findings referred to in paragraph (a) above.

(d) Each Board, including a majority of the Independent Trustees/Directors, will: (i) Determine at each quarterly meeting that the loan transactions during the prior quarter were effected in compliance with the conditions and procedures set forth in the application; and (ii) review no less frequently than annually such conditions and procedures for continuing appropriateness.

(e) On behalf of each Fund, each Norwest Trust, Stagecoach, and LAT will maintain and preserve: (i) Permanently, in an easily accessible place, a written copy of the procedures and conditions (and modifications thereto) described in the application or otherwise followed in connection with lending securities; and (ii) for a period of not less than six years from the end of the fiscal year in which any loan transaction occurred, the first two years in an easily accessible place, a written record of each loan transaction setting forth a description of the security loaned, the identity of the person on the other side of the loan transaction, the terms of the loan transaction, and the information or materials upon which the determination was made that the loan was made in accordance with the procedures set forth above and the conditions to the application.

Applicants' Conditions

Applicants agree that the order granting the requested relief will be subject to the following conditions:

1. Each Fund's securities lending program will comply with all present and future applicable Commission and staff positions regarding securities lending arrangements.

2. The approval of the Boards, including a majority of the Independent Trustees/Directors, will be required for the initial and subsequent approvals of Norwest Bank's service as lending agent for the Funds, for the institution of all procedures relating to the securities lending programs of the Funds, and for any periodic review of loan transactions for which Norwest Bank acts as lending agent.

For the Commission, by the Division of Investment Management, under delegated authority.

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41766; File No. SR–GSCC–98–04]

Self-Regulatory Organizations; Government Securities Clearing Corporation; Order Approving a Proposed Rule Change Relating to the Establishment of a Cross-Margining Program

August 19, 1999.

On November 16, 1998, the Government Securities Clearing Corporation (''GSCC'') filed with the Securities and Exchange Commission (''Commission'') a proposed rule change (File No. SR–GSCC–98–02) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''ACT'').[1] Notice of the proposal was published in the **Federal Register** on February 10, 1999.[2] The Commission received five comment letters from four commenters.[3] For the reasons discussed below, the Commission is approving the proposed rule change.[4]

I. Description

Under the rule change, GSCC will establish a cross-margining program with futures clearing organizations (''FCOs'').[5] GSCC will begin cross-margining with the New York Clearing Corporation (''NYCC'')[6] and intends to set up cross-margining arrangements with other FCOs.[7]

A. General Description of the Cross-Margining Program

Under the rule change, cross-margining will be available to any GSCC member that is a member of or that has an affiliate[8] that is a member of an FCO that has entered into a cross-margining agreement with GSCC. Any such member (or pair of affiliated members) may elect to have its margin requirements at both clearing organizations calculated based upon the net risk of its cash and forward positions at GSCC and its offsetting positions in related futures contracts carried at the FCO. Cross-margining is intended to lower the cross-margining participant's (or pair of affiliated members') overall margin requirement.

GSCC and each FCO will determine which of their members are eligible to participate in the cross-margining program. In order to be a GSCC cross-margining participant, a member must either (a) also be a member of an FCO or (b) have an affiliate that is a member of an FCO.[9] In addition, the GSCC member (and its affiliate, if applicable) must sign an agreement under which it agrees to be bound by the cross-margining agreement and which allows GSCC or an FCO to apply the member's (or its affiliate's) margin collateral to satisfy any obligation of GSCC to an FCO (or vice versa) that results from the default of the member (or its affiliate).

Margining based on the net risk of correlated positions will be carried out through an arrangement under which GSCC and the FCO agree to share the proceeds from correlated positions and supporting collateral. Under this arrangement, each clearing organization will hold and manage its own collateral.

GSCC will offset each cross-margining participant's residual margin amount at GSCC against the offsetting residual margin amounts of the participant (or its

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

[2] Securities Exchange Act Release No. 41019 (February 3, 1999), 64 FR 6727.

