[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

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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");
Section 17A of the Securities Exchange Act of 1934 (the "Act"). 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 attention 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. 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 and ultimately enacted the Securities Acts Amendments of 1975 (the "1975 Amendments").

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

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

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

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, Congress provided that the Commission could not grant registration to clearing agencies unless they exhibited certain organizational characteristics and capabilities (the "Requirements") or were otherwise exemplied by the Commission.

Pursuant to this authority, on November 3, 1975, the Commission adopted Rule 17Ab2-1 and Form CA-1 for the registration of clearing agencies. In accordance with Rule 17Ab2-1(c)(1), thirteen clearing agencies applied for registration. The Commission granted temporary registration to all thirteen clearing agencies 

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; (2) had rules that assured the safeguarding of securities or funds that were in its custody or control or for which it was responsible; (3) had rules that did not impose any schedule of prices, or fixed rates or other fees, for services rendered by participants. 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). 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

References:

1. Section 17A(b)(3)(A)-(I) of the Act discussed infra.
2. Section 17A(b)(1) of the Act.
4. 17 CFR 240.17Ab2-1.
5. Rule 17Ab2-1(c)(1) (17 CFR 240.17Ab2-1(c)(1)(ii)) authorizes the Commission to register a clearing agency "temporarily" for 18 months, or a longer time, and then register it as a clearing agency.
6. On December 1, 1975, the Commission granted temporary registration to DTC, Bradford Securities Processing Services, Inc. ("BSPS"), SCCP, Boston Stock Exchange Clearing Corporation ("BSECPC"), MFTC, OCC, MCC, PSDTC, PCC, and TADD Depository Corporation ("TADD"). Temporary registration was granted to New England Securities Depository Trust Company ("NESDTC") on September 24, 1975; to NSCC on October 24, 1975; and to Philadelphia on October 24, 1975. The Commission terminated the registrations of BSPS and TADD at their request on March 22, 1982.
9. Id.
10. Section 17A(b)(1)(E) of the Act.
11. 17 CFR 240.17Ab2-1(c)(2)
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. 

In reliance 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. 

### 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 (1) acts as a custodian of securities in connection with a system for the central clearing of securities by which it had no trades. 

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 discipline participants, 27 and to provide participants with due process when they may be adversely affected by those decisions. 28

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 provide services to the clearing agency's custodial function, with which it had no trades. 


28 For example, Section 17A(b)(3)(A) of the Act provides, among other things, that a clearing agency must have rules to ensure the safeguarding of funds and securities in the clearing agency's custody, 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 41929-28.

29 TAD did not file a revised application for registration. As discussed at note 15 supra, the registration of TAD and IBDA have been continued.
clearing corporations guarantee participant obligations.  

A securities depository is a "centralized" 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.** 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").** Securities credited 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.**

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, 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 Philadelphia are wholly-owned subsidiaries of the Philadelphia Stock Exchange Inc. ("Phx"). Profits earned by the SCCP or Philadelphia that are not rebated to participants or retained by the clearing agencies are returned to the parent stock exchange. As with any corporation, Phx, as shareholder, elects SCCP's and Philadelphia's boards of directors.**

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.** 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. ** OCC is owned by its participating options exchanges.**

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 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
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. Moreover, that rule review process is continuous, since clearing agencies periodically enhance their services in ways that require rule filings.

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 ("BCFRS"), as appropriate, 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.

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; ** and (iii) keeping its Form CA-1 submission current. In addition, all registered clearing agencies must continue to satisfy each condition established, or undertakings related to, this Order and any other relevant undertaking or Commission Order.

**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. 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; clearing 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, affidavit, and book-entry.


For example, the Requirement in Section 17A(d)(1)(A) of the Act that a clearing agency accept deposits and securities is discussed throughout this Order (i.e., CCPO's proposed requirement in Section 17A(d)(1)(A) of the Act that a clearing agency accept deposits and securities is discussed throughout this Order)


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opportunity to be represented in the selection of directors of the company or to participate in the administration of its affairs and [it] provide that participants shall be approved of proposed rule changes in order to facilitate their comments.17

17 See Security Exchange Act Release No. 16192 (October 15, 1941) for the proposal to reverse certain course in the event of minority interest by employees of the company, the company can be accused of acting in the best interest of the company. Although MSFC has not reviewed this matter, it has been represented that the majority interest of shareholders as expressed in the best interest of the company. 15 U.S.C. §§ 78ff.”


