, or should be exempted from, the Requirements and could therefore be granted full registration pursuant to Rule 17Ab2-1(c)(2).[19] Since that time, in connection with the oversight of clearing agencies, the Commission staff has reviewed the registration applications and numerous supplements and the Commission has extended the temporary registrations by order on a number of occasions, with

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Pacific Clearing Corporation ("PCC"); National Securities Clearing Corporation ("NSCC"); and Philadelphia Depository Trust Company ("Philadep").

[2] Securities Exchange Act of 1934, *as amended*, 15 U.S.C. 78a *et seq.* (1976).

[3] 17 CFR 240.17Ab2-1.

[4] *See, e.g.*, Securities and Exchange Commission, *Study of Unsafe and Unsound Practices of Brokers and Dealers*, H.R. Doc. No. 231, 92d Cong., 1st Sess. 13 (1971).

[5] *See, e.g., Clearance and Settlement of Securities Transactions, Hearings on S. 3412, S. 3297, and S. 2551 Before the Subcom. on Banking, Housing and Urban Affairs*, 92d Cong. 2d Sess., 95-96 (1972).

[6] Pub. L. No. 94-29, 89 Stat. 97 (1975).

[7] 15 U.S.C. 78q-1.

[8] Section 17A(b)(1) of the Act.

[9] Section 17A(b)(3)(A)-(I) of the Act discussed *infra*.

[10] Section 17A(b)(1) of the Act.

[11] Securities Exchange Act Release No. 11787 (November 3, 1975), 40 FR 52356 (November 10, 1975).

[12] 17 CFR 240.17Ab2-1.

[13] 17 CFR 249b.200.

[14] Rule 17Ab2-1(c)(1) (17 CFR 240.17Ab2-1(c)(1)) authorizes the Commission to register a clearing agency "temporarily" (for 18 months or such longer time as the Commission may provide by order), and to exempt a temporarily registered clearing agency from satisfying one or more of the Requirements.

[15] On December 1, 1975, the Commission granted temporary registration to DTC, Bradford Securities Processing Services, Inc. ("BSPS"), SCCP, Boston Stock Exchange Clearing Corporation ("BSECC"), MSTC, OCC, MCC, PSDTC, PCC, and TAD Depository Corporation ("TAD"). Temporary Registration was granted to New England Securities Depository Trust Company ("NESDTC") on September 24, 1976; to NSCC on October 24, 1977; and to Philadep on October 24, 1979. The Commission terminated the registrations of BSPS and TAD at their request on March 22, 1982. Securities Exchange Act Release No. 18583 (March 22, 1982), 47 FR 13262 (March 29, 1982).

[16] Section 17A(b)(3)(A) of the Act.

[17] *Id.*

[18] Section 17A(b)(3)(E) of the Act.

[19] 17 CFR 240.17Ab2-1(c)(2).

the most recent extension to expire on September 30, 1983.[20]

As part of its efforts to provide guidance to the clearing agencies in structuring their organizations, systems, capacities, and rules to comply with the Requirements, the Commission proposed [21] and published [22] standards (the "Standards") to be used by the Division of Market Regulation (the "Division") in reviewing and making recommendations whether all or any clearing agencies should be granted full registration. The Standards illustrate specific objectives that each clearing agency's rules, procedures, or systems should achieve to be granted full registration.[23]

In response to the Commission's request in the Standards Release, twelve temporarily registered clearing agencies submitted amended Forms CA–1 in December 1980, along with rule proposals designed to comply with the Standards, or, in certain cases, requests for exemptive relief from certain of the Requirements or the Standards.[24]

C. Clearing Agency Functions and Organization

Section 3(a)(23)(A) of the Act defines a clearing agency as:

any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.[25]

The clearing agencies that are the subject of this Order perform a wide variety of securities processing functions, but share many of the same legal and operational characteristics. These clearing agencies perform securities processing and operational and financial monitoring services for their participants, including banks, broker-dealers, and institutional investors. As self-regulatory organizations ("SROs") under the Act,[26] these clearing agencies have both the authority and the obligation, among other things, to deny participation to statutorily disqualified [27] or incompetent [28] applicants for membership, to discipline participants,[29] and to provide participants with due process when they may be adversely affected by those decisions.[30]

Different types of clearing agencies, however, provide differing clusters of services for their participants. Clearing corporations generally receive trade data respecting exchanges or over-the-counter ("OTC") trades between broker-dealers, and compare,[31] account for [32] and settle [33] the netted securities transactions. In connection with with Continuous set Settlement ("CNS")

[20] Securities Exchange Act Release No. 18584 (March 22, 1982), 47 FR 13266 (March 29, 1982). The Commission today also is expecting the temporary registrations of BSECC and NESDTC until September 30, 1984 in a separate order

[21] *See* Securities Exchange Act Release No. 13584 (June 1 1977), 42 FR 30066 (June 10, 1977); Securities Exchange Act Release No. 14531 (March 6, 1978), 43 FR 10288 (March 10, 1983).

[22] Securities Exchange Act Release No. 16900 (June 17 1980), 45 FR 41920 (June 23, 1980) ("Standards Release").

[23] For example, Section 17A(b)(3)(A) of the Act provides, among other things, that a clearing agency must have rules to assure the safeguarding of funds and securities in the clearing agency's custody control, or for which it is responsible The Standards provide that a clearing agency among other things, must have an internal audit department, that reviews objectively the clearing agency s operations and reports its findings to the clearing agency Standards Release, 45 FR at 41926–28

[24] TAD did not file a revised application for registration As discussed at note 15 *supra*, the registrations of TAD and BSPS have been cancelled

[25] Section 3(a)(23)(A) of the Act, 15 U.S.C. 78c(a)(23)(a) broadly defines "clearing agency" and this definition may require entities, other than those that are the subject of this Order or the order extending temporary registration for two clearing agencies, discussed at note 20 *supra*, to apply for registration with the Commission. Examples of such entities might include securities custodians, transfer agent depositories, securities drafting and collection services, and entities providing other limited or specialized clearing services. By granting full registration to the nine named clearing agencies, the Commission does not intend to limit or narrow the Act's definition of clearing agency or the clearing agency registration requirements. Section 3(a)(23)(B) of the Act creates certain exclusions from the definition of clearing agency, and Section 17A(b)(1) of the Act grants the Commission power to exempt certain clearing agencies from the Act's registration requirements. In this connection, several banks or subsidiaries of bank holding companies that perform various securities processing functions have requested that the Commission exempt them from the clearing agency registration requirements, pursuant to this subsection. The Commission is addressing those requests in a separate proceeding.

[26] Section 3(a)(25) of the Act

[27] Section 17A(b)(4)(A) of the Act

[28] Section 17A(b)(4)(B) of the Act

[29] Section 17A(b)(3)(C) of the Act

[30] Section 17A(b)(5) of the Act

[31] "Comparison" is the process by which broker-dealers match trades previously executed in the marketplace. That process culminates in the production, and submission to the clearing agency's accounting operation, of trade data that have been matched by both sides to the trade. Street-side comparison of trade data between buying and selling broker-dealers should be distinguished from a similar matching of trade data between a broker and his institutional customer, commonly called the "confirmation and affirmation process" *See* note 36 *infra*.

Traditional comparison of exchange trades occurs either: (i) on the floor of the exchange when, following execution of the trade, parties to the trade "reconfirm" the terms of the trade and submit trade data manually, or on an automated basis, to the clearing corporation ("floor-derived comparison"); or (ii) after the end of the trading day, when buyer and seller independently submit trade data to a clearing corporation, which then attempts to match-up those data ("conventional comparison").

OTC street-side comparison is conventional and is performed for all clearing corporations by NSCC The operating costs of the National OTC Comparison System are borne *pro rata* by the participating clearing corporations and their participants.

[32] The accounting process generates the money and securities settlement obligations of participants in clearing corporations. Several types of accounting systems are used by clearing corporations. The most sophisticated accounting system is the Continuous Net Settlement ("CNS") system, which severs the link between the original parties to the compared trades and interposes the system as the *contra* party The system generates a single, daily net "buy" or "sell" position for each securities issue in which a participant has compared trades scheduled to settle on the fifth day after trade date and nets accumulated settlement obligations in that issue. As the *contra* side for each net settlement obligation, the clearing corporation's CNS system, rather than the original parties to the trades, becomes the entity obligated to deliver or receive securities and money The clearing corporation protects itself against financial risk by, among other things, obtaining mark-to-the-market payments on open obligations from each participant whose failure to satisfy those open obligations would place the system at risk Unlike CNS systems, daily balance order ("DBO") systems traditionally have not interposed clearing corporations between parties. Instead, a DBO system generates a daily net "buy" or "sell" position for each issue of securities in which a participant has a compared trade due to settle, and allocates among, and issues to, participants net daily settlement orders to deliver or receive As a result, a participant may be required to deliver securities to, or receive securities from, a participant with which it had no trades. Although securities and money settlement are pursuant to DBOs, fails are treated as fails between the parties to the DBO and must be resolved between them (rather than with the system). Other accounting systems, such as trade-by-trade systems, do not net deliver and receive obligations and require that those obligations be settled directly between the original parties, contract-by-contract.

[33] Obligations generated by the accounting function are satisfied through the settlement process by the delivery and receipt of funds and securities CNS money settlement occurs at the clearing corporation with net securities movements being made at the affiliated securities depository

systems,[34] clearing corporations guarantee participant obligations.

A securities depository is a "custodial" clearing agency that operates a centralized system for the handling of securities certificates. Depositories accept deposits of securities from broker-dealers, banks, and other financial institutions; credit those securities to the depositing participants accounts; and, pursuant to participant's instructions, effect book-entry movements of securities.[35] The physical securities deposited with a depository are held in a fungible bulk; each participant or pledgee having an interest in securities of a given issue credited to its account has a *pro rata* interest in the physical securities of the issue held in custody by the securities depository in its nominee name. Depositories collect and pay dividends and interest to participants for securities held on deposit. Depositories also provide facilities for payment by participants to other participants in connection with book-entry deliveries of securities and provide facilities for customer-side settlement of institutional trades through, for example, the National Institutional Delivery System ("NIDS").[36] Securities credied to a participant's or a pledgee's account may be withdrawn by the participant in physical form for delivery to persons who do not maintain accounts with the depository.[37]

In contrast to those two types of clearing agencies, OCC is unique. OCC issues options on equity securities, as well as on a variety of other financial instruments,[38] records participants' options positions, and determines participants' daily options net settlement obligations. OCC also receives exercise instructions from participants, randomly assigns exercise notices to participants with short positions in the exercised options, and facilitates settlement of the obligations arising from exercise. OCC provides rules and procedures for the settlement of stock index and other non-equity options obligations, and forwards trade data on individual equity option exercises and assignments to correspondent clearing corporations for settlement with other settling trades in those securities.

Clearing agencies that have applied for registration are owned and controlled in two basic ways. Most of the applicant clearing agencies are wholly-owned subsidiaries of affiliated national securities exchanges. For example, SCCP and Philadep are wholly-owned subsidiaries of the Philadelphia Stock Exchange Inc. ("Phlx").[39] Profits earned by the SCCP or Philadep that are not rebated to participants or retained by the clearing agencies are returned to the parent stock exchange. As with any corporation, Phlx, as shareholder, elects SCCP's and Philadep's boards of directors.[40]

Other clearing agencies, however, are owned and controlled by several entities. NSCC, for example, is owned by the New York Stock Exchange, Inc. ("NYSE"), the American Stock Exchange, Inc. ("AMEX"), and the National Association of Securities Dealers, Inc. ("NASD"). The members of NSCC's board of directors, however, are elected by participants according to a formula linking the number of votes held by each participant to the participant's use of NSCC services.[41] DTC is owned by the NYSE, AMEX, NASD, and its participants. Participants are permitted to purchase stock, and hence vote for directors, in proportion to their use of DTC services.[42] OCC is owned by its participating options exchanges.[43]

II. Review Methodology

During the last several years, the Commission has given special attention to the Forms CA-1 submitted by each clearing agency. During the review, the Commission attempted to identify significant respects in which clearing agency rules, systems, and procedures appeared to be inconsistent with the Requirements. The Commission's review placed special emphasis on potential financial exposure to clearing agencies, their participants, and the public resulting from peculiarities in services provided or in the manner in which those services were organized. In addition to reviewing the Forms CA-1, the Commission's determinations were based on its continuous monitoring and oversight of the operations of each clearing agency and the exemplary history of the National System.

