V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act.[18] that the proposed rule change (SR–AMEX–97–37), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[19]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39643; International Series Release No. 1114; File No. 601–01]

Self-Regulatory Organizations; Morgan Guaranty Trust Company of New York, Brussels Office, as Operator of the Euroclear System; Order Approving Application for Exemption From Registration as a Clearing Agency

February 11, 1998.

I. Introduction

On March 5, 1997, Morgan Guaranty Trust Company of New York (''MGT''), Brussels office (''MGT-Brussels''), as operator of the Euroclear System [1] pursuant to a contract with Euroclear Clearance System Société Coopérative, a Belgian cooperative (''Belgian Cooperative''),[2] filled with the Securities and Exchange Commission (''Commission'') an application on Form CA–1 [3] for exemption from registration as a clearing agency pursuant to Section 17A of the Securities Exchange Act of 1934 (''Exchange Act'') [4] and Rule 17ab2–1 thereunder.[5] Notice of MGT–Brussels' application was published in the **Federal Register** on May 15, 1997.[6] Six comment letters were received in response to the notice of filing of the Euroclear application.[7] This order grants the application of MGT–Brussels, as operator of the Euroclear System, for exemption from registration as a clearing agency to the extent the Euroclear System performs the functions of a clearing agency with respect to transactions involving U.S. government and agency securities for its U.S. participants subject to the conditions and limitations that are set forth below.

II. Description of Euroclear System Operations [8]

Euroclear provides several services to its participants, including securities clearance and settlement, securities lending and borrowing, and securities custody.[9]

A. Securities Clearance and Settlement

The Euroclear System functions as a clearance and settlement system for internationally traded securities. Securities settlement through the Euroclear System can occur with other participants in the Euroclear System (''internal settlement''), with members of Cedel Bank, société anonyme, Luxembourg (''Cedel''), the operator of the Cedel system (''Bridge settlement''), or with counterparties in certain local markets that are not members of either the Euroclear System or Cedel (''external settlement'').

The annual volume of transactions settled in the Euroclear System has grown from about US$3 trillion in 1987 to over US$34.6 trillion in 1996. The fastest growing segments of this activity have been repurchase and reverse repurchase agreements (''repos''), book-entry pledging arrangements, securities lending, and other collateral transactions [10] involving non-U.S. government securities.[11] Although the individual certificated or uncertificated government securities of these countries are immobilized or dematerialized with the central banks or central securities depositories (''CSDs'') in their home markets, book-entry positions with respect to such securities can be acquired, held, transferred, and pledged by book-entry on the records of Euroclear in any of the 35 currencies available in the Euroclear System because of the links to local custodian banks, central banks, CSDs, and national payment systems around the world.

1. Internal Settlement: Clearance and Settlement of Trades Between Euroclear System Participants

Transactions between Euroclear System participants in the Euroclear System can be settled either against payment or free of payment.[12] Upon

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[18] 15 U.S.C. 78s(b)(2).

[19] 17 CFR 200.30–3(a)(12).

[1] For purposes of this order, the term ''Euroclear'' refers to MGT-Brussels in its capacity as operator of the Euroclear System. MGT-Brussels is the Brussels branch of MGT that has acted as the operator of the Euroclear System through its Euroclear Operations Centre since the creation of the Euroclear System in 1968. The Euroclear Operations Centre is a separate, independent operational unit established within MGT-Brussels to operate the Euroclear System.

In 1972, a package of rights described as the Euroclear System was sold to Euroclear Clearance System Public Limited Company, and English limited liability company (''ECS–PLC''). ECS–PLC purchased the rights to receive the revenues generated by the Euroclear System services, to approve participants, to determine eligible securities, to establish fees, and to make other similar decisions. MGT-Brussels retained all of the assets and means necessary to operate the Euroclear System and granted a license to ECS–PLC to use the Euroclear System trademarks.

