result of being rejected, such trades must settle on a trade-for-trade basis. A participant may request a waiver of this restriction by providing to MBSCC such assurances as MBSCC may request.[6] These assurances may include but are not limited to (i) a letter describing the reason for the request and the applicable accounts for which relief is sought and containing a representation that the use of multiple accounts is not for the purpose of influencing MBSCC's clearance and settlement process or (ii) an opinion of counsel relating to the use of multiple accounts that is satisfactory to MBSCC.[7]

II. Discussion

The Commission believes the proposal is consistent with the requirements of Section 17A of the Act.[8] Specifically, Section 17A(b)(3)(F)[9] states that the rules of a clearing agency must be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible and to protect investors. Under the SBO processing, MBSCC makes cash adjustments to account for variances in the par amount of securities delivered by participants as permitted by the Public Securities Association guidelines.[10] MBSCC believes that the ability to include trades among related accounts could cause a perception that participants might influence the amount of their cash adjustments through submissions of internal trades. Specifically, MBSCC believes it could be possible for a participants to create and submit to MBSCC for SBO settlement fictitious trades between related accounts that would permit the participant to share in a positive cash balance adjustment. By reducing the possibility that a participant can manipulate SBO settlement in such a manner, the proposed rule change should further MBSCC's ability to safeguard the funds in its custody or control and to protect investors.

III. Conclusion

For the reasons stated above, the Commission finds that MBSCC's proposal is consistent with Section 17A of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[11] that the proposed rule change (File No. SR–MBSCC–95–08) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[12]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–12469 Filed 5–16–96; 8:45 am]

BILLING CODE 8010–01–M

contravene the purposes of the proposed rule change. Letter from Anthony H. Davidson, Attorney, MBSCC, to Michele Bianco, Division, Commission (November 1, 1995).

[6] MBSCC has received two requests for a waiver. Letter from John J. Rioux, Vice President and Assistant General Counsel, J.P. Morgan & Co. Incorporated, to George Parasole, Director of Member Services, MBSCC (February 1, 1996) and letter from Edward K. McCarthy, General Counsel, Liberty Brokerage Inc., to George Parasole, Director of Member Services, MBSCC (February 7, 1996).

[7] Letter from Anthony H. Davidson, Attorney, MBSCC, to Jerry Carpenter, Assistant Director, Division, Commission (April 15, 1996).

[8] 15 U.S.C. 78q–1 (1988).

[9] 15 U.S.C. 78q–1(b)(3)(F) (1988).

[10] Such guidelines permit the over delivery or under delivery of two percent of the par amount of securities to be delivered. MBSCC's cash adjustment procedures pro rate the resulting positive or negative balances to the MBSCC participants with netted out positions.

[Release No. 34–37197; File No. SR–MSRB–95–13]

Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the Municipal Securities Rulemaking Board Relating to Fee Assessments and Reporting of Sales or Purchases Pursuant to Rules A–13, A–14, and G–14

May 10, 1996.

I. Introduction

On August 11, 1995 the Municipal Securities Rulemaking Board (''Board'' or ''MSRB) submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to change the fees assessed under Rules A–13 and A–14, as well as to change the reporting requirements under Rule G–14. The proposed rule change was published for comment in the Federal Register (''Original Proposal'').[3] In November 1995, the MSRB submitted Amendment No. 1 to the proposed rule change which was also published for comment (''Amended Proposal'').[4] The Commission received twenty-three comment letters in all. For the reasons discussed below, the Commission is approving the proposal.

[11] 15 U.S.C. 78s(b)(2) (1988).

[12] 17 CFR 200.30(a)(12) (1995).

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

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 36150 (August 23, 1995), 60 FR 45197 (August 30, 1995).

[4] Securities Exchange Act Release No. 36492 (November 20, 1995), 60 FR 58422 (November 27, 1995).