42 SEC Docket 1429
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 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. 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 be voted on 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 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. 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 interests 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.

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.

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. 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; and (ii) will insure that participants receive a hearing by an impartial panel before a sanction may be levied (except when the clearing agency is authorized to act summarily). 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, offers its participants, among other services, automated, book-entry transfer of securities positions, vault facilities, access to NIDS, 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...
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 basis 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 Philadelphia 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 Philadelphia'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 Philadelphia may institute disciplinary proceedings. 7

In addition, SCCP and Philadelphia 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 Philadelphia fifteen to seventeen member boards of directors (a majority of whom must be participants of SCCP or Philadelphia, respectively, and a majority of whom must be governors of the Phlx). 7 These changes also require Phlx to consider fairly the interests of participants in nominating and electing SCCP's and Philadelphia's boards, and provide participants with an opportunity to nominate additional directors. 7 Finally, SCCP and Philadelphia 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 Philadelphia 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. 7 3

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 fund cash in its "Operating Account" at a large commercial bank to finance those positions. 4 This activity, that includes debits and credits related to SCCP clearing 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 is generally limited to the cash balance in the Operating Account, calculated daily, after all CNS and other clearance and settlement debts and credits have been made. 7

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 borrowers' interest rates slightly below the

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

7 4 SCCP maintains a separate corporate account for ordinary business-related items.

7 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 50-1 and 15c2-1 (17 CFR 240.50-1 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. 7 4

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Although SCCP financing is neither a short-term unanticipated use nor a longer-term extraordinary use contemplated by the Standards, SCCP's use of clearing fund assets that provides important support to significant segments of SCCP's participant community. 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 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 securities 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.

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. Moreover, if the value of securities collateralizing SCCP's specialist obligations declines significantly concurrently with multiple participant defaults, SCCP may be unable to cover losses incurred in closing-out these 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 capacity 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-regulated 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 request for exemption from compliance with the Standards respecting clearing fund use, the Commission 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. 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' positions.
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 BFGRS 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, which authorized the Commission to authorize a clearing agency to operate on a temporary basis and to perform clearing agency functions. NSCC proposed a two-phase merger of three clearing corporations separately owned by the AMEX, the NASD, and the NYSE. After holding hearings and receiving extensive public comment on NSCC's application for registration, the Commission granted temporary registration to NSCC, subject to several substantial conditions and extensive Commission monitoring of both NSCC and its impact on other clearing agencies and the securities industry.

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 and reaffirmed its decision to register NSCC. 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.

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. 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 activities 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.

5. DTC

DTC, the largest registered securities depository based on deposits, offers participants a variety of depository services. DTC also performs services remains subject, as practicable, to the conditions of the Registration Order, as subsequently modified by any relevant Commission letter, release, action, or order.

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, 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, the securities tendered to bidders' agents in tender offers.

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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 capability 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, SCCPs 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 Phildefer 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 those rendered by similar clearing agency companies. 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 clearing services;102 trade settlement services through the PSE interface; book-entry depositary 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 thereby revised its by-laws and rules. In contrast, PSDTC's Form CA-1, including PSDTC's by-laws and rules, as filed in December 1989, 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 enable PCC, rather than the PSE, to invest and to pledge clearing fund assets. Moreover, 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 letters of credit 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 candidates 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 may nominate a board candidate by petitioning the nominating committee.110

Finally, PCC's rule changes strengthen 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 to: (1) 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 rule 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.


102 SCCP established the first CNS system in 1980.


104 See discussion in text at notes 86-88 supra regarding appropriate clearing agency uses of clearing participant fund assets.


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 52-53 infra regarding the Requirements for fair representation of participants in the election of clearing agencies' boards of directors.

108 See discussion in text accompanying notes 94-95 supra regarding 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 subject its shareholders, 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 participants' 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 due process requirements for clearing agency disciplinary proceedings.

114 See discussion in text at notes 52-53 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.

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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)(C) of the Act. 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, a request for which should stay the imposition of a proposed sanction unless the sanction is a summary suspension. 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 by including in its rules the statutory list of sanctions 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.