[2] the Belgian Cooperative was established in 1987 to further facilitate communication between Euroclear and the international securities industry and to encourage participation in the Euroclear System. It received a license from ECS–PLC to exercise some of ECS–PLC's rights as owner of the Euroclear System. Neither ECS–PLC nor the Belgian Cooperative is an operating company. Among other thins, MGT-Brussels maintains all Euroclear System participant accounts on its own books, maintains all of the contractual relationships with Euroclear System participants and Euroclear System depositories in its own name, and provides all of the personnel, systems, trademarks, and operational capability used to deliver the Euroclear System services to Euroclear System participants. For a more complete description of the structure of the Euroclear System, refer to Section II of the Euroclear notice, *Infra* note 6.

[3] Copies of MGT-Brussels' application for exemption (''Euroclear application'') are available for inspection and copying at the Commission's Public Reference Room (File No. 601–01).

[4] 15 U.S.C. 78q–1.

[5] 17 CFR 240.17Ab2–1.

[6] Securities Exchange Act Release No. 38589 (May 9, 1997), 62 FR 26833 (notice of filing of application for exemption from registration as a clearing agency) (''Euroclear notice'').

[7] Letters from C.R. Trusler, Director, Nomura International plc (June 5, 1997); S. Guenzi, Senior Products Manager Custody H.O.–Financial Institutions, Credito Italiano (June 12, 1997); Harvé Pennanec'h, Head of Back-Office, Capital Markets Divison, Société Générale (June 16, 1997); D.G. Pritchard, Director, Global Collateral Support Unit, NatWest Markets (June 16, 1997); Preben Borup, Senior Vice President, BG Operations, and Tom Jensen, First Vice President, Head of Custody and Settlement, BG Operations, Bikuben Girobank A/S (June 17, 1997); and S.L. Richardson, Executive Manager, Operations, ANZ Bank (June 18, 1997). The comment letters for File No. 601–01 are available for inspection and copying in the Commission's Public Reference Room.

[8] A more complete description of Euroclear System operations is contained in the Euroclear notice, *supra* note 6.

[9] The contractual relationship between Euroclear and its participants is defined by the Terms and Conditions Governing the Use of Euroclear (''Terms and Conditions'') as supplemented by Supplementary Terms and Conditions Governing the Lending and Borrowing of Securities through Euroclear (''Supplementary Terms and Conditions''), the Operating Procedures of the Euroclear System (''Operating Procedures''), and various other documents, all of which are governed by Belgian law. Among other things, the Terms and Conditions provide that Euroclear participants agree that their rights to securities held through the Euroclear System will be defined and governed by Belgian law.

[10] Collateral transactions are designed to enable Euroclear System participants to reduce their financing costs, increase their yields on securities, reduce their credit and liquidity exposures, and to manage market and operational risks.

[11] Government securities of the following countries are currently eligible for clearance and settlement in the Euroclear System: Argentina, Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Portugal, South Africa, Spain, Sweden, Switzerland, Thailand, and the United Kingdom.

[12] When a securities transaction is settled ''against payment,'' movement of the securities is made in return for a corresponding payment, usually cash. When a securities transaction is settled ''free of payment,'' movement of the securities is made

receipt of valid instructions for a settlement between participants, the Euroclear System's computer system attempts to match instructions between corresponding counterparties on a continuous basis according to a defined set of matching criteria. Matching generally is required in order for the instructions to be settled except for certain actions specifically taken by participants (*e.g.*, transfers between accounts maintained by the same participant). Matching of an instruction is attempted until it is either matched or cancelled.

Internal settlement of transactions is accomplished by book-entry transfer and provides for simultaneous exchange of cash and securities. Settlement is final (*i.e.*, irrevocable and unconditional) at the end of each of the securities settlement processing cycles of which there are currently three per day.[13]

The overnight securities settlement process is completed early in the morning of the business day in Brussels for which settlement is intended. Daylight securities settlement processing is completed in the afternoon of each business day with settlement dated for that day. The daylight settlement cycle, which is restricted to internal settlements, permits participants to resubmit previously unmatched instructions or unsettled transactions and permits the processing of new instructions for same day settlement. All daylight instructions not settled are automatically recycled for settlement in the next overnight securities settlement cycle.