II. Description and Scope of the Proposed Rule Change

The proposal changes the MSRB's existing fee structure to impose, effective March 1, 1996, transaction-based fees on inter-dealer transactions. The proposal establishes a transaction fee of $.005 per $1,000 par value of bonds on all inter-dealer sales transactions, and effective October 1, 1995, increases the annual fee, applicable to each broker, dealer, and municipal securities dealer who conducts municipal securities business, from $100 to $200. Effective March 1, 1996, the proposal permits the MSRB to use reported transaction information for the purpose of assessing transaction fees.

Rule G–14 requires each inter-dealer transaction that is eligible for automated comparison to be reported to the MSRB through National Securities Clearing Corporation, the central facility provider for the automated comparison process. The corollary change to Rule G–14 under the proposal authorizes the MSRB to use the reported transaction information to assess inter-dealer transaction fees. The MSRB will send monthly invoices to dealers that report inter-dealer sales transactions on their own behalf, and/or on behalf of another dealer.[5] The dealer will be responsible for the timely payment of the entire fee amount to the MSRB, but the MSRB expects that clearing dealers will pass through the fees to executing dealers based upon their transaction volume. To assist the clearing dealer, the invoice will separate out the fees due on the transactions submitted by the clearing dealer on behalf of identified executing dealers.[6] As improvements are made in the timely and accurate reporting of transactions under Rule G–14, including the correct identification of executing brokers, the MSRB will consider revisions in the billing procedure to accommodate direct billing of executing brokers.

As explained in its filing, the proposal is intended to increase revenue to the MSRB to cover budgetary expenditures. The MSRB anticipates its technology expenditures to rise over the next few years as it implements transparency

[5] Under the proposal, the MSRB will bill only for those trades for which the buy and sell sides ultimately have agreed on trade details such as price, transaction amount, and value.

[6] Rule G–14 requires that in each inter-dealer transaction the clearing dealer identify the executing dealer on whose half the transaction is reported. Nevertheless, trades are reported lacking the executing broker's identifier. The fees due on those trades will appear on the clearing dealer's invoice assigned to ''blank''.

improvements with its institutional and retail transaction reporting system.

The MSRB's rationale for implementing inter-dealer transaction fees is that dealers should be assessed fees based upon their level of participation in the market. The MSRB understands that the transaction fee will have a substantial effect on participants whose transaction activity is primarily or exclusively in the inter-dealer market.[7]

III. Summary of Comments

The Commission received thirteen comment letters on the rule change as originally proposed[8] and an additional ten comment letters on the amended proposal.[9] Of the twenty-three comment letters received, twenty-one were from municipal securities broker's brokers who opposed the aspect of the proposal which would establish an inter-dealer transaction fee.[10]

A. Comments on the Original Proposal

The comments focused almost exclusively on the new transaction fee. All but one of the broker's brokers commented that the proposed fee generated an inequitable burden on the broker's broker and in effect amounted to a double assessment on transactions involving a broker's broker.[11]

Two commenters suggested the MSRB consider different fee structures that might achieve the MSRB's goals. The PSA suggested that the MSRB eliminate both the existing annual fee and underwriting assessment and establish a new annual fee.[12] The PSA proposed an annual fee based on a municipal securities firm's underwriting ranking. Depending on the firm's ranking, a firm would pay between $1,000 and $100,000 per year. The PSA believes this proposal distributes the financial burden more evenly and would simplify the billing process.