[3] Letters from Dennis A. Dutterer, President and Chief Executive Officer, Board of Trade Clearing Corporation (March 3, 1999 and May 18, 1999); Sal Ricca, President, GSCC (April 19, 1999); George F. Haase, Jr., President, New York Clearing Corporation (April 23, 1999); and Scott C. Rankin, Vice President and Assistant General Counsel, The Bond Market Association (July 23, 1999).

[4] The Commission also notes that the Commodity Futures Trading Commission (''CFTC'') has approved New York Clearing Corporation's proposal to enter into a cross-margining arrangement with GSCC. Letter from David Van Wagner, Acting Associate Director, Division of Trading and Markets, CFTC to George F. Haase, Jr., President, New York Clearing Corporation.

[5] Under the rule change, the term *FCO* is defined in GSCC's Rules as a clearing organization for a board of trade designated as a contract market under Section 5 of the Commodity Exchange Act that has entered into a cross-margining agreement with GSCC. This will include NYCC and any other futures clearing organization with which GSCC establishes a cross-margining arrangement.

[6] Until January 15, 1999, NYCC was known as the Commodity Clearing Corporation.

[7] Each FCO that participates in cross-margining with GSCC will have a separate cross-margining agreement with GSCC. According to GSCC, each of these agreements will have essentially similar terms, and no preference will be given by GSCC to one FCO or its members over another. GSCC will file proposed rule changes for all proposed cross-margining arrangements with other FCOs, setting forth any difference in a proposed new cross-margining arrangement from the cross-margining arrangements with NYCC and any other approved cross-margining arrangements.

[8] The term *affiliate* will be defined in each cross-margining agreement between GSCC and an FCO. Under the form agreement between GSCC and NYCC that GSCC included with its filing, ''affiliate'' means a clearing member of one clearing organization that (1) directly or indirectly controls, (2) is directly or indirectly controlled by, or (3) is under common control with a clearing member of another clearing organization. Ownership of 10% or more of the common stock of an entity is deemed control of the entity under the definition.

[9] The GSCC cross-margining arrangement will be applicable on the futures side only to positions in a proprietary account of a cross-margining participant (or its affiliate) at an FCO. The arrangement will not apply to positions in a customer account at an FCO that would be subject to segregation requirements under the Commodity Exchange Act.

affiliate) at each FCO pro rata based upon the residual margin amount available at each.[10] GSCC and each FCO may then reduce the amount of collateral that they collect to reflect the offsets between the cross-margining participant's positions at GSCC and its (or its affiliate's) futures positions at an FCO. If more than one FCO is cross-margining with GSCC for a cross-margining participant, the participant's long or short position in government securities at GSCC will be apportioned pro rata among its offsetting short or long positions (if any) at each FCO.[11]

Each clearing organization will guarantee the cross-margining participant's (or its affiliate's) performance to the other clearing organization up to a specified maximum amount. Each clearing organization's guaranty will be backed by the positions and margin deposits of its cross-margining participant. The amount of the guaranty will ordinarily be equal to the amount of the offsetting residual margin used to reduce the cross-margining participant's margin requirement.

GSCC will issue a guaranty to each FCO with respect to a cross-margining participant (or its affiliate) in an amount based on the pro rata allocation among the FCOs of the participant's residual margin amounts. In the event of a default and liquidation of a cross-margining participant, the loss sharing arrangements as between GSCC and each FCO will be based on the same pro rata shares. Loss sharing between clearing organizations will be subject to a cap.

B. Summary of the Operation of the Cross-Margining Program

Data Exchange: GSCC and each FCO will exchange daily position and margin data for each cross-margining participant (or pair of affiliated members) with respect to each product eligible for cross-margining.

Collateral Management: Margin collateral will be collected, maintained, valued, and returned separately by GSCC and each FCO according to its own rules and procedures. GSCC will not maintain cross-margining accounts for a cross-margining participant separate from the cross-margining participant's regular account at GSCC, and there will be no separate collateral pool at GSCC for cross-margining activity.