2. Bridge Settlement: Clearance and Settlement of Trades Between a Euroclear System Participant and a Cedel Member

Participants can also send instructions authorizing receipt and delivery of securities between the Euroclear System and the Cedel system, both free of payment and against payment. Simultaneous delivery versus payment (''DVP'') is possible for settlement of trades between a participant in the Euroclear System and a Cedel member because of the electronic bridge established between the two organizations.

For settlement of trades between a Euroclear System participant and a Cedel member, matching of instructions consists of nine daily comparisons of delivery and receipt instructions. During these comparisons, each clearance system electronically transmits a file of proposed deliveries and expected receipts to the other clearance system. This exchange of information allows each clearance system to report matching results to its participants.[14]

3. External Settlement: Clearance and Settlement of Trades Between a Euroclear System Participant and a Local Market Counterparty

Participants can also send instruction authorizing receipt and delivery of securities free of payment and against payment between the Euroclear System and certain domestic markets' clearance and settlement structures. Euroclear has two types of relationships, direct and indirect links, with local market clearance systems. A direct link is where Euroclear has its own account with the local clearance system and holds securities and sends instructions directly in that clearance system. With an indirect link, an intermediary (*i.e.*, a depository) is used to perform Euroclear System settlement activities in the local market.[15] In certain markets, Euroclear may have both direct and indirect links for different instruments.

B. Securities Lending and Borrowing

Securities lending and borrowing is utilized to increase settlement efficiency for the borrower and to allow lenders to generate income on securities held in the Euroclear System. Lenders receive a fee for securities lending and do not incur safekeeping fees for securities lent. With standard lending and borrowing, there is no linkage between a particular borrower and a particular lender. In effect, participants borrow securities from the lending pools.[16] With reserved lending and borrowing, there is a linkage between the borrower and the lender, but the counterparty's identities are not disclosed.[17] Consequently with both standard and reserved lending and borrowing, borrowers' names and lenders' names are never revealed to one another.

Securities lending and borrowing is an integral part of the overnight securities settlement process. This integration permits Euroclear to determine borrowing requirements and the supply of lendable securities on a trade-by-trade basis throughout each overnight securities settlement processing. Generally, securities lending and borrowing is available only through the overnight securities settlement process.

C. Custody

Securitiess held by Euroclear System participants are held through a network of depositories. Depositories may hold securities on their premises or hold securities with subcustodians or with local clearance systems. Depositories of the Euroclear System may include custodian banks, including some MGT branches, central banks, local clearance systems, and Cedel. Depositories are

without any corresponding payment, such as when securities are pledged as collateral.

[13] Euroclear's internal securities processing consists of two overnight settlement cycles and one daylight settlement cycle.

[14] Bridge settlement was enhanced in September 1993 to allow for multiple overnight transmissions of instructions between Cedel and the Euroclear System. The bridge provides finality for DVP cross-system trades when the receiving clearance system confirms acceptance of a proposed delivery and that confirmation is received by the delivery clearance system.

[15] Securities held by participants in the Euroclear System are held by custodian banks or local clearing systems. Except where required by local law, Euroclear will not permit bank subsidiaries to serve as depositories. All securities held by a depository on its books for the Euroclear System are credited to a segregated custody account in the name of MGT-Brussels, as operator of the Euroclear System. Depositories receive instructions regarding the movement of Euroclear System securities directly from Euroclear. Euroclear participants do not directly deal with depositories regarding the settlement of securities transactions within the Euroclear System or the custody of securities. *See* Section II.C. *infra*.