In conducting its review, the Commission has made every effort to take into account inherent differences among the clearing the agencies that are subject to this Order. In addition, in determining propriety of requests for exemptions from certain aspects of the Act, the Commission gave special attention to the unique characteristics of the requesting clearing agency. Thus, the Commission required uniformity among clearing agencies only where crucial to effectuate statutory goals and to protect investors and the public interest.

During the review process, the Commission staff had extensive conversations with the various clearing agencies concerning identified deficiencies in, or unique features of, their rules, systems, and procedures. In the cooperative spirit envisioned in the Act, each clearing agency has made many necessary changes to conform its rules, systems, and procedures to the Requirements and the Standards. The

[34] *See* note 32 *supra*. In addition, most clearing corporations provide non-automated settlement services, such as envelope delivery systems. Envelope delivery systems permit a delivering participant to pass securities in envelopes to the clearing corporation which, in turn, delivers the envelopes to designated receiving participants.

[35] *See, e.g.*, DTC, *Participant Operating Procedures*, §§ B and C. *See also* note 33 *supra*. Depositories also facilitate the pledging of securities between participants.

[36] In a typical institutional trade, an investment manager instructs a broker to execute a trade. After executing the trade, the broker sends to the investment manager a written statement, called a "confirm," specifying the terms of that trade. *See* Rule 10b-10 (17 CFR 240.10b-10). If the confirm matches the investment manager's instructions, *i.e.*, if the broker executed the trade properly, the investment manager will issue instructions; called an "affirm," to the custodian bank authorizing the bank to receive or deliver securities against payment to or by the executing broker. To promote timely customer-side settlement of institutional trades, various SROs have taken significant steps to encourage investment managers, brokers and custodian banks to confirm, affirm, and settle most institutional trades through the facilities of a securities depository. DTC, in cooperation with MSTC, PSDTC, and Philadep, operates an automated settlement system called the National Institutional Delivery Sysem ("NIDS"). The NIDS, in conjunction with depository interfaces, permits most institutional trades to be quickly, accurately, and cheaply confirmed, affirmed, and settled by a net book-entry movement and/or a single money obligation. See Securities Exchange Act Release No. 19227 (November 9, 1982), 47 FR 51658 (November 16, 1982).

[37] Certificates may be withdrawn (i) after re-registration in a name designated by the withdrawing party or (ii) in the name of a depository's nominee, in which case the nominee appoints the withdrawing party as attorney to effect transfer of the certificate. *See e.g.*, DTC, *Participant Operating Procedures*, §§ D and E.

[38] *See* note 151 *infra*. All options issued by OCC are registered with the Commission, pursuant to the Securites Act of 1933, *as amended*, 15 U.S.C. 77a-77aa (1976).

[39] *See* File No. 600-4 (SCCP), Form CA-1, Attachment A, at 1.

[40] Other regional clearing corporations and depositories are similarly organized and controlled. Because Section 17(A)(b)(3)(C) of the Act requires that the rules of the clearing agency assure fair representation of its shareholders (or members) and participants in the selection of its directors and the administration of its affairs, the regional clearing agencies have recently re-structured their by-laws, rules, and procedures to satisfy this requirement. *See* discussion in text accompanying notes 52-62 *infra*.

[41] *See* File No. 600-15 (NSCC), Form CA-1, at Exhibit A, Annex 1, at 18; Exhibit A, Annex 2, at 4; and Exhibit A, Annex 3.

[42] *See* File No. 600-1 (DTC) Form CA-1 at Exhibit A and Addendum 1.

[43] *See* File No. 600-8 (OCC), Form CA-1 at Exhibit A, Vol. I, and OCC By-laws, Art VII, §§ 1-5.

Commission wishes to commend the clearing agencies for their excellent and dedicated efforts, particularly during the last year, to up-date and refine their Forms CA-1.

The Commission's oversight of clearing agency compliance with the Act has not been confined to review of Forms CA-1. Indeed, in carrying out the Commission's general oversight responsibilities, the Commission has reviewed, pursuant to Section 19(b) of the Act, each of the many proposed rule changes filed by the clearing agencies. Those rule changes have concerned most of the major services and systems of each clearing agency, all of the recent enhancements to clearing agency services, and all schedules of fees.[44] Moreover, that rule review process is continuous, since clearing agencies periodically enhance their services in ways that require rule filings.[45]

The Commission also conducts, pursuant to Section 17(b) of the Act, routine or cause inspections of clearing agencies, which help ensure the continuing integrity of clearing agency operations. In connection with those inspections, the Commission has scrutinized the operations of most of the temporarily registered clearing agencies and has worked in a cooperative setting with each inspected clearing agency, as well as with the Board of Governors of the Federal Reserve System ("BGFRS"), as appropriate,[46] to refine and enhance clearing agency safety and efficiency. Inspections have provided an informed and important backdrop to the Commission's determination today to grant full registration to the subject clearing agencies, and they will continue to aid the Commission's on-going enforcement responsibilities concerning clearing agencies.

III. Scope of This Order and Its Effects on Clearing Agencies and Commission Oversight

This Order confirms that each clearing agency subject to the Order is operating in substantial compliance with the Act. The Commission recognizes that Congress did not intend the full registration proceedings to continue indefinitely, but, instead, anticipated that these proceedings should end as soon as the Commission could make the fundamental findings specified in the Requirements. The Commission does not intend this Order to suggest that no further modifications of the subject clearing agencies' rules, systems, procedures, and practices are needed now or in the future. Indeed, the findings made in this Order are intended to supplement the Commission's, or any other appropriate regulatory agency's, continuing authority under the Act to regulate evolving clearing systems.[47] The Commission will continue to use its oversight, inspection, and enforcement authority as necessary and appropriate to further the purposes of the Act, and, as necessary, will use its rulemaking authority under Sections 17A (d)(1) and (e) of the Act to ensure continued development of the National System. In any event, the Commission anticipates that in the future, the fully registered clearing agencies will make all needed adjustments in their rules, systems, and procedures in the cooperative spirit the Commission has experienced to date.

As a result, the self-regulatory obligations of the fully registered clearing agencies cannot end with this proceeding. Each clearing agency must continue to satisfy the Requirements and the Standards, including (i) filing with the Commission, pursuant to Rule 17a-22, any notice distributed to all clearing agency participants; (ii) filing any changes in rules, systems, or procedures as required by Section 19 of the Act and Rule 19b-4 thereunder;[48] and (iii) keeping its Form CA-1 submission current. In addition, all registered clearing agencies must continue to respect all conditions established, or undertakings related to, this Order and any other relevant undertaking or Commission Order.[49]

IV. Findings: Application of Statutory Standards to Clearing Agencies

A. Introduction

The following discussion explains in detail the specific obligations imposed by the Requirements, as interpreted by the Standards, that a clearing agency must satisfy before the Commission may grant it full registration. To avoid unnecessary repetition, this Order does not discuss each Requirement and each Standard with respect to each clearing agency; instead, each Requirement is discussed in conjunction with the clearing agency that presented illustrative issues respecting that Requirement.[50] This Order also discusses the amendments to by-laws, rules, systems, and procedures that each clearing agency has made (or has undertaken to make) to satisfy the Requirements and the Standards. Finally, the Order indicates that, subject to the conditions and undertakings noted in this Order, all clearing agencies subject to this Order substantially satisfy the Requirements.

B. MCC and MSTC

MCC and MSTC are wholly-owned clearing agency subsidiaries of the Midwest Stock Exchange ("MSE"). MCC and MSTC offer participants a wide range of integrated services referred to as the MST System. These services include trade recording; trade comparison, clearance, and settlement; CNS and trade-for-trade settlement accounting; clearance and settlement, through the Regional Interface Organization ("RIO"), of participants' trades with participants settling in other clearing corporations; safekeeping of bearer and registered municipal bonds; confirmation, affirmatin, and book-entry

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[44] During Fiscal Year 1983, the Division's Office of Securities Processing Regulation received and reviewed approximately 140 proposed rule changes filed by the various clearing agencies.

[45] In addition, the Commission staff daily reviews announcements of clearing agency system adjustments and other important events, received by the Commission pursuant to Rule 17a-22 (17 CFR 240.17a-22).

[46] DTC, PSDTC, and MSTC are limited purpose trust companies and members of the Federal Reserve System. The BGFRS, as an appropriate regulatory agency ("ARA"), has certain regulatory authority and responsibilities with respect to these clearing agencies. *See* Sections 3(a)(34)(B) and 19 of the Act. In addition, the Commission has consulted with the BGFRS under appropriate circumstances, particularly when reviewing proposed rule changes filed by these depositories, pursuant to Section 19(b) of the Act, and Rule 19b-4 (17 CFR 240.19b-4) thereunder.

[47] Unlike with other SROs, the Commission does not have authority under Section 19(c) of the Act to abrogate, add to, or delete from, particular rules of particular registered clearing agencies.

[48] Proposed rule changes submitted by these clearing agencies currently pending before the Commission are not affected by this proceeding. Similarly, agreements limiting or governing the operations of any pilot programs instituted by any clearing agency remain in effect. *See, e.g.*, Securities Exchange Act Release No. 13706 (June 30, 1977), 42 FR 35715 (July 11, 1977); Securities Exchange Act Release No. 13741 (July 12, 1977), 42 FR 37082 (July 19, 1977); and Securities Exchange Act Release No. 19911 (June 24, 1983), 48 FR 30506 (July 1, 1983) (proposed rule changes that would permit depository participants to transmit and receive data using computer terminal systems); Securities Exchange Act Release No. 13337 (March 7, 1977), 42 FR 15159 (March 18, 1977); Securities Exchange Act Release No. 13375 (March 15, 1977), 42 FR 15996 (March 24, 1977), Securities Exchange Act Release No. 13392 (March 18, 1977), 42 FR 16690 (March 29, 1977); Securities Exchange Act Release No. 14109 (October 27, 1977), 42 FR 58991 (November 14, 1977) (proposed rule changes eliminating interface fees between depositories).

[49] *See, e.g.*, notes 117 and 119-21 *infra*. Similarly, issues raised in previous inspections that have not been resolved fully herein remain subject to inspection undertakings.

[50] For example, the Requirement in Section 17A(b)(3)(A) of the Act that a clearing agency safeguard funds and securities is discussed primarily with respect to SCCP. SCCP has an unusual financing program that requires the continuous use of special protective measures.

settlement of institutional trades through NIDS; and facilities for borrowing and lending securities.

Staff review of MCC's and MSTC's applications and rules revealed substantial compliance with the Act and the Standards concerning registration of clearing agencies.[51] At the staff's request, however, MCC and MSTC amended a number of rules and by-laws to cure deficiencies respecting fair representation and due process.