Unified Margin Calculation: GSCC will agree with each of the FCOs on the particular products cleared by each that are sufficiently price correlated to be eligible for cross-margining treatment (*e.g.*, cash positions in two-year Treasury notes and futures on two-year Treasury notes). Such products will be referred to as "eligible products" and a cross-margining participant's long or short positions in eligible products will be called "eligible positions." GSCC and FCO will agree upon a common margin formula including the percentage of principal amount to be used as the base margin calculation on each long or short position in each eligible product, any disallowance factors to be applied when offsetting long and short margin amounts in different eligible products, and the minimum charges for offsetting positions.[12]

Coordinated Mark to Market Process: GSCC and each FCO will coordinate their daily mark to market and variation margin processes. If a cross-margining participant does not pay its debit mark or make a required clearing fund or margin deposit to one clearing organization on a particular business day, the other will be so informed and will not pay out to that participant (or its affiliate) any credit mark or clearing fund or margin withdrawal relating to cross-margined positions.

Daily Calculation of Cross-Margining Reduction and Cross-Guaranties: On each business day, GSCC will complete its own internal margining process for buy-sell, repo, and Treasury auction transactions for each cross-margining participant (including to the extent permitted in GSCC's rules the setting off or netting of GCF repo transactions with other activity).[13] Each FCO will perform an equivalent internal process for each of its cross-margining members by offsetting long margin amounts against short margin amounts for futures and options on futures contracts that are eligible products to the extent specified in the FCO's rules.[14]

After completing the internal margining process, each clearing organization may have "residual" long or short margin amounts for a member in various eligible products. The residual long or short margin amount is the amount of long or short margin (*i.e.*, margin with respect to a long position or a short position) that has not been "used up" in the internal offsetting process.[15]

Each FCO will inform GSCC how much residual long or short margin amount in each eligible product that the FCO intends to make available for cross-margining offsets on that day for each cross-margining participant. GSCC then will determine the amount of the long or short residual margin offered by each FCO that GSCC can offset against the participant's short or long residual margin amounts at GSCC for purposes of determining the cross-margining reduction.[16] GSCC will inform each FCO of the cross-margining reduction as between GSCC and that FCO for each cross-margining participant. The cross-margining reduction is the amount by which GSCC and the FCO may each appropriately reduce its cross-margining participant's margin requirement to reflect the cross-margining offset.[17]

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[10] All possible offsets among positions carried by a cross-margining participant within a single clearing organization will be carried out before any offsets are carried out between GSCC and the FCO.

[11] For example, if a cross-margining participant has a $9 million residual short margin amount at GSCC and residual long margin amounts in the same product of $8 million at FCO 1 and $4 million at FCO 2, GSCC will use two-thirds of the $9 million margin amount ($6 million) for offset against the participant's FCO 1 activity and one-third of the $9 million margin amount ($3 million) for offset against FCO 2 activity.

[12] According to GSCC, an appropriate conversion method will be agreed upon to equate the size of futures and cash positions for offset purposes.

[13] For a description of GSCC's GCF Repo service, refer to Securities Exchange Act Release No. 40623 (October 30, 1998), 63 FR 59831 [File No. SR–GSCC–98–02] (order approving proposed rule change).

[14] For example, on each business day, GSCC and NYCC each will calculate for each cross-margining participant an initial margin requirement with respect to eligible positions. This calculation will be done independently based upon an agreed upon method without the other clearing corporation's review. However, GSCC and NYCC will review generally each other's margining process on a periodic basis, and each will have the obligation to inform the other of any material changes to its margining process.