[16] A participant that is an ''automatic standard borrower'' is eligible to borrow securities to execute delivery instructions when there are insufficient eligible securities available in its securities clearance accounts to effect a settlement in the overnight securities settlement process. A participant that is an ''opportunity standard borrower'' sends standard borrowing requests to Euroclear on a case-by-case basis according to expected borrowing needs.

A participant that is an ''automatic standard lender'' makes securities available to the lending pool during each overnight securities settlement cycle. Subsequent to each overnight securities settlement cycle, securities borrowed from the lending pool are allocated back to the lenders according to a given set of priorities. If the lendable position from automatic standard lenders for a given issue is expected to be insufficient to meet estimated borrowing demand in the next overnight securities settlement cycle, ''opportunity standard lenders'' may be contacted by Euroclear to make additional securities available for borrowing.

[17] A participant that wishes to reserve securities for future borrowing can do so by submitting a reserved borrowing request to Euroclear. Reserved borrowing differs from standard borrowing in that once a reserve borrower's request matches a lendable supply, the lender is committed to lend the securities, and the borrower is obligated to borrow them. Reserved borrowing minimizes the risk of settlement failure resulting from an inability to obtain a standard borrowing in the overnight securities settlement process due to a lack of supply in the lending pool.

An ''automatic reserved lender'' makes securities in its securities clearance accounts available on demand for reserved lending subject to the lender's selected options. When a reserved borrowing request is matched to securities automatically available for reserved lending, a reservation is initiated and the securities are blocked in the reserved lender's securities clearance account from the reservation date to the loan start date. ''Opportunity reserved lenders'' are contacted by Euroclear when the supply of lendable securities from automatic reserved lenders is not sufficient to cover reserved borrowing requests in a given issue.

selected based upon their custody capabilities, financial stability, and reputation in the financial community. All depositories and subdepositories are appointed with the approval of the Belgium Cooperative's board of directors and are reapproved on an annual basis. This network of depositories allows linkages with domestic markets to effect external deliveries and receipts of securities thereby facilitating cross-border securities movements.

Chase Manhattan Bank currently acts as the Euroclear System's depository in the United States for the limited purpose of holding positions in certain foreign and internationally-traded securities (*e.g.*, such as the Regulation S portion of certain global bonds issued by foreign private issuers, Yankee bonds, and book-entry debt securities issued by the World Bank) which are represented by certificates immobilized in The Depository Trust Company or by electronic book-entries on the records of a Federal Reserve Bank.

Securities deposited in the Euroclear System may be in either physical form (*e.g.*, bearer or registered) or in dematerialized form. Securities are held on the books of a depository in an account in the name of MGT-Brussels as operator of the Euroclear System. Where the depository is not also the local clearing system, securities may be deposited in the local clearance system where the depository is located.[18]

Each Euroclear System participant has one or more securities clearance account(s) with associated transit accounts. Securities held by participants in the Euroclear System are credited to the participants' securities clearance accounts or transit accounts. Euroclear System participants have the option to request the segregation of their own and client securities in separate securities clearance accounts.

Securities in the Euroclear System are held in fungible bulk. Under Belgian law and pursuant to the Terms and Conditions,[19] each participant is entitled to a notional portion, represented by the amounts credited to its securities clearance account(s) and transit account(s), of the pool of securities of the same type held in the Euroclear System.[20]

D. Liens, Rights, and Obligations

In addition to any pledge of specific accounts agreed to by a participant due to extensions of credit by MGT-Brussels[21] all assets held in the Euroclear System are subject to rights of set-off and retention.[22] Furthermore, participants' assets held in the Euroclear System (except for assets held for customers and identified as such pursuant to the Operating Procedures or by agreement with Euroclear) are subject to a statutory lien in favor of MGT-Brussels, as operator of the Euroclear System, pursuant to Belgian law.[23] Participants are also obligated to cover any cash or securities debit balances that they may incur.