1. *Fair Representation*

Section 17A(b)(3)(C) of the Act, concerning fair representation, requires:

[t]he rules of the clearing agency [to] assure a fair representation of its shareholders [or members] and participants in the selection of its directors and administration of its affairs. (The Commission may determine that the representation of participants is fair if they are afforded a reasonable opportunity to acquire voting stock of the clearing agency, directly or indirectly, in reasonable proportion to their use of such clearing agency.][52]

The Act does not define fair representation or set up particular standards of representation. Instead, it provides that the Commission must determine whether the rules of the clearing agency regarding the manner in which decisions are made give fair voice to participants as well as to shareholders in the selection of directors and the administration of its affairs. Interpreting the Act, the Standards require that:

[t]he rules of the clearing agency should (i) provide participants with a meaningful opportunity to be represented in the selection of the clearing agency's directors and the administration of its affairs and (ii) provide that participants shall be apprised of proposed rule changes in order to facilitate their comment on such changes to the Commission.[53]

a. *Nomination and Election of the Board of Directors.* With respect to providing participants with a meaningful opportunity to be represented in the selection of the board of directors and the administration of the clearing agency's affairs, the Standards counselled that each clearing agency's procedures be evaluated on a case-by-case basis. The Standards also described several methods by which a clearing agency could comply with the fair representation standard, including nominations for board of directors by a nominating committee which would be composed of, and selected by, participants or their representatives, or direct selection of a number of the directors by, and from among, the users.[54]

(i) *MCC*

Formerly, the MSE, MCC's sole shareholder, selected MCC's board of directors. Since the members of MCC's board were identical with those of the MSE's Board, as a practical matter, the selection of MCC's board was determined by the MSE election. Pursuant to MSE procedures, a nominating committee, elected by MSE members, nominated individuals to serve on the MSE's Board of Governors. The nominating committee selected its nominees with a view to choosing directors "interested in and knowledgeable about the various aspects of MSE operations and of the securities business and the activities of the Midwest Clearing Corporation. * * *"[55] MSE members, however, also could file a petition, signed by at least ten members, naming nominees other than those named by the nominating committee. At the MSE's annual meeting, each member was entitled to cast one vote for each open position.

The Commission believes that, at a minimum, fair representation requires that the entity responsible for nominating individuals for membership on a clearing agency's board of directors should be obliged by by-law or rule to make noninations with a view toward assuring fair representation of the interests of shareholders and of a cross-section of the community of participants. To this end, MCC amended its by-laws to establish a separate nominating committee comprised of participants that will nominate individuals for membership on MCC's board of directors. Furthermore, the new by-law would require that MCC's nominating committee make nominations to the board with a view toward providing fair representation of the interests of the shareholder and a cross-section of the community of participants.[56]

With respect to the process of selecting directors, because the Commission is unaware of any MCC participants that are not also MSE members, the Commission believes that the previous indirect method of selecting MCC board members has in practice enabled fair representation of participants at MCC. In the future, however, as more categories of participants join MCC without also becoming members of the MSE,[57] an opportunity for direct participation by all MCC participants in the selection of MCC's board is essential. Accordingly, MCC has amended its by-laws to allow participants to file a petition, signed by at least ten participants, to nominate as directors additional persons beyond those proposed by the nominating committee. In addition, at the annual meeting, the MSE, as sole shareholder, will be required to elect directors from among the individuals nominated to be directors, including those nominated by participants, and to vote its share in a manner that ensures representation of the interests of a cross-section of participants.

(ii) *MSTC*

MSTC's board of directors is currently divided into two classes, with Class A directors having a numerical majority over Class B directors. Class A directors are appointed by the sole shareholder, the MSE, and are selected by the MSE "with a view towards providing fair representation for the interests of . . . [the MSE] and of those members of [MSE] which are participants of . . . [MSTC]."[58]

[51] MCC and MSTC recently filed amendments to their rules that relate to the Requirements. *See, e.g.*, Securities Exchange Act Release No. 18497 (August 9, 1982), 47 FR 36334 (August 19, 1982) and Securities Exchange Act Release No. 18948 (August 9, 1982), 47 FR 36335 (August 19, 1982) (allocation of losses due to participant defaults among the participant's fund, the contingency reserve fund, undivided corporate profits, and retained earnings); Securities Exchange Act Release No. 18823 (June 21, 1982), 47 FR 28512 (June 30, 1982) (MCC credits, and MSTC discounts, fees for participants settling trades in volume at the Midwest clearing agencies); Securities Exchange Act Release No. 18426 (January 18, 1982), 46 FR 3247 (January 22, 1982) (MCC guarantee of trades settling in the CNS accounting operation); Securities Exchange Act Release No. 18348 (December 17, 1981), 46 FR 62592 (December 24, 1981) and Securities Exchange Act Release No. 18340 (December 16, 1981), 46 FR 62594 (December 24, 1981) (allocation of income earned from investment of participant fund assets). In addition, Securities Exchange Act Release No. 19165 (October 21, 1982), 47 FR 49127 (October 29, 1982) noticed for comment amendments to MSTC's reversal and close-out authority that enable MSTC to reverse certain entries in the event of participant insolvency if MSTC ceases to act on behalf of the insolvent. Although MSTC plans to revise this authority, it has undertaken to administer existing rules consistent with broker participants' obligations under Rule 15c3-3 (17 CFR 240.15c3-3).

[52] 15 U.S.C. 78q-1(b)(3)(C).

[53] Standards Release, 45 FR at 41923.

[54] *See* Securities Exchange Act Release No. 14531 (March 6, 1978), 43 FR 10288 (March 10, 1978) and the Standards Release, 45 FR at 41923.

[55] Midwest Stock Exchange, Inc. Constitution, Article IV, Section 4(b)(iii), Midwest Stock Exchange Guide (CCH) ¶1034.

[56] Securities Exchange Act Release No. 20022 (July 29, 1983), 48 FR 36234 (August 9, 1983).

[57] For example, it is possible that, in the future, certain NIDS trades will be eligible for settlement in MCC's CNS accounting operation. In that event, NIDS users, particularly MSTC bank participants, may decide to join MCC.

[58] Midwest Securities Trust Company By-laws, Article III, Section 2, Midwest Stock Exchange Guide (CCH) ¶3032.

Class B directors may be selected in two ways. At least sixty days before each annual shareholders meeting, the MSE nominates six individuals for election as the six Class B directors. Copies of the nominating list are mailed to each MSTC participant that is not a MSE member ("non-member participant"). Non-member participants may file, within thirty days prior to the annual meeting, a petition signed by not less than three non-member participants to nominate additional persons as the Class B directors. If no nominating petition is filed by non-member participants, the MSE appoints as Class B directors the individuals named in its nominating list. If a nominating petition has been filed by non-member participants, MSTC sends each non-member participant a ballot setting forth the names of all nominees and the number of votes to which each non-member participant is entitled, determined by a formula set forth in the by-laws. At the annual meeting, the MSE appoints as Class B directors the six individuals receiving the highest number of votes.

MSTC has undertaken to revise its by-laws governing election of its board not only to conform to the Act and the Standard regarding fair representation, but also to make useful additional changes not directly related to the issue of fair representation.[59] Officials at MSTC have represented to the Commission that the revisions, when completed, will abolish all distinctions between MSE-member participants and non-member participants, and will provide all participants with an opportunity to nominate individuals for election to the board by petition. In that way, both types of participants—MSE-members as well as non-members—will have the same ability to nominate board members directly through the petition process.

MSTC also has represented to the Commission that the new by-laws would provide for a separate nominating committee within MSTC that, like its counterpart at MCC, will be required by the MSTC by-law to nominate with a view toward providing fair representation on MSTC's board of directors for the interests of the shareholder and a cross-section of the community of participants.[60] MSTC and MSE have represented that until MSTC's by-laws are amended, all nominations for board positions will continue to be made with a view toward providing fair representation for the interersts of both the shareholder and a cross-section of MSTC's participants.

b. *Participation in the Clearing Agency's Affairs*

The Act also requires that clearing agency rules ensure fair representation of participants in the administration of the clearing agency's affairs. The Standards recognize that to participate meaningfully in the administration of the clearing agency's affairs, participants must have sufficient information about those affairs. Accordingly, the Standards require clearing agencies to furnish participants with the next or a description of a proposed rule change and an account of its purpose and its effect so that participants may comment to the Commission in a timely manner.[61] The Standards further require that clearing agencies furnish participants with annual financial statements and an annual report on internal accounting control prepared by an independent public accountant. MCC and MSTC amended their rules in those respects to conform to the Act and the Standards.[62]

2. *Other Matters*

MCC and MSTC filed additional proposed rule changes with the Commission to address specific obligations established by the Requirements and the Standards.[63] These proposals include substantial amendments to MCC's and MSTC's disciplinary procedures and (i) will allow the clearing agency to impose on a participant any sanction specified in the Act; [64] and (ii) will insure that participants receive a hearing by an impartial panel [65] before a sanction may be levied (except when the clearing agency is authorized to act summarily).[66] The Commission believes these changes in MCC's and MSTC's disciplinary rules are consistent with the Requirements and the Standards.

Subject to fulfilling the undertakings noted above, the Commission has determined that MCC's and MSTC's rules, by-laws, and procedures are substantially consistent with the Requirements and the Standards. Accordingly, the Commission is granting MCC and MSTC full registration as clearing agencies under the Act.

C. SCCP—Philadep

SCCP and Philadep are wholly-owned clearing agency subsidiaries of the Phlx. SCCP offers its participants clearance and settlement services for all exchange trades and it provides comparison (through the National OTC Comparison System), clearance, and settlement services for OTC securities transactions, including settlement with other clearing agencies' participants through the RIO interfaces, and dividend and interest processing. Unlike most other clearing corporations, SCCP also offers margin financing for broker-dealer participants and serves as money settlement agent for Philadep, its affiliated depository. Philadep, as a regional depository facility and limited purpose trust company organized under the laws of Pennsylvania,[67] offers its participants, among other services, automated, book-entry transfer of securities positions, vault facilities, access to NIDS,[68] and securities lending services.

1. *Review of Forms CA–1*

a. *General Amendments to SCCP's and Philadep's Forms CA–1*

Review of SCCP's and Philadep's

[59] For example, MSTC expects to increase the size of its board of directors and is contemplating adding public members to the board.

[60] MSTC anticipates filing these revisions with the Commission during September 1983.

[61] Also, as a related matter, because of interdependence among clearing agencies within the National System, the Commission believes, and the Standards require, that notice of proposed rule changes should be given to other registered clearing agencies to enable them to review and comment on such changes in a timely manner. *See* discussion accompanying notes 159–60 *infra*.

[62] Securities Exchange Act Release No. 19744 (May 9, 1983), 48 FR 21689 (May 13, 1983); Securities Exchange Act Release No. 20223 (September 23, 1983), 48 FR ( ); Securities Exchange Act Release No. 20224 (September 23, 1983), 48 FR ( ).

[63] *See, e.g.*, Securities Exchange Act Release Nos. 19980 and 19981 (July 18, 1983), 48 FR 34171 (July 27, 1983). These rule amendments established a 60-calendar day limitation on MCC's and MSTC's power to waive, suspend, or extend the time for doing any act under the rules or procedures, unless the waiver, suspension, or extension is ratified by the board of director's; disclosed the formulae used by MCC and MSTC to determine each participant's minimum required participant fund contribution; and clarified that notice to a participant that the clearing agency has ceased to act for it will be made by telephone, cable, or similar medium.

[64] Section 17A(b)(3)(G) of the Act.

[65] Sections 17A(b)(3)(G), (b)(5)(A), (b)(5)(B) and (b)(5)(C) of the Act.

[66] The Commission believes the Act requires that, when a clearing agency's management recommends that a participant be disciplined, the clearing agency must inform the participant of the specific charges against it, must notify the participant of the opportunity to be heard at a *de novo* trail by impartial adjudicators, and must keep a record of the proceeding. Except in cases of summary action or when the charged participant knowingly waives his right to a hearing, the clearing agency must provide the opportunity to be heard before imposing any final sanction. *See* Section 17A(b)(5)(A) of the Act.

[67] Philadep is the only temporarily registered depository that is not a member of the BGFRS.