[15] A margin amount may be "used up" whether or not there has been a full offset against it. For example, assume that a GSCC member has a $1 million gross margin requirement on a short position in the 10-year note (offset class F) that is offset against a $1 million gross margin requirement on a long position in the long bond (offset class G). Because there is a 20% disallowance on offsets between classes F and G, the member has a $200,000 margin requirement after the offset. However, both $1 million margin amounts have now been entirely used up, and nothing is available for further offset either within GSCC or for cross-margining with an FCO.

[16] The *cross-margining reduction* is determined by the residual margin amounts made available by an FCO and "used" by GSCC in determining the amount of the cross-guaranties. It does not depend upon the amount, if any, by which either GSCC or an FCO actually reduces a cross-margining participant's margin requirement. In other words, after an offer by an FCO of $1 million in residual margin and acceptance by GSCC of that amount for offset, the cross-margining reduction would be $1 million, and the base amount of the cross-guaranties would be fixed at that amount. However, either clearing organization might nevertheless decide to reduce the cross-margining participant's clearing fund or margin requirement by less than $1 million or not at all. In any event, the cross-margining reduction under the cross-margining agreement would still be $1 million. The clearing organization would simply have made a determination to hold more collateral without affecting the amount of the guaranty it receives from the other clearing organization.

[17] If a cross-margining participant has eligible positions at more than one participating FCO, the

As a result, the maximum cross-margining reduction that a cross-margining participant will receive will be determined by the amount of residual margin taken by GSCC. For example, if an FCO offers $1 million in residual short margin for a particular member in 2-year note futures and if GSCC sets all of that amount off against a $2 million cash position in the 2-year note, then the cross-margining reduction amount will be $1,000,000 for GSCC and $1,000,000 for the FCO.

Under the anticipated terms of the cross-margining agreements between GSCC and each participating FCO, GSCC will be deemed to have extended its guaranty of a cross-margining participant's (or its affiliate's) obligation to each FCO in a base amount equal to the cross-margining reduction for that participant. Similarly, each participating FCO will be deemed to have extended its guaranty of the cross-margining participant's (or its affiliate's) obligation to GSCC in the same base amount. For example, if GSCC has a residual short margin amount for a cross-margining participant of $10 million in a product which is offset against an FCO's residual long margin amount of $4 million, then the base amount of the cross-guaranties is $4 million, and GSCC can reduce the participant's margin requirement for that product to $6 million because the FCO will have guaranteed $4 million.[18]

Each clearing organization will represent to the other that it will margin a cross-margining participant's positions such that the amount of margin is adequate to cover the cross-margining participant's obligations to that clearing organization including the obligation to reimburse any payment under the guaranty. In addition, on any day that is a business day for an FCO and not for GSCC or vice versa, the gross-guaranties as they existed on the immediately preceding business day will remain in effect. It shall be the responsibility of the clearing organization that is open for business on such day to adjust its margin requirements with respect to cross-margining participants to cover such cross-margining participants' obligations.[19]

Default of a Cross-Margining Participant: Liquidation and Loss-Sharing: If a cross-margining participant becomes insolvent and its eligible positions are liquidated by GSCC and the FCO(s), GSCC and each FCO will calculate its "net loss" or "net surplus" from the liquidation.[20] GSCC and each FCO will use their best efforts to coordinate the liquidation of eligible positions so that offsetting or hedged positions can be closed out simultaneously. GSCC and each FCO may unilaterally elect not to terminate or suspend and liquidate the eligible positions of its cross-margining participant. However, a clearing organization that does so will remain liable to the other on this guaranty. In addition, a clearing organization that elects not to liquidate the eligible positions of a defaulting participant will be deemed to have no net loss and no net surplus.

In the event a cross-margining participant is liquidated, if either GSCC or an FCO has a net loss and the other has a smaller net loss, no net loss, or a net surplus, then the one with the larger net loss ("worse-off party") is entitled to receive a payment from the other ("better-off party") that equalizes its losses. The amount of this equalizing payment will be capped at the least of: (1) The "maximum guaranty amount" of the better-off party; (2) if the better-off party has a net loss, an amount that together with its net loss equals its total cross-margining reduction; or (3) the worse-off party's net loss.