E. MGT-Brussels Banking Services

MGT-Brussels, acting in its separate banking capacity and not as operator of the Euroclear System, provides certain banking services to Euroclear System participants. Banking services provided include the provision of credit to Euroclear System participants, triparty repo[24] and collateral monitoring services, and a securities lending guarantee.

1. Provision of Credit to Euroclear Participants

MGT-Brussels offers credit facilities to Euroclear participants on an uncommitted basis under limits periodically determined by MGT. Credit decisions are made according to MGT credit guidelines. Credit facilities are generally required to be secured and are normally collateralized by participant assets within the Euroclear System. In order to secure credit, participants affirm to MGT-Brussels that they are not pledging client securities and that no other liens have been granted to third parties on pledged securities.[25]

Securities that participants pledge to secure credit extensions from MGT-Brussels are valued at their market price which is adjusted according to the type of instrument, underlying currency, rating of the issue, the issuer, and the country of the issuer. For debt securities, accrued interest is added to market price for the purpose of calculating collateral value.

2. Triparty Repo and Collateral Monitoring

MGT-Brussels also offers monitoring services whereby participants can use the Euroclear System to facilitate repo settlement/collateral posting, substitution of securities, and margin monitoring.

3. Securities Lending Guarantee

As part of the Euroclear securities lending and borrowing program, MGT guarantees securities lenders the return of securities lent or the cash equivalent if the borrower defaults on its obligation to return such securities.

III. Comment Letters

The Commission received six comment letters in response to the notice of filing of the Euroclear application.[26] All were in favor of the Commission granting Euroclear an exemption from registration as a clearing agency. Many of the commenters noted there would be a reduction in risks and an increase in liquidity as a result of permitting transactions involving U.S. government and agency securities to be processed by the Euroclear System. Specifically, several commenters believed that under an exemption from clearing agency registration Euroclear could facilitate the use of U.S. government and agency securities as collateral thereby reducing the risks to credit providers and the costs to credit seekers. Commenters also believed that permitting Euroclear to clear and settle U.S. government and agency securities would increase liquidity and further deepen the market for these securities which would benefit the U.S. government and its taxpayers by keeping the costs of borrowing low.

Commenters also cited Euroclear's operating record and financial condition in support of the exemption. Commenters articulated their belief that

[18] All securities accepted by a depository are credited to a segregated custody account in the name of MGT-Brussels as operator of the Euroclear System at the depository or local clearance system or are credited to the depository's account at the local clearance system.

[19] *Supra* note 9.

[20] Under Belgian law, Euroclear is required to hold interests in the same amount of any securities that may from time to time be credited to the accounts of Euroclear System participants and is prohibited from pledging or otherwise using any such securities for its own benefit without the consent of the relevant account holder.

[21] *See* Section II.E. *infra.*

[22] When assets are held subject to the right of set-off, the holder of the assets may apply the assets to satisfy debts owned to the holder by the actual owner of the assets. When assets are held subject to the right of retention, the holder of the assets may refuse to return the assets to their owner if the owner is indebted to the holder.

[23] Article 41 of the Belgian Law of April 6, 1995.

[24] A triparty repo arrangement generally consists of three parties, the borrower, the lender, and a collateral agent (*i.e.*, MGT-Brussels). In this arrangement, the borrower initiates a repo by ''selling'' securities to the lender in exchange for cash from the lender. Simultaneously with this transaction, the borrower agrees to repurchase these securities on a specified or undetermined future date. The collateral agent maintains custody of the securities for the duration of the repo and handles all operation aspects of the transaction including distribution of income, substitutions, and mark to market securities valuations.

[25] In a limited number of circumstances, MGT-Brussels may agree to permit pledging of client securities or the securities of the related parties where the participant's legal and regulatory regime permits, appropriate legal opinions are delivered, and certain other conditions are met.

[26] *Supra* note 7.