[68] *See Securities Exchange Act Release No. 19029 (September 1, 1982), 47 FR 39775 (September 9, 1982).*

Forms CA–1 [69] disclosed several areas that concerned the Commission. These areas included procedures for disciplining participants, procedures for assuring fair representation of participants, standards for participant admission and participation, and systems for safeguarding participant funds and securities.

As a result, during the review of SCCP's Forms CA–1, SCCP submitted a proposed rule change that established an operations committee of the board of directors, with responsibility to review on an on-going basic SCCP's systems, services, margin rules, clearing fund, linkage with other clearing agencies, and other operations, as the committee may consider appropriate. SCCP also amended its rules to permit it to review the adequacy of participant contributions to the clearing fund more frequently than quarterly, should it be appropriate, and to authorize SCCP to demand and collect from participants money payments and other forms of further assurance of financial responsibility and operational capability. In addition, SCCP amended its rules to enable the reversal of certain CNS deliveries to insolvent participants. These general surveillance abilities, collateral requirements, and full procedures for closing-out outstanding obligations of insolvent participants are important safeguards that, in conjunction with SCCP's clearing fund assets and insurance against certificate related losses, substantially enhance SCCP's ability to protect itself and its participants.

SCCP and Philadep also filed proposed rule changes to require that applicants or participants, as appropriate, be given specific notice of the grounds under consideration for discipline, imposition of sanctions, limitation of access to SCCP's and Philadep's services, or denial of participation. These rule changes, among other things, provide applicants with an opportunity for a hearing prior to a determination to deny admission and exclude "associated persons" from the categories of participants against whom SCCP and Philadep may institute disciplinary proceedings.[70]

In addition, SCCP and Philadep filed rule changes establishing board of directors nominating committees that consist of participants and that are charged with the responsibility of assuring fair representation for a cross-section of participants. These changes, among other things, also establish at SCCP and at Philadep fifteen to seventeen member boards of directors (a majority of whom must be participants of SCCP or Philadep, respectively, and a majority of whom must be governors of the Phlx).[71] Those changes further require Phlx to consider fairly the interests of participants in nominating and electing SCCP's and Philadep's boards, and provide participants with an opportunity to nominate additional directors.[72] Finally, SCCP and Philadep filed proposed rule changes that enhance the process of reviewing applications for clearing agency membership, permit financially and operationally responsible sole proprietors to become participants, and create admissions committees to apply those standards.

All SCCP and Philadep rule changes filed during the course of the registration proceeding were published for comment and will be approved by the Commission as consistent with the requirements of the Act, and in particular, with Section 17A.[73]

b. *Use of the Clearing Fund to Finance Settlement Activity of Phlx Specialists*

(i) *Description of the Financing Program*

As a special service to SCCP participants, SCCP finances Phlx members' securities purchases and obtains the necessary funds by investing a percentage of SCCP's clearing fund assets in this financing program. In general terms, each day SCCP uses some clearing fund cash to help certain participants, primarily Phlx specialists, pay for purchases of Phlx-listed securities. To secure these loans, SCCP places a lien on the financed securities and on certain other securities in specialists' margin accounts. Thus, in effect, SCCP invests the cash portion of its clearing fund in its financed participants' equity positions and secures those "investments" with equity collateral in the issues financed.

More specifically, SCCP uses the clearing funds cash in its "Operating Account" at a large commercial bank to finance those positions.[74] Activity in that account includes debits and credits related to SCCP clearance and settlement functions (such as money payments and receipts for SCCP participants' CNS activity) as well as cash clearing fund contributions. SCCP's financing activity generally is limited to the cash balance in the Operating Account, calculated daily, after all CNS and other clearance and settlement debits and credits have been made.[75]

Although SCCP uses the cash balance in its Operating Account to finance specialist, proprietary, and customer omnibus margin accounts, specialist margin accounts comprise approximately 90 percent of SCCP's financing activity. Because SCCP does not often engage outside financing, SCCP customarily charges its borrows interest rates slightly below the

[69] In addition to filing Forms CA–1, SCCP and Philadep have filed in recent years various rule changes concerning their participation in the National System, which the Commission separately approved. For example, the Commission approved SCCP proposed rule changes that: (1)permit SCCP participants to buy-in securities against SCCP (as guarantor of delivery) and authorize SCCP to conform the buy-in extension provisions to NASD and other clearing agency time frames (Securities Exchange Act Release No. 19230 (November 10, 1982), 47 FR 51969 (November 18, 1982)); (2) eliminate SCCP's pre-settlement guarantee (of delivery to the *contra* party) and mandatory pre-settlement marks-to-the-market relating to most trades between Phlx members (Securities Exchange Act Release No. 19668 (April 13, 1982), 48 FR 16795 (April 19, 1982)); and (3) enhance OTC trade comparison for SCCP participants by expediting the resolution of unmatched aged OTC transactions (Securities Exchange Act Release No. 18277 (November 20, 1981), 46 FR 58239 (November 30, 1981)). Furthermore, the Commission approved certain Philadep proposed rule changes that: (1) authorize Philadep to participate in NIDS (Securities Exchange Act Release No. 19209 (September 1, 1982), 47 FR 39775 (September 9, 1982); *see also* note 36 *supra*) and (2) enable participants to accept exchange and tender offers for certain securities issues without withdrawing the certificates from the depository (Securities Exchange Act Release No. 18967 (August 16, 1982), 47 FR 36742 (August 23, 1982)).

[70] Clearing agencies have limited disciplinary authority respecting "associated persons" of participants. *See, e.g.*, Section 19(d)(1) of the Act. *See also* Securities Exchange Act Release No. 17810 (May 19, 1981), 46 FR 28546 (May 27, 1981); Securities Exchange Act Release No. 18771 (May 28, 1982), 47 FR 24677 (June 7, 1982).

[71] To assure that result, at least one board member must be both a SCCP participant and a Phlx governor.

[72] *See* discussion *supra* in text accompanying notes 52–62 concerning fair representation of participants.

[73] The Commission expects to issue those orders at the end of the thirty-day statutory waiting period.

[74] SCCP maintains a separate corporate account for ordinary business-related items.

[75] At the end of each day, CNS credits and debits in the Operating Account should balance, leaving SCCP with the entire clearing fund cash for its financing activities.

For financing purposes, SCCP resorts to the aggregate cash clearing fund contributions in the Operating Account after all clearance and settlement obligations are satisfied. In the past, SCCP has obtained limited additional cash for financing purposes by rehypothecating, consistent with Rules 8c–1 and 15c2–1 (17 CFR 240.8c–1 and 15c2–1), up to 10 percent of the aggregate specialists' positions being financed. SCCP represented to the Commission that such specialist positions are not pledged routinely, but only when necessary to continue carrying financed positions.

prevailing broker-dealer call rate. Generally, SCCP marks-to-the-market specialists' net purchases from trade date forward, and finances, as of settlement date, up to 75 percent of those positions.[76] When settlement occurs, SCCP, on behalf of each specialist, fully pays the *contra* party by crediting that party's account. In turn, each specialist pays SCCP at settlement at least 25 percent of the purchase price of financed securities.[77]

Historically, SCCP has included a number of safeguards to protect SCCP and its participants from potential financial exposure associated with the insolvency of a specialist or the volatility of specialist securities issues. SCCP's primary protection—a lien on funds and margined securities issues in the specialist's margin account—enables SCCP, in the usual case, to liquidate all SCCP-financed positions and retain any needed proceeds.[78] SCCP also requires specialists to maintain "initial" equity as of trade date and to pay presettlement marks-to-the-market.[79] In addition, SCCP closely monitors the "concentration" of securities issues in each specialists's margin account.[80]

(ii) *The Exemption Request*

Because SCCP's financing program entails continuous and substantial use of clearing fund assets, SCCP, in its Form CA–1, requested an exemption from the Act and the Standards concerning limitations on use of clearing fund assets. SCCP argued that, by facilitating specialists' capabilities to make markets in Phlx-listed securities,[81] its financing activity facilitates the clearance and settlement process. Moreover, SCCP asserted, the funds are protected properly by SCCP's risk-limiting procedures.[82] Finally, SCCP argued that it would incur additional operating expenses of between $150,000 and $200,000 if it had to rely on outside financing.[83]

(iii) *Applicable Legal Standards*

Section 17A(b)(3)(F) of the Act requires the rules of the clearing agency to be designed, among other things:

> to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, . . . and, in general, to protect investors and the public interest . . .

The Act does not specify particular safeguards to be adopted by clearing agencies. The Standards, however, specify several safeguards, one of which is an adequate fund of liquid assets, contributed by participants in proportion to their use of clearing agency services, that can be used to indemnify the clearing agency and its participants against losses resulting from clearance and settlement activity (commonly referred to as the "clearing fund" or the "participants fund"). The Standards provide that the clearing fund should be used to protect:

> participants and the clearing agency (i) from the defaults of participants and (ii) from clearing agency losses (not including day-to-day operating expenses) such as losses of securities not covered by insurance or other resources of the clearing agency.[84]

The Standards further provide that the clearing fund should be:

> (i) composed of contributions based on a formula applicable to all users; (ii) in cash or highly liquid securities; and (iii) limited in the purposes for which it may be used.[85]

Since the fundamental purpose of the clearing fund is to protect clearing agencies against financial exposure resulting from participant defaults and clearing agency losses not covered by insurance or other resources of the clearing agency,[86] the Standards state that the fund should not be used in a manner that exposes it to unreasonable risks. The Standards, however, expressly recognize two instances in which the clearing fund may be used for other purposes: First, clearing agencies may invest the cash portion of the clearing fund in safe and liquid investments, such as United States Government obligations; [87] and second, clearing agencies may temporarily apply a limited portion of the clearing fund to meet unexpected and unusual clearing agency requirements for funds. Furthermore, the Standards suggest that a portion of the clearing fund may be used for a legitimate purpose for a longer period of time, provided that: (i) the funds are properly protected; (ii) the funds are used to facilitate the process of clearance and settlement; and, (iii) the participants and the Commission specifically approve the use during the registration proceedings.[88] Thus, the Standards contemplated that a clearing agency would not invest the bulk of its clearing fund in ways that would involve a greater risk than investment in United States Government obligations.

Nonetheless, the Commission has recognized in its recent Order concerning the structure of NSCC's clearing fund that the universe of permissible uses, under the Act and the Standards, is larger than short-term unanticipated uses and specially approved certain longer-term uses. [89] In that Order, the Commission approved NSCC's short-term pledge of clearing fund assets other than cash as collateral for loans to satisfy temporary losses or liabilities incident to its clearance and settlement business.[90] The Commission looked to the reasonably short-term nature of the loan [91] and NSCC's expectation that it would only pledge such securities when it would otherwise be permissible to assess the fund.[92] The Commission also approved NSCC's use of the cash portion of the clearing fund in certain circumstances in view of the "carefully controlled use" by NSCC of clearing fund cash and the economic and administrative value of making

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[76] The 25% equity requirement is designed to help protect SCCP against a decline in the market value of financed securities.

[77] SCCP may demand repayment of the loan at any time.

[78] Of course, if the market value of a financed specialist's position declined precipitously, the value of the lien to SCCP would diminish in kind.

[79] SCCP imposes the equity requirement as of trade date and requires mark-to-the-market payments beginning one day after trade date (T+1). By collecting the daily mark-to-the-market payments, SCCP is protected further against any decline in the market value of purchased securities from T+1 until settlement.

[80] An unduly large position in a violatile securities issue (in relation to that specialist's positions in other securities issues) presents special risks because, in the event of that specilist's default, SCCP, as creditor, must look primarily to those positions for satisfaction of the outstanding loan amount. In that situation, SCCP is a risk that a substantial intra-day market movement may reduce the collateral value of those securities below the level of payment obligations.

[81] Presumably, convenient financing on a continuous basis lends liquidity to the Phlx's auction market.

[82] In particular, SCCP notes that its mark-to-the-market program is "automated and timely, including the pricing."