Another commenter, a broker's broker, offered three alternatives to the MSRB's proposal to initiate an inter-dealer transaction assessment.[13] This broker's broker suggested moving to a flat fee structure based on a firm's aggregate market activity. The suggestion is similar to the PSA's, but would use both transaction data and underwriting data to determine a firm's level of market participation. The annual fee would range from $1,000 for the smallest 1,700 firms to $20,000 for the top 50 firms. As a second alternative, Kenny suggested the MSRB meet its funding needs by maintaining the underwriting assessment at $.03 per $1,000 par value and increasing the annual fee for all members to $1,000. Lastly, Kenny suggested that a logical alternative would be for the MSRB to initiate a revenue-based assessment, thus capturing the true participation of each firm in the municipal securities market.[14]

In response to these comments, the MSRB reduced the proposed transaction fee by 50%, but determined to retain its proposed structural changes.[15] The MSRB defended its decision to include sales transactions reported by brokers' brokers in the inter-dealer assessment, noting that broker's brokers represent the sell side on 35% of the par value of reported inter-dealer transactions. In comparison, broker's brokers do not participate in underwriting and consequently would pay no percentage of the underwriting assessment. The MSRB does not find the transaction fee to be disproportionate or unduly burdensome because the broker's brokers comprise a very significant portion of the inter-dealer market. The MSRB asserts that, for the purposes of the transaction fee, transactions involving a broker's broker, although executed at the direction of other dealers, are to be viewed as separate offsetting purchase and sale transactions. Accordingly, the fee does not amount to a double assessment for the ''same'' transaction but amounts to a fee assessed on any participant on the sell side of any inter-dealer transaction.

The MSRB also believes its proposed transaction fee is likely to be more easily administered than the alternatives offered by the PSA and other commenters. The MSRB stated that it

---

[7] In recognition of this fact, and in response to concerns of commenters and the Commission, the MSRB amended the filing to reduce the originally proposed transaction fee by 50% from $.01 to $.005 per $1,000 par value. The amendment left intact the $.03 per $1,000 underwriting assessment.

[8] *See* letters from Peter C. Byram, Senior Vice President, J.J. Kenny Drake, to Secretary, SEC, dated September 7 1995 (''J.J. Kenny letter 1''); from Richard G. McDermott, Jr., President, Chapdelaine & Co., to Secretary, SEC, dated September 11, 1995 (''Chapdelaine letter''); from John J. Lynch, Jr., Executive Vice President, J.F. Hartfield & Co., Inc., to Secretary, SEC, dated September 12, 1995 (''Hartfield letter''); from Richard W. Smith, President, RW Smith & Associates, Inc., to Jonathan G. Katz, Secretary, SEC, dated September 13, 1995 (''RW Smith letter 1''); from Thomas G. Caffrey, President, Titus and Donnelly, Inc., to Secretary, SEC, dated September 14, 1995 (''Titus letter''); from Patricia MacGeorge, Treasurer, EMR Securities, Inc., to Jonathan G. Katz, Secretary, SEC, dated September 15, 1995 (''EMR letter''); from Robert J. Ellwood, President, R.W., Ellwood & Co., Inc., to Secretary, SEC, dated September 18, 1995 (''R.W. Ellwood letter 1''); from James J. Smith, President, Smith Peters & Stark, to Jonathan G. Katz, Secretary, SEC. dated September 18, 1995 (''Smith Peters letter''); from Brian Kelly, President, Municipal Partners, Inc., to Secretary, SEC, dated September 19, 1995 (''Municipal Partners letter''); from John V. Kick, Treasurer, Barr Brothers & Co., Inc., to Secretary, SEC, dated September 19, 1995 (''Barr letter''); from James Avena, President, Tullett and Tokyo Securities, Inc., to Jonathan G. Katz, Secretary, SEC, dated September 19, 1995 (''Tullett letter 1''); from Glenn Grossman, Senior Managing Director Cantor Fitzgerald, to Jonathan G. Katz, Secretary, SEC, dated September 19, 1995 (''Cantor letter''); and from George Brakatselos, Vice President, Public Securities Association, to Secretary, SEC, dated September 20, 1995 (''PSA letter 1''). Letters were also submitted to the MSRB and forwarded to the Commission. *See* letters from John B. Licata, Chief Executive Officer, Sonoma Securities Corp., dated October 10, 1995 (''Sonoma Letter''), from George Brakatselos, Vice President, Public Securities Association, to Mr. Christopher Taylor, Executive Director, MSRB dated November 1, 1995 (''PSA letter 2''), and from Peter C. Byram, Senior Vice President, J.J. Kenny Drake, Inc., to Board of Directors, MSRB, dated September 19, 1995 (''J.J. Kenny Drake letter 2'').