2. Clearing Agency Standard of Care

The Standards urged clearing agencies to embrace a strict standard of care in safeguarding participants' funds and securities. The Standards called on registered clearing agencies to undertake, by rule, to deliver all fully-paid-for securities in their control, or, as directed by, the participant for whom securities are held. The Standards further urged registered clearing agencies to assume full responsibility for their participants for the acts or omissions of clearing agencies' sub-custodians 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 depositaries are limited purpose trust companies. As such, they are each subject to 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, and maintain significant safeguards, including substantial insurance coverage, respecting loss of funds and securities in their possession or control.

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. 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. With respect to the use of DTC's clearing fund assets, therefore, the Commission 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." As discussed in the Standards, the report should 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 discovered and any corrective action taken or proposed to be taken."

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

127 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 agents, 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; (iii) the clearing agency's sub-custodian or agent or any person claiming through any one or more of them; (iv) measures designed to assure (a) software integrity; (b) adequacy of accounting controls; and (c) data accuracy.

128 See discussion supra at notes 89-92.

129 See discussion supra in text at notes 84-90 regarding use of clearing fund assets.

130 Standards Release, 45 FR at 41825.

131 Standards Release, 45 FR at 41828.

132 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.
As envisioned by the Standards and as further elaborated in Securities Exchange Act Release No. 19744 (May 9, 1983), 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). 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. That 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”) as supplemented by the Standards Release.

As noted above, DTC requested reconsideration of the internal accounting control report requirement. In particular, as DTC suggested, engaging an independent public accountant to perform an audit 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, DTC agreed that, if permitted to limit the accountant’s study and evaluation to a three-month period each year, 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.

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. Moreover, if the electing agencies that wish to elect this alternative should address their written request for interpretive assistance to the Division of Market Regulation.
OCC's clearing agency's internal audit function 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 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. Many of OCC's other rules 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 for a period 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 41838. 186 See, e.g., Securities Exchange Act Release No. 19130 (October 14, 1983), 45 FR 49404 (October 21, 1982) (requiring increased minimum clearing fund contributions for participants clearing and settling non-equity options); Securities Exchange Act Release No. 18998 (July 21, 1983), 45 FR 34554 (July 29, 1983) (prevailing methods for calculating participants' contributions to clearing funds); Securities Exchange Act Release No. 17457 (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. 18998 (August 20, 1982), 45 FR 7772 (August 26, 1982) (enabling participants to satisfy OCC margin obligations by depositing with OCC certain common stocks); Securities Exchange Act Release No. 18504 (June 25, 1982), 42 FR 57490 (July 2, 1982) (simplifying and automating OCC's procedures regarding participants' pledged escrow receipts to cover certain options positions); Securities Exchange Act Release No. 18903 (April 19, 1983) (expanding OCC's simplified and automated escrow receipt procedures to non-equity options); Securities Exchange Act Release No. 18756 (April 19, 1983) (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. This intensive review of OCC's rules and procedures, in combination with the review of OCC's Form CA-1, has led the Commission to conclude that, except for two examples 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.

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 of persons designated by 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. 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." 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. 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 express 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.

OCC's letter of credit program to ensure that OCC maintains its current high safety standards and its current portfolio diversity policy. 187 OCC By Laws, Art. I § 11) and Art. V § 1.

188 See letter dated December 12, 1980, to the Commission staff, from Wayne P. Lubkinghausen, Chairman and President of OCC, at 2.

189 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 associated 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.\textsuperscript{177} 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 statutory eligible participants that express clear interest in OCC membership by developing suitable participation standards and arrangements.\textsuperscript{178} 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.\textsuperscript{179} Specifically, OCC requested that the 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.\textsuperscript{180}

\textsuperscript{177} 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 net-cash 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.

\textsuperscript{178} As noted above, OCC recently took such action promptly and responsibly when a non-broker-dealer showed serious interest in becoming an OCC participant.

\textsuperscript{179} See letters dated December 12, 1988 and April 23, 1989, from Marc L. Berman, Executive Vice President and General Counsel, OCC, to the Commission staff. See also discussion at note 61 supra.

\textsuperscript{180} See, e.g., letter dated December 12, 1988, from Marc L. Berman, Executive Vice President and General Counsel, OCC, to the Commission staff (File No. SR-OCC-80-0).

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, MTC, OCC, MCC, PSIDTC, FCC, NSCC, and Philadelphia be, and they hereby are, granted full registration as clearing agencies.