Generally, the guaranty arising from the cross-margining reduction will be a cap on the amount of loss that either GSCC or an FCO can incur as the result of a default by a participating member (or its affiliate) to the other. The "maximum guaranty amount" of GSCC or the FCO will exceed the amount of the cross-margining reduction only to the extent that the better-off party has funds of the participant remaining (*i.e.*, a "net surplus") after satisfying all other obligations of the participant to the better-off party.[21]

C. Information Specific to the Current Form Agreement Between GSCC and NYCC

Participation in the Cross-Margining Program: Any netting member of GSCC other than an interdealer broker will be eligible to participate. Any clearing member of NYCC will be eligible to participate.

Positions subject to Cross-margining: The products that will initially be eligible for cross-margining at GSCC are its offset classes for the 2-year note, 5-year note, 10-year note, and 30-year bond and at NYCC are its 2-year note, 5-year note, 10-year note, and 30-year bond futures products. Residual margin amounts will be applied only within the same "offset class" (*e.g.*, the 2-year note against the 2-year note future). All eligible positions maintained by a cross-margining participant in its account at GSCC and in its (or its affiliate's) proprietary account at NYCC will be eligible for cross-margining.

Unified Margin Factors: GSCC and NYCC will apply GSCC's margin factors to eligible positions.

Daily Procedures: On each business day by midnight, NYCC will inform

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participant's total margin reduction at GSCC will be the sum of the cross-margining reductions between GSCC and each FCO.

[18] As noted above, GSCC and each FCO will retain the right to reduce a cross-margining participant's clearing fund or margin requirement by less than the amount of the cross-margining reduction or not to reduce it at all.

[19] The cross-margining participant's margin or clearing fund deposit will remain fixed at the clearing organization that is closed, and the closed clearing organization must therefore continue to rely on the guaranty based on the previous day's cross-margining reduction. However, the clearing organization that is open ordinarily will be able to assess and collect additional margin or clearing fund deposits if needed to reflect updated positions in the participant's account on its own books as well as the fixed guaranty obligation that is still outstanding to the other clearing organization.

[20] Under the form agreement between GSCC and NYCC that GSCC included with its filing, net surplus and net loss are calculated as follows:

In the event that (i) the sum of "available margin" and any proceeds of eligible positions realized by such clearing organization (including securities deliverable to and amounts receivable with respect to securities deliverable by such cross-margining participant in settlement of eligible positions) and any mark to market payments or other settlement amounts due from such clearing organization with respect to eligible positions exceeds (ii) the sum of the mark to market payments or other settlement amounts owed to such clearing organization with respect to or as a result of the closeout of eligible positions (including securities deliverable by or amounts payable with respect to securities deliverable to such cross-margining participant with respect to eligible positions) plus any interest expense, fees, commissions, or other costs reasonably incurred in such closeout or otherwise arising from such eligible positions, then the amount of such excess shall be deemed to be the net surplus. In the event that the sum referred to in clause (i) of the preceding sentences is less than the amount referred to in clause (ii), the difference shall be the net loss.

"Available margin" is defined as the amount of clearing fund deposits, margin, or other collateral remaining after satisfaction of all obligations of the cross-margining participant to the clearing organization other than obligations arising from eligible positions.

[21] Where a cross-margining participant had eligible positions at more than one FCO, GSCC's net loss or net surplus for purposes of the cross-margining agreement between GSCC and any one FCO will be a portion of GSCC's aggregate net loss or net surplus from all eligible positions and available margin at GSCC that is equal to the portion of the residual margin at GSCC that was offset against the residual margin at that FCO. For example, assume that FCO 1 and FCO 2 each offer GSCC $2 million in residual short margin based on a $200 million short position in futures on the 10-year note. If GSCC has only $2 million in residual long margin, it would "take" $1 million residual from each FCO for offset purposes. If GSCC incurs a $10 million loss in liquidating the $200 million futures position, GSCC's "net loss" for purposes of its agreement with FCO 1 would ordinarily be half of that or $5 million. However, the cross-margining agreements will also contain provisions permitting further contribution by FCO 1 if FCO 1's net surplus exceeds $5 million and FCO 2 contributes less than $5 million.