[9] *See* letter from Richard W. Smith, President, RW Smith & Associates, Inc. to Jonathan G. Katz, Secretary, SEC. dated November 8, 1995 (''RW Smith letter 2''); from Dominick F. Antonelli, Chief Operating Officer, Roosevelt & Cross, Inc., to Robert Colby, Deputy Director, SEC, dated November 9, 1995 (''Roosevelt letter''); from the employees of RW Smith & Associates, Inc., to Jonathan G. Katz, Secretary, SEC, dated December 5, 1995 (''Smith employees' letter''); from Richard W. Smith, President, RW Smith & Associations, Inc., to Jonathan G. Katz, Secretary, SEC, dated December 6, 1995 (''RW Smith letter 3''); from George Brakatselos, Vice President, Public Securities Association, to Secretary, SEC, dated December 8, 1995 (''PSA letter 3''); from Peter C. Byram, Senior Vice President, J.J. Kenny Drake, to Jonathan G. Katz, Secretary, SEC, dated December 6, 1995 (''J.J. Kenny letter 3''); from O. Gene Hurst, President, Wolfe & Hurst Bond Brokers, Inc., to Jonathan Katz, Secretary, SEC, dated December 8, 1995 (''Wolfe letter''); from Robert J. Ellwood, President, R.W. Ellwood & Co., Inc., to Secretary, SEC, dated December 12, 1995 (''R.W. Ellwood letter 2''); from John J. Lynch, Jr., Executive Vice President, J.F. Hartfield & Co., Inc., to Secretary, SEC, dated December 15, 1995 (''Hartfield letter 2''); and from James Avena, President, Tullett and Tokyo Securities, Inc., to Jonathan G. Katz, Secretary, SEC. dated December 15, 1995 (''Tullett letter 2'').

[10] These firms transact exclusively with other dealers and not with issuers or public investors. The two nonbroker's broker comment letters received by the Commission were from the Public Securities Association (''PSA''). The PSA also sent a comment letter to the MSRB recommending an alternative fee structure. All three PSA letters focused on the proposals' impact on the brokers' broker.

[11] The Sonoma letter opposed the increase in the annual fee, arguing that the increase was not fair to a small firm with little municipal securities business.

[12] *See* letter from George Brakatselos, Vice President, Public Securities Association, to Mr. Christopher Taylor, Executive Director, MSRB, dated November 1, 1995 (''PSA letter 2'').

[13] *See* letter from Peter C. Byram, Senior Vice President, J.J. Kenny Drake, Inc. to Board of Directors, MSRB, dated September 19, 1995 (''J.J. Kenny letter 2'').

[14] Many commenters echoed the opinion that an assessment based on revenues, similar to that used by the National Association of Securities Dealers and the New York Stock Exchange, would be a more equitable method of determining a firm's participation in the municipal securities market. *See* Hartfield letter, Titus letter, Municipal Partners letter, Cantor letter, Barr letter, PSA letter 1, RW Smith letter 2, and Hartfield letter 2.

