

the amount of fees paid by the member to GSCC with respect to the calendar quarter (adjusted as appropriate for rebates, clearance charges, and other miscellaneous charges); (3) the amount of rebate for each of the first three calendar quarters of a year will be equal to 50 percent of accumulated net income; and (4) the rebate for the last calendar quarter of a year will be equal to 100 percent of the remaining excess net income for the year.

GSCC has the right to exclude or include, as applicable, anticipated expenses, losses, liabilities, and revenues from its calculation of excess net income. For example, GSCC has the discretion to reserve for development expenses and the costs of special projects.

GSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act and the rules and regulations thereunder because it fulfills GSCC's mission of operating in a not-for-profit manner consistent with maintaining the integrity of GSCC's capital base, financial structure, and risk management process.

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

GSCC does not believe that the proposed rule change will have an impact or impose a burden on competition.

(C) Self-Regulation Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments relating to the proposed rule change have not yet been solicited or received. Members will be notified of the rule change filing and comments will be solicited by an Important Notice. GSCC will notify the Commission of any written comments received by GSCC.

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

Because the foregoing change establishes or changes a due, fee, or other charge imposed by GSCC, it has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act³ and Rule 19b-4(f)(2) thereunder.⁴ At any time within sixty days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of

investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at GSCC. All submissions should refer to the File No. SR-GSCC-2001-05 and should be submitted by August 1, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44495; File No. SR-GSCC-00-02]

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

June 29, 2001.

On April 17, 2000, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-GSCC-00-02) 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 January 9, 2001.² No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

A GSCC's netting member's clearing fund requirement is based on a formula designed to take into account the three basic risks posed to GSCC by netting members. These risks include: (1) That a member might not pay a funds only settlement amount due to GSCC; (2) that a member may fail to settle a long-term repo; and (3) that a member might not deliver or take delivery of securities that comprise a net settlement position.

As a result, there are three components to each member's clearing fund deposit requirement with the sum of the three being a member's overall requirement. The three components are (1) the funds adjustment (FAD) component,³ (2) the repo volatility component,⁴ and (3) the receive/deliver settlement component.⁵ GSCC computes four receive/deliver settlement amounts each day. The four results are compared daily, and the largest amount is used in determining a member's clearing fund requirement. The four receive/deliver settlement computations are as follows: (1) Post-offset margin amount (POMA);⁶ (2) average POMA;⁷ (3) adjusted

² Securities Exchange Act Release No. 43791 (January 2, 2001), 66 FR 1709.

³ The funds adjustment component is based on each member's average funds only settlement amount. The relevant variable in this calculation is the size of the settlement amount. It does not matter whether the funds are to be collected from the member or paid to the member.

⁴ The repo volatility component reflects the interest rate exposure incurred by GSCC in guaranteeing the contractual rate of interest on a repo transaction. The repo volatility factor essentially represents an estimate of the amount that repo market rates might change over the remaining course of the repo.

⁵ The receive/deliver settlement component is based on the size and nature of net settlement positions. The margin collected on net settlement positions is determined by applying margin factors that are designed to estimate security price movements. The factors are expressed as percentages and are determined by historical daily price volatility. By multiplying security settlement values by their corresponding margin factors, GSCC estimates the amount of loss to which it is potentially exposed from price changes. Margin amounts on receive (long) and deliver (short) positions are allowed to offset each other. The extent to which an offset is allowed is determined by product and the degree of similarity in time remaining to maturity.

⁶ The POMA computation offsets gains against losses in liquidating a member's positions that are anticipated based on historical experience. The POMA essentially is the total margin on the current day's positions and forward net settlement positions taking into account allowable offset percentages.

⁷ The average POMA computation is based on the member's twenty highest POMA amounts occurring in the most recent 75 business days.

³ 15 U.S.C. 78s(b)(3)(A)(ii).

⁴ 17 CFR 240.19b-4(f)(2).

⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

POMA;⁸ and (4) liquidation amount. The liquidation computation, which is the subject of this rule filing, is a floor amount designed to ensure that if the margin offsets ordinarily allowed in calculating the receive/deliver settlement component do not reflect actual market conditions during a liquidation period, GSCC nonetheless will have a sufficient level of collateral protection. In other words, this minimum requirement protects against the risk that during a liquidation period the yield curve will be aberrational. In such a situation, collection of a minimum amount of margin based on gross calculation should ensure that GSCC will have sufficient collateral to cover liquidation losses.

The proposed rule change lowers the percentage calculated on the net long and net short positions in the liquidation amount calculation from 25 percent to 10 percent. GSCC believes that this more appropriately balances the level of margin it collects against the liquidity needs of its members.

GSCC believes that 25 percent was overly conservative for several reasons. First, GSCC's experience has demonstrated that its POMA and average POMA calculations provide adequate protection against potential settlement risks. By calculating an average POMA (based on a member's twenty highest POMA amounts occurring in the most recent 75 business days), GSCC ensures that it calculates a historically sufficient receive/deliver settlement component for a member even when current activity results in a relatively low requirement. Also, periodic studies conducted by GSCC assessing the risks presented to it from the potential default by a member on its obligations to GSCC have concluded that GSCC's methodologies for identifying and computing its risks provide it with a high level of protection on an individual and aggregate basis.

Second, the liquidation amount ignores and negates much of the protection afforded by a hedging strategy. The more a member engages in a hedging strategy with respect to its trading, the more it protects itself and in turn its clearing corporation from the risk of its failure. However, GSCC believes that the current 25 percent requirement effectively disregards the protection afforded to GSCC by a

member that engages in trading activity on a fully hedged basis.

II. Discussion

Section 17A(b)(3)(F)⁹ of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible. Because the Commission believes that even with the liquidation component of the clearing fund formula reduced from 25 percent to 10 percent, GSCC's clearing fund formula will give GSCC sufficient resources to protect it in a situation where a member is insolvent and fails to settle with GSCC. As such, the Commission believes GSCC's proposal is consistent with its obligation to assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible.

III. 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(b)(3)(F) 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-00-02) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44508; File No. SR-ISE-2001-17]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the International Securities Exchange LLC Relating to Permanent Approval of its Allocation Algorithm Pilot

July 3, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 23, 2001, the International Securities Exchange LLC (the "Exchange" or the

"ISE") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the ISE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to amend Supplementary Material .01 to Rule 713 to adopt the Exchange's current allocation algorithm pilot program on a permanent basis. The Exchange's allocation algorithm pilot was approved by the Commission on May 22, 2000,³ and recently was extended until August 1, 2001.⁴ The text of the proposed rule change is available at the ISE and the Commission.

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

In its filing with the Commission, the ISE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The ISE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

ISE Rule 713 provides that, at a given price, customer orders have priority, based on the time priority of such orders. ISE Rule 713(e) provides that if there are two or more non-customer orders or market maker quotations at the Exchange's inside market, after filling all customers at that price, executions will be allocated between the non-customer orders and market maker quotations "pursuant to an allocation procedure to be determined by the Exchange from time to time * * *." ISE Rule 713(e) also states that, if the primary market maker ("PMM") is quoting at the Exchange's inside market, it will have precedence over non-

⁸ The adjusted POMA computation is the same as the POMA with the exception that it excludes all trades that are scheduled to settle on the current day. This is done based on the assumption that those trades will in fact settle on the current day and that calculating POMA in this manner will more accurately reflect GSCC's settlement exposure during the current day.

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 42808 (May 22, 2000), 65 FR 34515 (May 30, 2000) ("Release No. 42808").

⁴ See Securities Exchange Act Release No. 44340 (May 22, 2001), 66 FR 29373 (May 30, 2001) ("Release No. 44340").