GSCC of the residual margin amounts it is making available. GSCC will inform NYCC by 2:00 a.m. how much of these residual margin amounts it will use.

D. GSCC Rule Changes

The rule change adds definitions relating to cross-margining to GSCC Rule 1. These definitions correspond generally to certain terms that will be defined in the cross-margining agreements.

The rule change amends Section 2 of GSCC Rule 4 to provide that the required fund deposit otherwise calculated for a cross-margining participant may be reduced at GSCC's sole discretion in an amount not to exceed the sum of the cross-margining reductions calculated under the various cross-margining agreements. The rule change amends Sections 5 and 6 of Rule 4 to clarify the application of those provisions in the context of the cross-margining arrangements. Specifically, the amendments provide tat GSCC may set off a cross-margining participant's obligation to reimburse GSCC for the payment of a guaranty against any asset of the participant that GSCC holds as collateral and against any amounts due to the participant. Section 6 of Rule 4 is also amended to provide that GSCC may apply a member's clearing fund deposits to satisfy a loss without treating the member as insolvent. The rule change also adds a provision to Section 2 of Rule 22 to specify that GSCC may but is not required to treat a cross-margining participant as insolvent if the member is declared to be insolvent by an FCO.

The rule change adds new Rule 43 to GSCC's rules to set forth How a GSCC netting member may become a cross-margining participant and its obligations as a cross-margining participant. Section 3 of Rule 43 provides that a cross-margining participant has the obligation to reimburse GSCC for any amount that it pays to an FCO on behalf of the participant (or its affiliated member) under a cross-margining guaranty. Rule 43 also cross-references the corresponding provisions of the cross-margining agreement which state that any obligations of a defaulting cross-margining participant to the FCO will be netted against any amounts held by or due to the participant as a result of its positions at GSCC. As a result, a defaulting participant will be entitled to receive from the close out of its positions and margin at GSCC only what remains after netting out the sum of its obligations to GSCC and the FCOs. Section 4 of Rule 43 provides that a cross-margining participant may be treated as insolvent at the discretion of GSCC if (1) the cross-margining participant is determined to be insolvent by an FCO or (2) the cross-margining participant's affiliate is deemed to be insolvent by an FCO and the cross-margining participant does not immediately upon GSCC's demand deposit with GSCC the amount of GSCC's cross-margining guaranty to the FCO.

II. Comment Letters

The Commission received five comment letters from four commenters in response to GSCC's filing.[22]

A. Letters From the Board of Trade Clearing Corporation

The Board of Trade Clearing Corporation (''BOTCC'') submitted two comment letters in response to GSCC's proposal. In its first comment letter, BOTCC stated its specific concerns with GSCC's proposal. BOTCC's second letter responded to some of the statements in GSCC's comment letter (which is described below). In its comment letters, BOTCC expressed concern with the structure of GSCC's proposed cross-margining program and with the legal enforceability of some of the payment mechanisms in the program.

BOTCC noted that GSCC's proposed cross-margining program differs from existing cross-margining programs in that GSCC and participating FCOs will each maintain their own collateral and will not pool cross-margining positions and margin deposits on those positions in a jointly controlled account. BOTCC stated that the primary protection against loss in current cross-margining programs is the fact that participating clearing organizations have a joint first priority lien on and security interest in all positions in cross-margined accounts, all funds and securities deposited to satisfy margin requirements, and all proceeds resulting from the liquidation of the accounts.