[15] Securities Exchange Act Release No. 36492 (November 20, 1995), 60 FR 58422 (November 27, 1995).

considered whether its fees could be derived from the total municipal securities revenues of dealers, and based on the advice of their outside auditors, concluded to not adopt such an assessment. The MSRB stated that the term ''municipal securities revenue'' is neither clearly defined nor uniformly computed by dealers. In addition, the MSRB believes it could receive a qualified opinion on its audited financial statements unless each dealer had its own ''municipal securities revenue'' computations independently audited prior to reporting them to the MSRB. The MSRB noted that even if it were, by rule, to define ''municipal securities revenue'', establish accounting rules for its computation, and require each dealer to use the accounting rules to compute ''municipal securities revenue''. it would still be necessary for each dealer to have the computation independently audited. The MSRB determined that the high cost to the dealer community of computing the ''municipal securities revenue'' would make this method of fee assessment impractical. The MSRB also considered the suggestions for raising the annual fee to $1,000 or implementing a staggered schedule based on the dealer's underwriting and/or transaction volume. The MSRB asserted that a $1,000 or more annual fee would constitute an inappropriate barrier to participation in the municipal securities market. The MSRB noted that in 1995, only 850 of the approximately 2,700 municipal securities dealers reported any inter-dealer transactions. Therefore, the MSRB surmised that approximately 1,850 dealers are merely executing an occasional municipal securities transaction as an accommodation for a customer, or are not active at all, but wish to remain capable of executing municipal securities transactions in the future. The MSRB concluded that raising the annual fee to $1,000 or more would likely result in only 850 or so firms continuing to pay the annual fee and participate in the municipal securities market. If this were to happen, the revenue projected would not be sufficient to meet the administrative needs of the MSRB.

B. Comments on the Amended Proposal

The Commission received ten comment letters on the MSRB's amended proposal that reduced the transaction fee from $.01 to $.005 per $1,000 par value of inter-dealer sales transactions. The commenters reiterated their concerns that a fee on inter-dealer transactions was an inappropriate method of measuring a firm's participation in the municipal securities market. The broker's brokers continued to opine that the MSRB did not fully understand the role of a broker's broker. The broker's brokers argued that any fee assessed on their sale transactions was in effect a double assessment on the dealer's sale transaction and thus inequitable.

IV. Discussion

The Commission must approve a proposed MSRB rule change if it finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that govern the MSRB.[16] The Commission believes that the approval of the proposal meets the above standard. Specifically, Section 15B(b)(2)(J) of the Act provides that each municipal securities broker and each municipal securities dealer shall pay to the Board such reasonable fees and charges as may be necessary or appropriate to defray the costs and expenses of operating and administering the Board.[17]

The MSRB and the broker's brokers both recognize broker's brokers as significant contributors to the municipal securities market. The MSRB contends that broker's brokers should be subject to the inter-dealer transaction fees in the same proportion as they participate in the inter-dealer transaction volume. In contrast, the broker's brokers believe that their sale transactions should be excluded from the inter-dealer assessment because they are in effect a part of the dealer's sale transactions which are already assessed a fee.

The Commission believes that as participants in the municipal marketplace, broker's brokers, like other dealers, should contribute to defraying the administrative costs of the MSRB, particularly as the MSRB undertakes initiatives to improve transparency in the municipal securities market. Historically, broker's brokers have paid only the minimal $100 annual fee despite their volume of transactions. The Commission believes that inter-dealer transaction volume is a reasonable indicator of a firm's participation in the municipal market.[18] This measure will be improved with the addition of institutional and retail transaction volume as the MSRB's transparency program expands in the coming years.

The Commission recognizes that inter-dealer transactions involving broker's brokers also involve a sell transaction by another dealer that is itself subject to the transaction fee. This is true however, not just for transactions involving broker's brokers, but for any riskless principal trade between dealers. Excluding broker's brokers' sales from transaction fees would largely insulate broker's brokers from payment of fees, not withstanding their significant role in municipal securities markets. Although the inter-dealer transaction fee adds a new cost to inter-dealer transactions, for the principal seller as well as the broker's broker, the Commission does not believe that such fees will significantly interfere with inter-dealer transactions involving broker's brokers, given the fee's relative small size and the usefulness of broker's brokers in conducting inter-dealer transactions efficiently and anonymously. While assessing fees based on municipal revenues might lead to fees that provide a more accurate assessment of a firm's participation in the municipal market, the Commission believes that such an approach currently raises definitional and reliability issues as discussed above.