[83] This amount would represent lost income plus new borrowing expenses for SCCP

[84] *See* Standards Release, 45 FR at 41929.

[85] *Id.*

[86] The Standards exclude day-to-day operating expenses from the types of "losses" for which the clearing fund may be used routinely

[87] Standards Release, 45 FR at 41929. The Commission continues to believe that such investments must be made by the clearing agency in light of its fiduciary responsibilities. *See also* note 89 *infra.*

[88] Standards Release, 45 FR at 41929.

[89] Securities Exchange Act Release No. 19230 (November 10, 1982), 47 FR 51969 (November 18, 1982) ("NSCC Order"), at 51972.

[90] In NSCC's program, the pledge of clearing fund assets, if not repaid within 30 days, results in the pledge being deemed a clearing fund assessment under NSCC's rules. The Commission determined that pledging clearing fund assets for a loan to cove. a temporary loss in lieu of making *pro rata* assessments does not subject such assets to unreasonable risk, under those circumstances.

[91] *See* NSCC Order, 47 FR at 51977

[92] NSCC anticipated such short-term use of clearing fund assets primarily when a member fails-to-settle and the lending bank requires a pledge to advance settlement monies or when NSCC makes erroneous payments, such as state transfer tax payments, as agent for its participants.

needed cash available to NSCC conveniently.[93]

(iv) *Discussion*

Although SCCP financing is neither a short-term unanticipated use nor a longer-term extraordinary use contemplated by the Standards, financing at SCCP is integrally related to clearance and settlement.[94] Moreover, SCCP's use of the clearing fund functionally constitutes an "investment" of clearing fund assets that provides important support to significant segments of SCCP's participant community.[95] The important question in assessing the financial responsibility of that program, therefore, is whether SCCP's financing arrangements, on balance, assure the safeguarding of clearing fund assets invested in that program.

SCCP's financing program has benefitted SCCP, its participants and, indirectly, the public in several ways. Primary benefits include income to SCCP [96] and financial support to SCCP specialists, which helps the Phlx maintain orderly and liquid markets, thereby enhancing the public's opportunity to obtain the best price in a particular Phlx-listed secuitities issue. Also, SCCP's financing program has buttressed specialist trading activity, which, in turn, can increase transaction fees for Phlx and SCCP. Furthermore, by permitting SCCP to avoid interest charges that it would otherwise incur by borrowing funds from outside sources to finance Phlx specialists, SCCP has experienced reduced costs, estimated to be between $150,000 and $200,000 per year. These benefits, of course, accrue to the entire SCCP participant community.[97]

The Commission believes that although SCCP's financing program, as it has operated historically, has provided significant benefits to SCCP, its participants, and the public, that program presents distinct risks of financial exposure to SCCP, to its clearing fund, and to its participants. Because SCCP's financing program permits SCCP to commit, for financing purposes, a substantial portion of clearing fund cash, in any given participant-default proceeding SCCP may not be able to access immediately that portion of the clearing fund.[98] Moreover, if the value of securities collateralizing SCCP's specialist obligations declines significantly concurrent with multiple participant defaults, SCCP may be unable to cover losses incurred in closing-out its obligations without further assessing participants. These events would be particularly troublesome absent a full range of risk-limiting measures at SCCP. In the past, SCCP has not monitored, other than through the Phlx, the financial capacity and operational capability of Phlx specialists and has not been authorized to demand further assurances from financially or operationally troubled participants. In addition, in the event of participant default, SCCP has not had express authority to reverse CNS deliveries to defaulting participants. In response to such concerns, however, SCCP amended its rules to establish formal safeguarding measures, which the Commission considers essential to the operation of a fully-registered clearing agency.

(v) *The Commission's Determination*

The Commission believes that SCCP's rules, as amended during the course of this registration proceeding, are consistent with the Act and the Standards, including the requirements respecting the safeguarding of funds and securities in the clearing agency's custody or control. In view of SCCP's rule amendments, SCCP's request for exemption from compliance with the Standard respecting clearing fund use has become moot and accordingly has been withdrawn.

A significant factor in the Commission's determination to approve SCCP's use of clearing fund cash in its financing program (as modified by the rule changes) is that SCCP was engaged in this activity in 1975, when Congress passed the 1975 Amendments. Those Amendments permitted SCCP, as a Reg T lender, to continue to finance securities purchases, while at the same time subjecting SCCP, as a clearing agency, to Commission regulation.[99] Thus, the Commission believes that the Act necessarily contemplates clearing agency financing to the extent permitted by Regulation T. Because Section 17A also requires safety in clearance and settlement, however, the Commission believes that SCCP's financing program must operate free of unreasonable risk.

The Commission is encouraged by SCCP's development of additional significant financial safeguards during this registration proceeding and fully anticipates that SCCP will continue to refine its systems and services in ways that further enhance their utility and safety. Accordingly, the Commission has determined that SCCP's financing activities are consistent with the Act and the Standards, but believes it appropriate to attach the following conditions to the program's continuing operation. First, pursuant to its rule change, SCCP must use its authority, as necessary and appropriate, to demand and collect further assurances of participants' financial stability and operational capacity, to reverse certain CNS deliveries to defaulting participants, and to close-out promptly and efficiently defaulting participants'

[93] As stated in that Order, a clearing agency's clearing fund should not be viewed in isolation but rather as one element in a complement of safeguards designed to protect the clearing agency against losses attributable to clearance and settlement operations. In addition to substantial insurance policies covering certificate-related losses, NSCC's safeguards include marks-to-the-market on open fail positions, special marks for positions in volatile securities or for more concentrated securities positions, special surveillance and collateral requirements for financially impaired members, additional assurance authority, and authority to reverse certain CNS deliveries to defaulting participants. NSCC Order, 47 FR at 51975.

[94] Although SCCP's rules in the past authorized the use of its clearing fund to satisfy routine expenses on a daily basis, SCCP has not used the clearing fund in a manner inconsistent with the Act and Standards. The Standards, as interpreted by the NSCC Order, provide that the rules of the clearing agency should limit the purposes for which the clearing fund may be used to protecting the clearing agency and its participants against losses or liabilities not covered by insurance or other resources of the clearing agency. Thus, while the Standards would permit limited and prudent investment of funds, the Standards require clearing agencies to protect clearing funds against unnecessary risks. *See* NSCC Order, 47 FR at 51971. Accordingly, SCCP filed a proposed rule change that requires its clearing fund to be used only to satisfy losses and liabilities incident to SCCP's clearance and settlement process, and not to cover routine, daily operating expenses.

[95] On average, specialist settlement volume approximates $3 million each day, which is roughly 15 percent of SCCP's total daily settlement volume.

[96] In 1982, SCCP derived a significant portion of its total income from margin account interest payments. SCCP has realized, on average, a higher rate of return through investing clearing fund cash in the financing program than if it had invested those assets in U.S. Government securities or in loans at overnight loan rates.

[97] Income SCCP earns from its financing program offsets some SCCP expenses, thus reducing SCCP's participant fees.

[98] As of August 5, 1983, about 69 percent of SCCP's clearing fund consisted of cash, all but about 15 percent of which is available to SCCP for financing purposes. (SCCP customarily retains an increment of clearing fund cash that it does not use for financing.)

[99] The 1975 Amendments prohibited all persons, other than registered broker-dealers, from subsequently becoming members of a national securities exchange. Section 31(a) of the 1975 Amendments, however, permitted non-broker organizations that were exchange members prior to that legislation's effective date to maintain their exchange membership without registering as a broker-dealer. Since SCCP was a non-broker Phlx-member prior to the effective date of the 1975 Amendments, SCCP was permitted to continue engaging in securities-related lending activities under Regulation T as an exchange member without registering as a broker-dealer. *See* Pub. L. No 94-29, section 31(a), 89 Stat. 97 at 170 (1975); 12 CFR 220.1, 220.1(b), 220.2(b), *as amended* at 48 FR 23161 (May 24, 1983).

open fails. In addition, as authorized by its rule change, SCCP must periodically assess the risks to the clearing agency from its financing program and other services, must maintain a reasonable, minimum level of uncommitted clearing fund cash for emergency use, must monitor the financial and operational capabilities of its borrowers, and must provide financing strictly in accordance with Rules 8c–1 and 15c2–1 under the Act. Finally, in light of the disparities in treatment created by using aggregate participant cash clearing fund contributions to finance the activity of only some participants, SCCP's registration is further conditioned on SCCP disclosing to all participants the nature, extent, and terms of its financing program.[100]

2. *Conclusion*

Based on the foregoing, the Commission believes that SCCP and Philadep at this time satisfy the Requirements and Standards and that they should be fully registered subject to the conditions noted herein.

D. PCC and PSDTC

PCC and PSDTC are wholly-owned clearing agency subsidiaries of the Pacific Stock Exchange, Inc. ("PSE"). The PCC/PSDTC complex offers to participants services comparable to other regional clearing agency complexes. For example. PCC/PSDTC offers trade recording services for PSE-listed and OTC securities transactions; OTC trade comparison services through its participation in the National OTC Comparison System;[101] CNS clearance services;[102] trade settlement services through the RIO interface; book-entry depository services; dividend and interest accounting; and participation in the NIDS.[103]

1. *The Commission's Review Process*

The Commission's review of PCC's Form CA–1, including PCC's by-laws and rules, was extensive and detailed. Such close and careful review was necessary because PCC's by-laws and rules for some time have not reflected PCC's modern clearance and settlement systems. In developing suitable contemporary rules, PCC staff met with the Commission staff periodically to discuss necessary changes and thereafter revised its by-laws and rules. In contrast, PSDTC's Form CA–1, including PSDTC's by-laws and rules, as filed in December 1980, substantially reflected PSDTC's current depository functions.

2. *Findings*

a. *PCC*

During this registration proceeding, PCC proposed many new by-laws and rules, the most important of which related to: (1) the structure, control, and use of PCC's clearing fund;[104] (2) financial responsibility and operational capacity standards for applicants and participants;[105] (3) disciplinary actions and hearing and appeal procedures;[106] (4) fair representation of participants in the director selection process;[107] and (5) meaningful safeguards against financial exposure in the event of participant default.[108]

PCC subsequently filed with the Commission comprehensive proposed rule changes to conform its by-laws, rules, and procedures to the Act and the Standards.[109] For example, PCC's amendments authorize PCC to take custody of its clearing fund assets and eanble PCC, rather than the PSE, to invest and to pledge clearing fund assets. Moreover, each participant's minimum required cash contribution has been increased significantly, and PCC now allows its participants to collateralize their clearing fund open account indebtedness (required contributions over the minimum cash amount) through the controlled use of letters of credit, in addition to traditional collateral such as U.S. Government securities.

To comply with the Act's fair representation requirement, PCC established a nominating committee, consisting of members of the PSE's board of governors' executive committee, to nominate condidates for PCC's board of directors. That nominating committee has the duty to assure fair representation of PCC's members when selecting nominees. In addition, any ten PCC participants now may nominate a board candidate by petitioning the nominating committee.[110]

Finally, PCC's rule changes stengthen significantly PCC's mechanisms against financial exposure from participant default or insolvency. For example, PCC can (1) reverse certain unsettled trades of an insolvent participant; (2) require a participant to pay PCC additional marks-to-the-market in certain circumstances (*e.g.*, when the participant has positions in volatile securities issues); and (3) require a financially or operationally troubled participant to provide PCC with further assurances of financial responsibility or operational capacity, such as providing additional clearing fund deposits.

b. *PSDTC*

As noted above, PSDTC's by-laws and rules required fewer revisions than PCC's to comply with the Act and the Standards. During this registration proceeding, however, PSDTC revised its by-laws and rules (1) to restructure PSDTC's participants fund and to narrow its usage;[111] (2) to provide financial responsibility and operational capacity standards for applicants and participants;[112] (3) to strengthen due process protections in disciplinary proceedings;[113] and (4) to assure fair representation for participants in the director selection process.[114] These rules changes will be approved by the Commission in separate releases.[115]

3. *Conclusion*

Based upon its review of PCC's and PSDTC's Forms CA–1, including the recent rule changes, the Commission

[100] SCCP has undertaken to disclose separately and specifically to its participants the nature, extent, and terms of its financing activities.