BOTCC stated that it believes that the structure of GSCC's proposal does not ensure that GSCC and the FCOs will have sufficient resources to satisfy losses that might result from a default of a cross-margining participant. BOTCC stated that GSCC's proposal does not provide for any limitation on the amount of guaranties that GSCC and the FCOs can extend to each other. In addition, BOTCC stated that under GSCC's proposal, margin reductions would be backed by mutual unsecured promises rather than by a pool of collateral controlled jointly by GSCC and the FCOs.

BOTCC also expressed concern that certain provisions of GSCC's proposed cross-margining program might not be enforceable under the U.S. Bankruptcy Code against a cross-margining participant that had filed a bankruptcy petition. Specifically, BOTCC stated that if GSCC became obligated to pay an FCO in order to equalize losses resulting from liquidating positions of a defaulting cross-margining participant, it would not be permitted under the Bankruptcy Code to setoff the participant's obligation to reimburse that amount to GSCC against any assets GSCC was holding for the participant.

Section 362(a) of the Bankruptcy Code[23] provides for a stay (known as the ''automatic stay'') of all actions against a debtor that has filed a bankruptcy petition for claims that arose before the petition was filed. However, Section 362(b)(6) of the Bankruptcy Code[24] provides an exception to the automatic stay which permits a clearing agency to setoff a mutual claim against the debtor for a margin payment or a settlement payment arising out of securities contracts against property that is held by or due from the clearing agency to margin or guarantee securities contracts. BOTCC stated that Section 362(b)(6) does not allow a clearing agency to setoff a pre-petition debt against a post-petition claim. BOTCC believes that a claim against the participant for reimbursement of an amount that GSCC paid to an FCO would be a post-petition debt and that GSCC would not be permitted under Section 362(b)(6) to setoff the reimbursement obligation against assets of that participant that GSCC was holding pre-petition (*e.g.*, surplus margin deposits). In addition, BOTCC believes that it is not clear that the reimbursement obligation is a ''margin payment'' or a ''settlement payment'' as defined in the Bankruptcy Code[25] because the obligation (a) is not a specific type of margin payment, (b) would not secure the cross-margining participant's already liquidated positions at GSCC, and (c) is not closely related to the settlement process.

B. Letter from GSCC

GSCC submitted a comment letter in response to BOTCC's first comment letter. With respect to BOTCC's statements on the structure of its proposed cross-margining program,

[22] *Supra* note 3.

[23] 11 U.S.C. 362(a).

[24] 11 U.S.C. 362(b)(6).

[25] The term ''margin payment'' is defined in Sections 101, 741, and 761 of the Bankruptcy Code, 11 U.S.C. 101, 741, and 761. The term ''settlement payment'' is defined in Sections 101 and 741 of the Bankruptcy Code, 11 U.S.C. 101 and 741.

GSCC stated that all cross-margining arrangements rely to some extent on unsecured promises between clearing agencies. GSCC noted that it and the FCOs can decide to reduce or eliminate the cross-margining reduction for a particular member or for all members. In addition, GSCC stated that it can increase the amount of collateral that a cross-margining participant is required to deposit to support its obligation to GSCC including GSCC's guaranty obligations to the FCOs. GSCC further stated that it believes that the structure of its cross-margining program has an advantage over traditional cross-margining programs in that the total possible liability of GSCC to another clearing agency can be precisely calculated at any given point in time.

With respect to BOTCC's statements regarding the enforceability under the Bankruptcy Code of a cross-margining participant's obligation to reimburse GSCC's payment of a guaranty to an FCO, GSCC stated that the reimbursement obligation would be a pre-petition claim because it would be a contingent contractual obligation that would arise at the time the cross-margining participant becomes subject to the cross-margin agreement. In addition, GSCC stated that it believes that the reimbursement obligation is a margin payment or a settlement payment because (a) it would be made in settlement of a debt owed to GSCC and (b) because it would represent a reimbursement to GSCC of a payment made to an FCO to meet variation margin and settlement obligations. GSCC further stated that in the alternative the cross-margining agreement is a ''netting contract'' under the Federal Deposit Insurance Corporation Improvement Act of 1991 (''FDICIA'') [26] and therefore is not subject to automatic stay provisions of Section 362 of the Bankruptcy Code.[27]

C. Letter From NYCC

NYCC stated that it supports GSCC's proposal and that the GSCC structure allows each clearing organization to use its own systems to monitor risk without having to set up a different system to monitor cross-margined positions. In addition, NYCC stated that all cross-margining arrangements rely on the risk systems, default protections, and the ability of a clearing organization to be able to fulfill its obligations.