MGT-Brussels' financial resources and its regulation by the Board of Governors of the Federal Reserve System (''Federal Reserve Board'') are sufficient to ensure the safety and soundness of the Euroclear System.[27]

IV. Discussion

A. Statutory Standards

Section 17A of the Exchange Act directs the Commission, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and the maintenance of fair competition, to use its authority to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions.[28] Registration of clearing agencies is a key element of the statutory objectives set forth in Section 17A.[29] Before granting registration to a clearing agency, Section 17A(b)(3) of the Exchange Act requires that the Commission make a number of determinations with respect to, among other things, a clearing agency's organization, rules, and ability to provide safe and accurate clearance and settlement.[30] Additionally, the Division of Market Regulation (''Division'') has published the standards it applies in evaluating applications for clearing agency registration.[31] These standards are designed to help assure the safety and soundness of the clearance and settlement system.

Section 17A(b)(1), moreover, provides that the Commission:

> May conditionally or unconditionally exempt any clearing agency or security or any class of clearing agencies or securities from any provisions of [Section 17A] or the rules or regulations thereunder, if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of [Section 17A], including the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds.[32]

As a result, in granting either exemptions from portions of Section 17A or from registration, the Commission requires substantial compliance with Section 17A and the rules and regulations thereunder based on a review of the standards.[33]

B. Evaluation of Euroclear's Application for Exemption

In the Commission's evaluation of Euroclear's application and the comments received, the Commission recognized that certain organizational, operational, and jurisdictional differences would prevent MGT-Brussels, as operator of the Euroclear System, from complying fully with all of the registration provisions set forth in Sections 17A and 19 of the Exchange Act and from meeting all the requirements set forth in the Standards Release. The evaluation was also made in the context of the limitations and conditions that the Commission is including in the exemption granted pursuant to this order. As discussed more fully below, Euroclear's exemption from clearing agency registration is subject to limitations on the type and volume of securities that it may process for its U.S. participants and requirements to submit certain information to the Commission on a periodic basis and at the Commission's request. In addition, MGT-Brussels is subject to regulatory oversight by the Federal Reserve Board.

1. Safeguarding of Securities and Funds

Sections 17A(b)(3) (A) and (F) of the Exchange Act require that a clearing agency be organized and its rules be designed to safeguard securities and funds in its custody or control or for which it is responsible.[34] The Commission believes that Euroclear substantially satisfies this standard. Among other things, the financial condition of, operational safeguards employed by, and the scheme of U.S. federal banking oversight of MGT-Brussels, as operator of the Euroclear System, should help to provide U.S. investors and the U.S. national clearance and settlement system with a level of protection in the areas of custody, clearance, and settlement risks that is comparable to those achieved with full clearing agency registration.

a. Organization and Processing Capacity. A clearing agency must be organized in a manner that effectively establishes operational and audit controls while fostering director independence.[35] The independent audit committee of MGT's board of directors is kept apprised of Euroclear's operations by MGT's regional and functional audit management. The head of MGT audit management has direct reporting lines to the audit committee of MGT's board of directors and to the Vice Chairman of MGT. MGT's audit management receives reports through Euroclear's separate audit division that is responsible for the internal audit process. In addition, the audit division has a direct reporting line to the general manager of Euroclear.

The internal audit process for Euroclear is based on a risk assessment methodology. Review of the participant, product, market, and service dimensions of Euroclear's business, including technology infrastructure, are considered in this risk based approach. The internal audit procedures include tests that are designed to independently assess the strengths and weaknesses of Euroclear's control environment.