[101] *See* Securities Exchange Act Release No. 18277 (November 11, 1981), 46 FR 58239 (November 30, 1981), regarding the National OTC Comparison System.

[102] PCC established the first CNS system in 1960.

[103] *See* Securities Exchange Act Release No. 19437 (January 18, 1983), 48 FR 3441 (January 25, 1983), regarding NIDS. *See also* note 36 *supra*.

[104] *See* discussion in text at notes 84–93 *supra* regarding appropriate clearing agency uses of clearing participant fund assets.

[105] *Cf* Securities Exchange Act Release No. 15744 (May 17 1982), 47 FR 22265 (May 21, 1982) (standards for NSCC broker-dealer applicants and participants), Securities Exchange Act Release No. 18417 (August 16, 1982), 47 FR 37990 (September 16, 1982) (standards for NSCC bank applicants and participants).

[106] *See* discussion in text accompanying notes 128–133 *infra* for the Requirements regarding the types of clearing agency disciplinary actions and the due process requirements for those actions.

[107] *See* discussion in text accompanying notes 52–62 *supra* regarding the Requirements for fair representation of participants in the election of clearing agencies' boards of directors.

[108] *See* discussion in text accompanying notes 84–93 *supra* relating to the Requirements regarding the safeguarding of securities and funds.

[109] These rule changes will be approved by the Commission in separate releases.

[110] PCC, at this time, has not yet subjected its shareholder, the PSE, to a duty to vote in a PCC board of director's election with a view toward assuring fair representation of a cross-section of the community of participants. To expedite full registration, and as a condition of that registration, however, PCC has undertaken to impose that responsibility through the PSE in the immediate future.

[111] PSDTC's problems relating to its participant's fund were identical to those at PCC. *See* note 104 *supra*.

[112] *See* note 105 *supra*.

[113] *See* discussion in text at notes 128–133 *infra regarding the Act's due process requirements for clearing agency disciplinary proceedings.*

[114] *See* discussion in text at notes 52–62 *supra* regarding the act's fair representation requirements.

[115] The Commission expects to issue those releases at the end of the 30–day statutory waiting period.

believes that PCC and PSDTC at this time satisfy the Requirements and Standards. Because PCC and PSDTC have recently undergone significant operational and management changes, however, the Commission and the BGFRS plan to monitor those clearing agencies' performances carefully during the next year. Nonetheless, the Commission hereby determines that PCC and PSDTC should be fully registered as clearing agencies under the Act, subject to the undertakings noted herein.

E NSCC

In 1976, NSCC applied to the Commission for temporary registration under Section 17A(b) and 19(a)(1) of the Act and Rule 17Ab2-1. NSCC proposed a two-phase merger of three clearing corporation separately owned by the AMEX, the NASD, and the NYSE. After holding hearings and receiving extensive public comment on NSCC's application for registration,[116] the Commission granted temporary registration to NSCC,[117] subject to several substantial conditions and extensive Commission monitoring of both NSCC and its impact on other clearing agencies and the securities industry.[118]

Since 1976, the Commission has monitored NSCC carefully and extensively. As part of its monitoring program, the Commission reviewed NSCC's efforts to satisfy all of the Registration Order's requirements [119] and reaffirmed its decision to register NSCC.[120] More recently, when the Commission determined that NSCC was in compliance with all of the conditions to its temporary registration, as modified, it permitted NSCC to enter the fully-merged phase of its operations.[121] In addition, the Commission has reviewed, on a continuing basis, and approved, as consistent with the Act, numerous proposed rule changes submitted by NSCC, pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder, affecting a broad range of NSCC's responsibilities, services, and activities.[122] Accordingly, the Commission's oversight of NSCC has been and continues to be rigorous and thorough.

Based upon the Commission's oversight of NSCC's activites and the review conducted in conjunction with these proceedings, the Commission has determined that NSCC's by-laws, rules, procedures, and systems, as amended, are consistent with the Requirements and the Standards. Accordingly, the Commission believes that NSCC should be granted full registration.

F. DTC

DTC, the largest registered securities depository based on deposits, offers participants a variety of depository services.[123] DTC also performs services for other securities depositories, notably as facilities manager for the NIDS.[124] In addition, as the "qualified securities depository" of NSCC, DTC performs critical functions on behalf of NSCC in connection with NSCC participant services. Finally, DTC, like other securities depositories, operates a Participant Terminal System consisting of a network of computer terminal stations located in participants' offices that enable participants to communicate instructions and inquiries to DTC and to receive messages and reports from DTC.[125]

DTC is substantially user owned, with each participant's ownership interest determined annually on the basis of that participant's use of DTC's services. User-participants are afforded the opportunity for practical representation in the administration of DTC's affairs through representation on DTC's board of directors,[126] and a periodic opportunity to comment on proposed rule changes.

When DTC filed its application for registration, it objected to, or requested exemption from, certain Standards: the standard of care; the limitation on the use of clearing fund assets; and the internal accounting control report requirement. After consultation with the Division, however, DTC withdrew its objection to application of the Standards concerning the use of the clearing fund and converted its objection to the internal accounting control report requirement to a request for a limited exemption. As discussed below, the Commission is not imposing a strict liability standard of care and is granting DTC's exemptive request from certain aspects of the internal accounting control report requirement. Accordingly, because review of DTC's application, as amended during this proceeding, revealed substantial compliance with the Act and the Standards,[127] the

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[116] *See, e.g.*, Securities Exchange Act Release No. 12274 (March 29, 1976), 41 FR 14455 (April 5, 1976).

[117] Securities Exchange Act Release No. 13163 (January 13, 1977), 42 FR 3916 (January 21, 1977) ("Registration Order").

[118] The Commission subsequently has modified these conditions as circumstances have required. *See* notes 119-122 *infra*.

[119] *E.g., File No. SR-NSCC-81-16, Securities Exchange Act Release No. 18327 (December 11, 1981), 46 FR 61379 (December 16, 1981) (fee schedule with geographically mutualized pricing); and "Notice of Submission of Report Evaluating Facilities Management Alternatives By NSCC," File No. S7-916, Securities Exchange Act Release No. 18296 (December 1, 1981), 46 FR 60082 (December 8, 1981) (report prepared by independent public accountants on NSCC's choice of facilities manager).*

[120] Order Affirming NSCC's Registration and Statement of Reasons, File No. 600-15, Securities Exchange Act Release No. 17562 February 20, 1981, 22 SEC Docket 129 (March 10, 1981), as referenced in 46 FR 14244 (February 26, 1981).

[121] Securities Exchange Act Release No. 19705 (April 26, 1983), 48 FR 20189 (May 4, 1983). NSCC remains subject, as practicable, to the conditions of the Registration Order, as subsequently modified by any relevant Commission letter, release, action, or order.

[122] *See, e.g.*, Securities Exchange Act Release No. 17343 (November 26, 1980), 45 FR 80224 (December 3, 1980) (allowing NSCC to process municipal securities transactions), modified by Securities Exchange Act Release No. 17660 (March 27, 1980), 46 FR 20017 (April 2, 1981); Securities Exchange Act Releae No. 18744 (May 17, 1982), 47 FR 22265 (May 21, 1982) (applicant and participant standards for broker-dealers and financial protections) modified by Securities Exchange Act Release No. 18417 (August 23, 1982), 47 FR 37990 (September 16, 1982); Securities Exchange Act Release No. 19191 (October 29, 1982), 47 FR 50597 (November 8, 1982) (applicant and participant standards for banks); NSCC Order, *supra* note 89 (clearing fund requirements for bank participants).

NSCC also proposed, and the Commission approved, rule changes that, among other things, addressed the obligations specified in the Requirements and the Standards. *See Securities Exchange Act Release No. 20123 (August 26, 1983), 48 FR 40049 (September 2, 1983) (NSCC's appeal procedures for applicants and participants who are denied participation, limited in their access to services, suspended, sanctioned or expelled by NSCC); Securities Exchange Act Release No. 20124 (August 26, 1983), 48 Fr 40051 (Septembr 2, 1983) (technical amendments that, among other things, conform NSCC's rules to the Standards).*

[123] DTC acts as a custodian for securities; performs computerized book-entry delivery of securities immobilized in its custody; performs computerized book-entry pledges of securities in its custody; and provides for withdrawals of securities on a routine or urgent basis. Ancillary services include: (i) book-entry distribution of securities offered in public underwritings; (ii) a dividend reinvestment service; (iii) a third-party pledge system in which OCC members may pledge to OCC securities on deposit at DTC that underlie options; (iv) a payment order service that allows participants to use their DTC accounts to settle money payments that are associated with securities transactions that occur outside the depository; and (v) a voluntary offering program for delivery of securities tendered to bidders' agents in tender offers.

[124] *See* note 36 *supra*.

[125] *See* note 48 *supra*. So that clearing agencies and federal regulators could obtain sufficient experience to assess system benefits and safety, these systems have operated as pilot programs since their inception. The Commission expects to consider whether to approve these systems in the near future.

[126] The election of the board of directors is conducted under a system of cumulative voting which ensures that no group controlling more than 50% of DTC stock can elect all directors.

[127] One significant variance from the Requirements, however, was noted with respect to assuring participants due process when disciplining participants or limiting their access to DTC services. As a result, DTC has undertaken to revise its rules to establish suitable procedural protections.

Commission is granting DTC full registration as a clearing agency, subject to DTC's fulfilling its undertakings.

1. *Capacity To Enforce Rules and To Discipline Participants in Accordance With Fair Procedures*

The Act requires clearing agencies to have authority to discipline participants for violations of clearing agency rules and to select appropriate sanctions from the list set forth in Section 17A(b)(3)(G) of the Act.[128] The Act also requires clearing agency disciplinary procedures to be fair. Thus, participants charged with a violation must be afforded the right to a fair and impartial hearing,[129] a request for which should stay the imposition of a proposed sanction unless the sanction is a summary suspension.[130] To assure impartiality, the hearing panel should be composed of directors or other persons disinterested in the initial disciplinary recommendation.

DTC has undertaken to amend its rules to conform to the Act,[131] by including in its rules the statutory list of sanctions [132] and by ensuring the right to be heard by an impartial panel in proceedings that could result in a recommendation to impose sanctions, deny participation, or limit access to services. Under the amended rules, the right to a hearing before persons disinterested in the initial recommendation will be granted to all participants regardless of the sanctions imposed, and any sanction, except summary suspension, will be stayed automatically upon a participant's request for a hearing.[133]

2. *Clearing Agency Standard of Care*

The Standards urged clearing agencies to embrace a strict standard of care in safeguarding participants' funds and securities.[134] The Standards called on registered clearing agencies to undertake, by rule, to deliver all fully-paid-for securities in their control to, or as directed by, the participant for whom securities are held. The Standards further urged registered clearing agencies to assume full responsibility to their participants for the acts or omissions of clearing agencies' sub-custodians [135] and, accordingly, required clearing agencies to assure that their sub-custodians have the capability to deliver promptly fully-paid-for securities at the direction of participants or the clearing agencies. Thus, under that Standard, a registered clearing agency would have been strictly liable to participants for losses incident to a failure by either the clearing agency or any of its sub-custodians to promptly deliver fully-paid-for securities to participants on demand.

The Commission does not believe sufficient justification exists at this time to require a unique federal standard of care for registered clearing agencies. The temporarily registered clearing agencies have demonstrated competence and a high level of responsibility in safeguarding securities and funds, whether in vaults, in processing areas, or in transit. As a result, these clearing agencies have experienced few losses. Moreover, when losses have occurred, clearing agencies have handled those losses in a very responsible manner, minimizing damage to solvent participants and avoiding disruptions in the National System.