D. Letter From the Bond Market Association

The Bond Market Association (''BMA'') stated that it strongly supports cross-margining arrangements like the one proposed by GSCC. In addition, the BMA stated that it agrees with GSCC's conclusion that the cross-margining program will benefit cross-margining participants by lowering their margin requirements and thereby allowing them more efficient use of collateral and reduced operational costs. Moreover, the BMA stated that it ''is comfortable expressing its agreement with GSCC's analysis of the FDICIA netting provisions and the Bankruptcy Code as they relate to its proposed cross-margining arrangement.''

III. Discussion

Under Section 19(b) of the Act,[28] the Commission is directed to approve a proposed rule change of a clearing agency if it finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder. Section 17A(b)(3)(F) of the Act [29] requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody and control of the clearing agency or for which it is responsible. Section 17A(a)(2)(A)(ii) of the Act [30] directs the Commission to use its authority under the Act to facilitate the establishment of linked or coordinated facilities for the clearance and settlement of transactions in securities, securities options, contracts of sale for future delivery and options thereon, and commodity options.

The comment letters that the Commission received from BOTCC raised questions about the structure of GSCC's proposed cross-margining program and about the legal enforceability of certain provisions of the program. GSCC stated in response that it believes that its cross-margining program will be safe and prudent from a risk management perspective and that its payment mechanisms will be enforceable against a defaulting cross-margining participant.

The Commission believes that GSCC's proposal should adequately limit GSCC's potential financial exposure to a defaulting cross-margining participant.[31] In particular, the Commission notes that GSCC may reduce or eliminate the cross-margining reduction to any cross-margining participant and that GSCC will be able to calculate precisely its potential liability to FCOs with respect to each cross-margining participant. Furthermore, the Commission has always viewed properly structured cross-margining programs as a significant risk reduction method because they reduce the extent to which clearing organizations have to independently manage the risk associated with some but not all of the components (*ie.*, the futures or government securities component) of a member's total portfolio. Therefore, the cross-margining program is structured so that GSCC will continue to be able to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible.

GSCC's proposal will also enable it to coordinate with the FCOs in the management of risks associated with their members' (or affiliated members') positions in government securities and in related futures contracts. The cross-margining program should also result in increased and better information sharing regarding the financial condition of participating joint and affiliated members. Therefore, GSCC's proposal should facilitate the establishment of linked or coordinated facilities for the clearance and settlement of transactions in government securities and in futures contracts.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the act and in particular with the requirements of Section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR–GSCC–98–04) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[32]

Margaret H. McFarland,

Deputy Secretary.

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[26] 12 U.S.C. 4401–4407.

[27] In its second comment letter, BOTCC responded to GSCC's statements and reiterated its statements regarding the structure of the proposed cross-margining program and the effect of the Bankruptcy Code an a cross-margining participant's reimbursement obligation. In addition, BOTCC stated that it believes that FDICIA only permits the enforcement of a netting contract against a bankrupt party if there is an applicable exception from the automatic stay.

[28] 15 U.S.C. 78s(b).

[29] 15 U.S.C. 78q-1(b)(3)(F).

[30] 15 U.S.C. 78q-1(a)(2)(A)(ii).

[31] The Commission believes that the arguments in GSCC's comment letter are persuasive. However, the Commission recognizes that in a bankruptcy proceeding a court could reach a different result.

[32] 17 CFR 200.30–3(a)(12).