Price Waterhouse currently acts as the independent auditors of MGT and MGT-Brussels, including Euroclear. Price Waterhouse conducts an annual audit of MGT's financial statements, which are included in the annual report of J.P. Morgan & Co. Incorporated on Form 10–

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[27] Two commenters believed that due to MGT-Brussels's financial posture, operational history, and present monitoring by the Federal Reserve Board, Euroclear should not be subject to any volume limitations with regard to the amount of U.S. government and agency securities Euroclear may process. Letters from C.R. Trusler, Director, Normura International plc (June 5, 1997) and S. Guenzi, Senior Products Manager Custody H.O.-Financial Institutions, Credito Italiano (June 12, 1997). A third commenter believed that any volume limitation should be only temporary. Letter from D.G. Pritchard, Director, Global Collateral Support Unit, NatWest Markets (June 16, 1997).

[28] 15 U.S.C. 78q–1.

[29] ''Clearing agency'' is defined in Section 3(a)(23) of the Exchange Act. 15 U.S.C. 78c(a)(23).

[30] 15 U.S.C. 78q–1(b)(3). *See also* Section 19 of the Exchange Act, 15 U.S.C. 78s, and Rule 19b–4, 17 CFR 240.19b–4, setting forth procedural requirements for registration and continuing Commission oversight of clearing agencies and other self-regulatory organizations.

[31] Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (''Standards Release''). *See also,* Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 (omnibus order granting registration as clearing agencies to The Depository Trust Company, Stock Clearing Corporation of Philadelphia, Midwest Securities Trust Company. The Options Clearing Corporation, Midwest Clearing Corporation, Pacific Securities Depository, National Securities Clearing Corporation, and Philadelphia Depository Trust Company).

[32] 15 U.S.C. 78q–1(b)(1).

[33] The Commission has previously granted exemptions from clearing agency registration, subject to certain volume limits, reporting requirements, and other conditions, to the Clearing Corporation for Options and Securities (''CCOS'') and to Cedel. Securities Exchange Act Release Nos. 36573 (December 12, 1995), 60 FR 65076 (''CCOS exemptive order'') and 38328 (February 24, 1997), 62 FR 9225 (''Cedel exemptive order'').

The Commission also has granted temporary registrations that included exemptions from specific statutory requirements of Section 17A. In granting these temporary registrations, it was expected that the subject clearing agencies would eventually apply for permanent clearing agency registration. *See e.g.,* Secrities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19839 (order approving Government Securities Clearing with a temporary exemption from compliance with Section 17A(b)(3)(C)).

[34] 15 U.S.C. 78q–1(b)(3) (A) and (F). Euroclear's relationship with its participants is governed by various operating agreements, including the Terms and Conditions, the Supplementary Terms and Conditions, and the Operating Procedures which define the rights and responsibilities of Euroclear and its participants. *Supra* note 9 and *infra* Section IV.B.6.

[35] Standards Release, *supra* note 31, 45 FR at 41925–26.

K, in accordance with generally accepted auditing standards. It also conducts an annual review of Euroclear's internal controls, policies, and procedures in accordance with SAS–70 guidelines.[36] Both reports are made available to Euroclear participants. Price Waterhouse also reports to the Belgian Banking and Finance Commission and to MGT's audit committee.

Based upon the foregoing, the Commission is satisfied that Euroclear's organizational and processing capacity substantially satisfies the requirements of the Exchange Act as elaborated on in the Standards Release because Euroclear's internal organizational structure, including its system of internal and external audit, is reasonably designed to provide the necessary flow of information to MGT's board of directors which should allow the necessary monitoring of Euroclear's operations and management's performance to assure the operational capability and integrity of Euroclear.

b. Financial Risk Management. The Standards Release states that a clearing agency should establish a clearing fund and promulgate rules to assure an appropriate level of contributions in accordance with, among other things, the risks to which the clearing agency is subject for the protection of clearing agency participants and for the national system for clearance and settlement.[37]

As discussed in Section II.A. above, Euroclear provides DVP settlement for securities transactions which are then batched for processing in one of two overnight cycles or in the daylight cycle depending upon when the transactions are received. Euroclear itself does not directly extend credit to its participants. Instead, as discussed in Section II.E. above, MGT-Brussels, in its banking capacity, offers credit facilities to Euroclear participants on an uncommitted basis under limits established and in accordance with guidelines set by MGT. Such credit facilities are utilized to avoid transaction failures.