Although not subject to strict liability under state law for the loss of participants securities, the applicant securities depositories are limited purpose trust companies. As such, they are each responsible under state or federal law, or both, to protect participants' securities and funds. In addition, the temporarily registered clearing agencies all have substantial systems of internal accounting control, are subject to continuous internal and external reviews respecting those systems,[136] and maintain significant safeguards, including substantial insurance coverage, respecting loss of funds and securities in their possession or control.[137]

3. *Use of the Participant's Fund*

As noted above, DTC expressed concern about limitations that the Standards impose on use of the participants' fund. Since the Standards were published, the Commission has clarified that the range of permissible uses of clearing fund assets covers all losses and liabilities incident to clearance and settlement activities.[138] DTC, therefore, has withdrawn its objection to the Standards and has represented that it will use clearing fund assets consistent with existing general Commission policies.[139] With respect to the use of DTC's clearing fund assets, therefore, the Commision believes that DTC's rules conform to the Requirements and the Standards.

4. *Internal Accounting Control Report*

The Standards require a clearing agency to "furnish annually to participants an opinion report prepared by its independent public accountant based on a study and evaluation of the clearing agency's system of internal accounting control for the period since the last such report.[140] As discussed in the Standards, the report shoud be based on a study of the system of internal accounting control, "including a review of the system and tests of compliance." The scope of the study, moreover, "shall be sufficient to provide reasonable assurance that any material weakness existing during the period [since the last report] would be discovered. The accountant's report [must] describe any material weakness is discovered and any corrective action taken or proposed to be taken." [141]

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[128] Statutory sanctions include: "expulsion, suspension, limitation of activities, functions, and operations, fines, censure, or any other fitting sanction." Section 17A(b)(3)(G) of the Act.

[129] *See* Section 17A (b)(3)(H) and (b)(5) of the Act; Standards Release, 45 FR at 41925. *See generally In re Charles H. Ross, Inc.*, Securities Exchange Act Release No. 16230 (October 1, 1979), 18 SEC Docket 557 (October 16, 1979).

[130] *See* Section 17A(b)(5)(C) of the Act.

[131] *See* letter from Edward J. McGuire, General Counsel, DTC, to the Division (August 10, 1983), File No. 600-5.

[132] *See* note 64 *supra*.

[133] The Commission believes that requests for further assurances and imposition of more stringent credit terms, such as cash and carry, ordinarily would not constitute "sanctions" under the Act. Thus, a participant's request for a hearing concerning those clearing agency determinations would not generate an automatic stay.

[134] *See* Standards release, 45 FR at 41930.

[135] More specifically, the Standards provided that clearing agency rules should acknowledge liability to participants for failure to deliver participants' securities resulting from:

(i) the negligence or misconduct of the clearing agency, the clearing agency's sub-custodians or agent, or any of their respective agents or employees; (ii) the placement, on fully-paid-for participant's securities held by the clearing agency, of any lien, claim, right, or charge of any kind in favor of the clearing agency, the clearing agency's sub-custodian or agent or any person claiming through any one or more of them; (iii) larceny; (iv) mysterious disappearance; or (v) any other cause for which the clearing agency has assumed responsibility. *Id.*

[136] *See id.*, at 41927-28.

[137] Preventive measures include (i) access control on-site, off-site, and in-transit; (ii) written procedures detailing steps involved in handling funds and securities; (iii) maintenance of an orderly and secure working environment; (iv) early warning systems and procedures responsive to fire, national disaster, and intrusion; and (v) measures designed to assure (a) software integrity; (b) adequacy of accounting controls; and (c) data accuracy.

[138] *See* discussion *supra* at notes 89-92.

[139] *See* discussion *supra* in text at notes 84-93 regarding use of clearing fund assets.

[140] Standards Release, 45 FR at 41925.

[141] Standards Release, 45 FR at 41928.

A material weakness was defined: as a condition for which the auditor believes that the procedures (or lack thereof) or the degree of compliance with them does not provide reasonable assurance that errors or irregularities in amounts that would materially affect the clearing agency . . . would be prevented or detected within a timely period by employees in the normal course of performing their assigned functions. *Id.*

Continued

As envisioned by the Standards and as further elaborated in Securities Exchange Act Release No. 19744 (May 9, 1983),[142] the scope of the study and evaluation would cover all clearing agency activities performed for participants, particularly trade recording, transaction processing, and depository activities (including those depository activities associated with securities positions and related money balances).[143] Of course, where clearing agency activities involve sub-custodians, the study and evaluation would encompass, to the extent necessary, controls at those organizations. Excluded from the scope of the study and evaluation, however, would be clearing agency corporate functions, such as payroll accounting.

The Standards established the internal accounting control report requirement in recognition of the crucial role of clearing agencies in the National System. The report was intended to promote confidence and to increase participation in the National System and, through an independent professional assessment of the system-wide safety and efficiency of clearing agencies, to facilitate and supplement Commission oversight and inspection of clearing agencies, consistent with the Commission's responsibility to foster safe and efficient clearing agency operations. Accordingly, the Standards proposed the annual "for-the-period" requirement to provide a very high degree of assurance to participants and to the Commission concerning the safety of overall clearing agency operations. To opine with respect to the system of internal accounting control for-the-period, the independent accountant would be required to comply with general standards established by the American Institute of Certified Public Accountants (the "AICPA") [144] as supplemented by the Standards Release.[145]

As noted above, DTC requested reconsideration of the internal accounting control report requirement. In particular, as DTC suggested, engaging an independent public accountant to prepare a report on the basis of a year-round study and evaluation of the clearing agency's system of internal accounting control would be unduly expensive and, in DTC's opinion, a three-month study and evaluation should be sufficient to meet the statutory requirements.

In response to the Commission's concerns underlying the annual "for-the-period" requirement,[146] however, DTC agreed that, if permitted to limit the accountant's study and evaluation to a three-month period each year,[147] DTC's internal audit department would undertake a review of DTC's system of internal accounting control throughout the year in a manner contemplated by the Standards and would report promptly to DTC's audit committee any material weaknesses found to exist. In addition, DTC agreed that DTC's outside accountants would review the internal audit department's audit plan, audit programs, staffing and work product and would report the results of their review to the DTC audit committee to assist that committee in ensuring that material weaknesses are prevented or detected timely by employees in the normal course of performing their assigned functions.

The Commission believes that the approach suggested by DTC, modified to provide for competent and continuous internal audit department review and testing of the system of internal accounting control, represents an appropriate alternative to the "annual period" requirement. Further, in recognition of the significant level of refinement achieved by DTC in its internal audit functions, the Commission is approving DTC's request to implement its proposed alternative, consistent with its representations to the staff and the general principles outlined below. Moreover, the Division will provide interpretive assistance to other clearing agencies that may wish to satisfy the requirements by electing this alternative.[148]

In making this determination respecting DTC and in considering other interpretive requests, the Commission notes the following general policy considerations. Clearing agencies play a crucial role in the processing of securities transactions, and clearing agency participants and their customers depend on safe and efficient clearing agency operations. Accordingly, to insure that material weaknesses are prevented or detected timely by employees in the normal course of performing their assigned functions, the Commission believes that DTC and other clearing agencies electing this alternative must establish and maintain the highest professional quality internal audit departments that (i) are adequately staffed with qualified personnel that possess the requisite technical expertise and maintain objectivity in the performance of their duties; and (ii) have appropriate audit plans, programs and procedures designed to meet the objectives of the Standards. Indeed, to be able to elect this alternative, the Commission believes clearing agencies must obtain agreement from their outside accountants to perform certain reviews and to report to the clearing agency's board of directors respecting the staffing, objectives, and performance of the clearing agency's internal audit department.[149] Moreover, if the electing

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The Commission has determined that accountants need not assess the effect of a weakness on other clearing agencies as originally required by the Standards.

[142] 48 FR 21689 (May 13, 1983).

[143] Thus, the controls that may need to be evaluated include, among others, general organization of the clearing agency, physical security, reconciliation of participant accounts, internal auditing, and insurance coverage. In addition, those specific services and operations that may need to be reviewed include: (1) Electronic data processing and communications systems (*E.G.*, participant terminal and institutional delivery systems); (2) trade and securities processing systems (data input and output, deposits, withdrawals, book-entry transactions, and dividends); and (3) all related money balances. This list, however, is intended to be illustrative, not comprehensive.

[144] *See, e.g.*, AICPA. Statement on Auditing Standards ("SAS") No. 30. Reporting in Internal Accounting Controls.

[145] For example, the Standards Release defines the term "Material weakness" for use in assessing the clearing agency's system of internal accounting control. *See* Standards Release, 45 FR at 41928.

[146] Generally, those concerns related to insuring that material weaknesses that mighty occur between discontinuous review periods should not be left uncorrected for a significant period of time. Because clearing agency supervisory personnel may fail to perform certain tasks important to an effective system of internal accounting control and because clearing agency management may change specific procedures or add new services in ways that adversely affect existing internal accounting controls, the Commission believes that continuous professional review and testing of the clearing agency's system of internal accounting control is crucial to maintaining confidence in the National System.

[147] DTC agreed that the scope of this three month study and evaluation would include all aspects of the system of internal accounting control over all activities performed for, or on behalf of, participants and would extend to controls related to money settlement. *See* note 143 *supra*.

[148] Clearing agencies that wish to elect this alternative should address their written request for interpretive assistance to the Division of Market Regulation.

[149] More specifically, the accountants should include in their three-month intensive study of the electing clearing agency's system of internal accounting control, a review of the internal audit department's ability to identify material weaknesses throughout the year. This review should include: internal audit department objectives; internal audit department staffing (levels, supervision, and technical expertise); internal audit department programs and procedures; testing of internal audit department work during the three-month period; and review of internal audit department documentation of reviews and tests performed throughout the year.

The accountant's report to the audit committee of board of directors should be made in such a manner as to inform the board fully of any deficiencies respecting the internal audit department discovered

Continued

clearing agency's internal audit department routinely has not performed extensive reviews and testing of the clearing agency's system of internal accounting control, the clearing agency's independent public accountant or other independent accountants acting in a special capacity should be engaged to review, or otherwise assist in preparing, the internal audit department's procedures and programs for reviewing, in a manner consistent with the Standards, the clearing agency's system of internal accounting control.

Based upon its review of DTC's Form CA–1, as amended (or to be amended) during this proceeding, the Commission has determined that DTC's by-laws and rules substantially conform to the Requirements and the Standards. Accordingly, the Commission is granting DTC full registration as a clearing agency under the Act, subject to the conditions and undertakings noted herein.

G. OCC

As indicated previously, OCC is unique among clearing agencies because it issues a variety of standardized options and, in connection with its role as issuer, performs specialized clearing services. Since the enactment of the 1975 Amendments, OCC has filed, and the Commission has approved, numerous proposed rule changes affecting certain of OCC's central systems and services.[150] Many of OCC's other rules and procedures were recently the subject of close scrutiny when the Commission reviewed and approved OCC's proposals for the issuance, clearance, and settlement of a variety of new options products.[151] This intensive review of OCC's rules and procedures, in combination with the review of OCC's Form CA–1,[152] has led the Commission to conclude that, except for two exempt areas discussed below OCC's rules and procedures meet all of the Requirements and the Standards. Accordingly, the Commission believes that OCC's application for full registration should be approved and its requests for limited exemptions should be granted.[153]

In connection with OCC's application for full registration, OCC requested an exemption from the following portion of Section 17A(b)(3) of the Act:

> . . . the rules of the clearing agency [must] provide that any (i) registered broker or dealer, (ii) other registered clearing agency, (iii) registered investment company, (iv) bank, (v) insurance company, or (vi) other person or class or persons as the Commission, by rule, may from time to time designate as appropriate to the development of a national system for the prompt and accurate clearance and settlement of securities transactions may become a participant in such clearing agency.