Many of the commenters were troubled that a small community of the municipal market would contribute a large portion of the MSRB's funding.[19] Accordingly, the MSRB reduced the inter-dealer transaction fee 50% to $.005 per $1000 par value.

The Commission does not view the proposed fees as inconsistent with the purposes of the Act. The Commission believes the MSRB's fees should be based, to the extent possible, on comprehensive measures of participation in the municipal market. To this end, the Commission encourages the MSRB to continue to consider the feasibility of a revenue-based fee structure, based on the municipal revenues of brokers, dealer, and municipal securities dealers. The Commission recognizes that such an approach involves definitional and reliability issues that would have to be resolved before a revenue-based fee could be adopted and therefore this fee structure is not a viable option in light of the MSRB's immediate revenue needs. The Commission urges the MSRB to revisit the feasibility of a revenue-

[16] 15 U.S.C. 78s(b). The Commission's statutory role is limited to evaluating rules as proposed against the statutory standards. *See* S. Rep. No. 75, 94th Cong., 1st Sess., at 13 (1975.)

[17] 15 U.S.C. 78*o*–4.

[18] The MSRB is projecting inter-dealer sales volume of $400 million in fiscal year 1996, with broker's brokers accounting for $140 million of it. Accordingly, broker's brokers will pay approximately $700,000 in inter-dealer transaction fees while dealers will pay approximately $1.3 million in inter-dealer transaction fees. In addition, many dealers may also incur an underwriting assessment.

[19] *See* J.J. Kenny letter 1, Hartfield letter, Titus letter, EMR letter, Ellwood letter 1, and PSA letter 1.

based fee structure and work with market participants to address the issues raised by this concept. In developing its fees the Commission encourages the MSRB to continue to build a consensus among market participants on how best to allocate the burden of funding the MSRB operations.

V. Conclusion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the Municipal Securities Rulemaking Board and, in particular, with the requirements of Section 15B of the Act.[20] Specifically, the Commission believes the proposal is consistent with the requirements of Section 15B(b)(2)(J) that the MSRB's rules be designed, among other things, to provide that each municipal securities broker and each municipal securities dealer shall pay to the MSRB such reasonable fees and charges as may be necessary or appropriate to defray the costs and expenses of operating and administrating the Board.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR–MSRB–95–13) is approved.

By the Commission.

Dated: May 10, 1996.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–12384 Filed 5–16–96; 8:45 am]

BILLING CODE 8010–01–M

[Release No. 34–37202; File No. SR–NSCC–95–17]

Self-Regulatory Organizations; National Securities Clearing Corporation; Order Temporarily Approving a Proposed Rule Change to Establish Additional Procedures for Placing Settling Members on Class A Surveillance and Collecting Clearing Fund and Other Collateral Deposits From Settling Members

May 10, 1996.

On December 20, 1995, the National Securities Clearing Corporation (''NSCC'') filed with the Securities and Exchange Commission (''Commission'') a proposed rule change (File No. SR–NSCC–95–17) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') to establish additional procedures for placing settling members on Class A Surveillance and collecting clearing fund and other collateral deposits from settling members.[1] Notice of the proposal was published in the Federal Register on March 12, 1996.[2] No comment letter were received. For the reasons discussed below, the Commission is temporarily approving the proposed rule change through May 31, 1997.

I. Description of the Proposal

NSCC's Board of Directors has determined that under certain circumstances settling members who clear securities transactions for over-the-counter (''OTC'') market makers or who themselves engage in OTC market making can have their financial viability materially impacted by such business.[3] Furthermore, if these settling members dominate one side of the market in their street-side trading positions, either directly by participating in OTC market making or indirectly by clearing transactions for OTC market makers, NSCC believes that the risk of default by the settling member increases.[4] In turn, this could potentially increase NSCC's exposure because NSCC is obligated to complete defaulting settling members' unsettled trades once NSCC's trade guarantee attaches.

The problem is magnified if one or more additional risk factors are present. These additional risk factors can include, without limitation:

(1) Concentrated short selling in dominated issues;

(2) Undue concentration of securities held in inventory by market maker(s) for dominated issues;

(3) Dominated issues also being IPOs less than six months past initial issuance particularly when the current value of the issue is significantly different from its initial sales price or there is undue concentration of inventory in the managing underwriter(s); and

(4) Clearing positions of market makers in dominated issues away from their primary clearing brokers.

Rule 15, Section 3 of NSCC's rules currently provides that any settling member[5] shall furnish to NSCC such adequate assurances of its financial responsibility and operational capability as NSCC may at any time or from time to time deem necessary or advisable in order to protect NSCC. Section 4 of Rule 15 states that such adequate assurances may include, but are not be limited to, increased clearing fund deposits of settling members. Furthermore, Section III.B.1.o. of Addendum B to NSCC's rules sets forth the guidelines for determining when NSCC may place a broker-dealer settling member on Class A surveillance status.[6] Pursuant to these guidelines, NSCC may place a broker-dealer settling member on Class A surveillance if there is any condition which could materially impact the operational or financial viability of the settling member which increases or potentially may increase exposure to NSCC.

In order for NSCC to reduce its potential exposure from the OTC market making activity described above, NSCC is adding Addendum O to its rules and procedures. Addendum O will permit NSCC to place settling members on Class A surveillance if they clear for or are themselves OTC market makers and (i) they do not have sufficient capital or access to capital to support either potential increases in market making activity in dominated OTC issues or (ii) there is the presence of the additional risk factors described above. At its discretion, NSCC may elect not to place settling members on Class A surveillance if it has obtained sufficient assurances that a high degree of mitigating circumstances exist.[7]

Furthermore, NSCC is adopting an interim collateralization policy which will allow NSCC in its discretion to require settling members placed on Class A surveillance that clear for or are themselves OTC market makers to meet

---

[20] 15 U.S.C. § 78*o*–4.

[1] 15 U.S.C. 78s(b)(1) (1988).

[2] Securities Exchange Act Release No. 36930 (March 6, 1996), 61 FR 10051.

[3] When a market maker, either alone or acting in concert with other market makers, takes net street-side trading positions (*i.e.*, non-retail trading with other broker-dealers) that constitute a disproportionately large percentage of the total net street-side buys or net street-side sells in any issue (*i.e.*, the market maker dominates one side of the market in the issue), the risk of default by that market maker can increase.

[4] However, to the extent that market makers' net street-side trading positions in dominated issues result from legitimate customer orders, the potential adverse impact on the financial viability of a settling member and the potential for increased exposure to NSCC could be mitigated. So long as the customer orders are legitimate, the risks associated with such positions are borne among the individual accounts of the market maker's customers and not concentrated solely in the proprietary accounts of the market maker.

[5] NSCC Rule 1 defines a ''settling member'' to include any NSCC member, non-clearing member and, except where a contrary intent is expressed in NSCC's rules, a special representative.

[6] Class A Surveillance permits NSCC, among other things, to increase a settling members clearing fund requirement by an amount equal to (i) up to 5% of the settling member's CNS long fail positions, plus (ii) up to 5% of the settling member's short fail positions, plus (iii) 2.5% or at NSCC's discretion up to 5% of the settling member's average non-CNS and non-mutual fund services debits, plus (iv) 2.5% of the settling member's average non-CNS and non-mutual fund services credits. NSCC Rules and Procedures, Addendum B, IV(C).

[7] However, the mere fact that a market maker has a large customer base may not necessarily constitute the necessary mitigating circumstances especially if the customers are retail and/or the market maker has a history of customer complaints or other adverse regulatory or disciplinary actions. Refer also to note 4.