Currently, OCC's rules provide that only registered broker-dealers are eligible for membership in OCC.[154] OCC has requested that "it be exempted from amending its rule to provide for participation by entities other than registered broker-dealers, unless and until such an entity expresses a bona fide interest in becoming an OCC participant."[155] In explaining the basis for its request, OCC argued that "such an exemption would be consistent with the purpose of Section 17A of the Act and the public interest" because, generally speaking, OCC believes that entities other than broker-dealers have little to gain through participation in OCC, and their participation would not result in significant benefits to the public.[156] Nonetheless, OCC has undertaken, as part of its registration, promptly to develop adequate and reasonable admission and participation standards to enable participation by any class of non-broker-dealer entities that expresses an interest in membership.

In advance of any such expression of interest, however, OCC believes that attempting to create financial and operational standards for non-participating institutions would require OCC to anticipate the possible forms of participation certain institutions, such as banks, may take and to develop standards in the abstract—a process

during the course of the review Although that report may be in the form of a letter to management and need not be distributed to participants as a part of the report on internal accounting control, that report (or the minutes of any audit committee meeting to receive an oral report, along with any exhibits) should be maintained by the clearing agency and be available for examination by the Commission's staff and the clearing agency's appropriate regulatory agency. *See* Standards Release, 45 FR at 41926.

[150] *See, e.g.*, Securities Exchange Act Release No. 19139 (October 14, 1982), 47 FR 46940 (October 21, 1982) (requiring increased minimum clearing fund contributions for participants clearing and settling non-equity options); Securities Exchange Act Release No. 19999 (July 21, 1983), 48 FR 34554 (July 29, 1983) (revising methods for calculating participants' contributions to clearing funds); Securities Exchange Act Release No. 17437 (January 9, 1981), 46 FR 5112 (January 19, 1981) (permitting the offset of certain exercised options against the value of certain assigned short positions in calculating participants' margin requirements); Securities Exchange Act Release No. 18994 (August 20, 1982), 47 FR 37731 (August 26, 1982) (enabling participants to satisfy OCC margin obligations by depositing with OCC certain common stocks); Securities Exchange Act Release No. 18844 (June 25, 1982), 47 FR 24046 (July 2, 1982) (simplifying and automating OCC's procedures regarding participants pledged escrow receipts to cover certain options positions); Securities Exchange Act Release No. 19669 (April 13, 1983), 48 FR 16793 (April 19, 1983) (expanding OCC's simplified and automated escrow receipt procedures to non-equity options); Securities Exchange Act Release No. 19956 (July 19, 1983), 48 FR 33956 (July 26, 1983) (allowing participants to pledge certain options positions as collateral for bank loans); Securities Exchange Act Release No. 17810 (May 19, 1981), 46 FR 28546 (May 27, 1981) (permitting OCC to deny an application for participation if a person associated with the applicant is subject to a statutory disqualification); Securities Exchange Act Release No. 18771 (May 28, 1982), 47 FR 24677 (June 7, 1982) (revising OCC's disciplinary rules). In addition, OCC has proposed, and the Commission has approved, certain technical amendments to OCC's rules and procedures to conform them to the Standards. *See* Securities Exchange Act Release No. 19760 (May 12, 1983), 48 FR 22668 (May 19, 1983).

[151] *See, e.g.*, Securities Exchange Act Release No. 18015 (August 6, 1981), 46 FR 40849 (August 12, 1981) (options on Government National Mortgage Association debt securities ("GNMAs")); Securities Exchange Act Release No. 19125 (October 14, 1982), 47 FR 46934 (October 21, 1982) (reauthorization of OCC's GNMA program); Securities Exchange Act Release No. 19127 (October 14, 1982), 47 FR 46941 (October 21, 1982) (options on securities issued by the U.S. Treasury); Securities Exchange Act Release No. 19274 (November 24, 1982), 47 FR 54393 (December 2, 1982) (options on foreign currencies); Securities Exchange Act Release No. 19333 (December 14, 1982), 47 FR 57377 (December 23, 1982) (options on certificates of deposit); Securities Exchange Act Release No. 19486 (February 4, 1983), 48 FR 6219 (February 10, 1983) (options on stock indices).

[152] *See* Section II *supra*.

[153] The Commission intends to continue to monitor carefully OCC's program of accepting letters of credit from participants to secure their OCC margin obligations. *See generally* OCC Rules at Chapter VI. On April 6, 1983, OCC held $1.87 billion in such letters of credit, representing 83% of all margin (including excess margin) held by OCC on that date.

In the past two years, the Commission has reviewed and approved aspects of OCC's letters of credit program (*see, e.g.*, Securities Exchange Act Release No. 19422 (January 12, 1983), 48 FR 2481 January 19, 1983) and Securities Exchange Act Release No. 19954 (July 18, 1983), 48 FR 33578 (July 22, 1983)) and has conducted an on-site inspection of OCC's letter of credit program. Based upon its reviews of these proposals and its inspection, the Commission believes that OCC administers its letter of credit program responsibly, requiring reasonable safeguards and insuring, among other things, wide diversity in its portfolio of bank letters of credit. These safeguards and OCC's administration of the program reduce greatly OCC's dependence upon any one issuing bank. Nonetheless, because OCC has no formal standards specifying the degree of portfolio diversity among domestic bank issuers of letters of credit, the Commission intends to monitor OCC's letter of credit program to insure that OCC maintains its current high safety standards and its current portfolio diversity policy

[154] OCC By-Laws, Art. I § 1(i) and Art.V § 1.

[155] *See* letter dated December 12, 1980, to the Commission staff, from Wayne P. Luthringshausen, Chairman and President of OCC, at 2.

[156] *Id.* OCC noted in its letter that "no clearing agency, investment company, bank or insurance company has ever sought to become an OCC participant." More recently, however, OCC advised the Commission staff that one commercial bank discussed with OCC the possibility of becoming an OCC participant. In response to this inquiry, OCC prepared proposed rules and bank admission standards that were substantially similar to its broker-dealer standards. When the bank dropped its inquiry, OCC decided not to file its proposal with the Commission for the time being.

which OCC believes would be costly and speculative.[157]

The Commission believes it appropriate to grant OCC a limited exemption from Section 17A(b)(3)(B) to enable OCC to limit participation to registered broker-dealers, provided that OCC promptly responds to any statutorily eligible participants that express clear interest in OCC membership by developing suitable participation standards and arrangements.[158] The Commission believes it would be burdensome and inappropriate to require OCC to establish speculative operational and financial participation standards for hypothetical classes of participants. The Commission agrees with OCC that the formulation of financial and operational standards for any class of participants requires costly analysis and refinement that seem premature absent genuine evidence of interest.

OCC also requested a partial exemption from the provision of the Standards that requires clearing agencies to provide its members and other registered clearing agencies with copies of the text or a description of proposed rule changes and a statement of their likely purpose and effect.[159] Specifically, OCC requested that this Standard be modified so that OCC need not provide the text and purpose of all proposed rule changes to other registered clearing agencies. In support of its request, OCC argued, primarily, that notice to other clearing agencies independent of **Federal Register** notice is duplicative and, secondarily, that most OCC proposed rule changes are irrelevant to the clearance and settlement business of other clearing agencies.[160]

The Commission believes it appropriate to grant OCC a limited exemption on the theory that OCC, as the issuer of standardization options, does not provide its participants with services that compete with the other clearing agencies.

Indeed, few of OCC's proposed rule changes affect the linkages or regulatory relationships that OCC has with those other clearing agencies, and any proposed rule change that is of general interest to other clearing agencies will continue to be noticed for their information in the **Federal Register**. Therefore, the Commission believes that, with the exception noted below, OCC need not send copies of its proposed rule changes to the other registered clearing agencies. In the case of any OCC proposed rule change that would affect the operations of other registered clearing corporations or depositories, however, the Commission expects OCC to send copies of the text and a statement of purpose and effect of the proposed rule change to all registered clearing agencies on or about the time the rule change is filed with the Commission. Timely distribution should enable all clearing agencies that may be affected by such an OCC proposal to review the proposal and to provide OCC or the Commission with timely comments.

Based on the Commission's review of OCC's Form CA-1, as amended, the Commission believes that OCC satisfies the Requirements and the Standards and should be granted full registration as a clearing agency, subject to the conditions noted herein. In addition, the Commission hereby grants a conditional exemption from Section 17A(b)(3)(B) of the Act and a limited exemption from the Standard that requires registered clearing agencies to distribute copies of proposed rule changes to other registered agencies.

V. Conclusion

Based on the foregoing, the Commission believes that the nine clearing agencies that are the subject of this ORder should be granted full registration, subject to the limitations, undertakings, exemptions, and other qualifications outlined or referenced above.

It is therefore ordered, pursuant to Sections 17(a)(2) and 19(a) of the Act and Rule 17Ab2-1(c)(2) thereunder, that DTC, SCCP, MSTC, OCC, MCC, PSDTC, PCC, NSCC, and Philadep, be, and they hereby are, granted full registration as clearing agencies.

By the Commission.

George A. Fitzsimmons,

Secretary.

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[157] In addition, OCC stated that its exemption request is supported by the legislative objectives underlying Section 17A, that is, to facilitate the development of more efficient procedures for the clearance and settlement of securities transactions and to reduce the physical movement of certificates in connection with street-side settlement. Beyond that, OCC argued, Congress recognized that eliminating physical certificate movement was not possible without institutional participation in the national depository system and, therefore, that the "access requirements" of Section 17A(b)(3)(B) of the Act were aimed at encouraging diverse institutional participation in depositories.

[158] As noted above, OCC recently took such action promptly and responsibly when a non-broker-dealer showed serious interest in becoming an OCC participant.

[159] *See* letters dated December 12, 1980 and April 23, 1983, from Marc L. Berman, Executive Vice President and General Counsel, OCC, to the Commission staff. *See also* discussion at note 61 *supra*.

[160] *See, e.g.*, letter dated December 12, 1980, from Marc L. Berman, Executive Vice President and General Counsel, OCC, to the Commission staff (File No. SR-OCC-80-6).

SMALL BUSINESS ADMINISTRATION

Texas; Region VI Advisory Council; Public Meeting

The Small Business Administration—Region VI—Advisory Council, located in the geographical area of Houston, Texas, will hold a public meeting from 9:30 a.m. until 1:30 p.m., Tuesday, November 1, 1983, at the Ramada Inn, Room 1, located at 6855 Southwest Freeway, Houston, Texas 77057. This meeting will be conducted to discuss such business as may be presented by members of the District Council, the staff of the U.S. Small Business Administration, and others attending. For further information, write or call Donald D. Grose, District Director, U.S. Small Business Administration, 2525 Murworth, Suite 112, Houston, Texas 77054, (713) 660-4409.

Jean M. Nowak,

Director, Office of Advisory Councils.

September 27, 1983.

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DEPARTMENT OF TRANSPORTATION

Maritime Administration

[Docket No. S-744]

Equity Carriers I, Inc., et al.; Application for Permission for Affiliated Companies to Operate Two Tanker Vessels in Domestic Intercoastal and Coastwise Trade

Equity Carriers I, Inc., charters and operates the dry bulk cargo vessel PRIDE OF TEXAS; Asco-Falcon II Shipping Company owns and operates the dry bulk cargo vessel STAR OF TEXAS; and Equity Carriers III, Inc., charters and operates the dry bulk carrier vessel SPIRIT OF TEXAS. These three vessels are engaged in service in the foreign trades and are covered by Applicants' ODS Contract MA/MSB-439, as amended, and are presently operating in the U.S. preference grain trades pursuant to section 614 of the Merchant Marine Act, 1936, as amended (Act), under which the ODS contract has been suspended, and no operating subsidy is now being awarded or paid with respect to such vessels.