Euroclear does not maintain a clearing fund. However, Euroclear employs various financial and operational risk management mechanisms, including its organization, financial condition, insurance, information technology and systems security, and other operational safeguards to substantially reduce the risk of financial loss by Euroclear and its participants. Therefore, the Commission believes that Euroclear's rules and procedures and the methods by which Euroclear safeguards the financial security of its clearing facilities substantially satisfies the requirements of the Exchange Act.

(i) Risk Management Division and Committee

Euroclear has a separate risk management division that is responsible for risk policy. The risk management division focuses on identifying, analyzing, and managing the risks of operating a multicurrency, cross-border clearance and settlement system. It has developed various risk management tools for identifying and managing the risks of clearance and settlement and other market activities. In addition, Euroclear also employs a Risk Advisory Committee (''RAC'') to review all aspects of risk prior to approval of new and existing markets, products, and services. The RAC is chaired by the head of Euroclear's risk management division and includes senior management from other divisions and reports directly to the Euroclear management team.

(ii) Financial Condition

MGT, which is the entity with ultimate fiscal responsibility for operations of the Euroclear System, is a U.S. bank that is ''well-capitalized'' and ''well-managed'' as those terms are defined under applicable U.S. Federal banking regulations.[38] MGT has over $13.5 billion in total capital and a total capital ratio of more than 11 percent[39] and access to billions of dollars of additional liquidity in the capital markets. Its senior debt is rated AAA by Standard & Poor's[40] and its long-term debt is rated Aa–1 by Moody's Investors Services.[41]

(iii) Insurance

Euroclear maintains certain insurance coverage against risk of physical loss or damage for securities in its custody, on the premises of its depositories, or in transit. Euroclear also maintains insurance to cover losses arising from forged securities.[42] Typically, Euroclear depositories are required to maintain insurance coverage with respect to securities that they hold on behalf of Euroclear in the same amounts and covering the same risks as they maintain with respect to securities they hold for their own account or for the account of other customers. This insurance coverage must be at least as comprehensive as the coverage customarily carried by banks in that local market acting as custodians.

(iv) Information Technology

Euroclear has an information technology division that is charged with the development and maintenance of its information technology infrastructure. This division is responsible for software engineering, application system development, and technical support for both systems software and the telecommunications networks. It provides communications help-desk facilities and conducts the day to day operation of Euroclear's data centers and contingency facilities.

Computer equipment utilized in the operation of the Euroclear System is located at two data centers and a business recovery facility. All significant systems include full back-up within Euroclear's computer center.[43] Emergency back-up power sources are provided through an independently sourced and routed main power supply, backed up by on-site diesel generators and batteries. A contingency center with a capacity of over 300 critical personnel and a back-up computer center each located at a different site provides the continuity of operations in the event of serious malfunctions at Euroclear's computer center.[44]

[36] Statement on Accounting Standards No. 70 (''SAS–70'') issued by the American Institute of Certified Public Accounts sets forth the guidelines for examination of the internal controls established for computerized information systems and manual procedures relating to (i) securities clearance and settlement; (ii) securities lending and borrowing; (iii) money transfer; and (iv) custody. *See* Section IV.C.3. *infra.* The most recent SAS–70 report was issued on March 31, 1997 and covers the period from January 1, 1996 to December 31, 1996.

[37] *Supra* note 31, 45 FR at 41929.

[38] 12 CFR 208.33(b)(1) (definition of ''well-capitalized'') and 12 CFR 225.2(s) (definition of ''well-managed''). *See also* 12 CFR 211.2(u) (definition of ''strongly capitalized'') and (x) (definition of ''well managed'').

[39] 12 CFR Part 208, Appendix A (defining total capital ratio).

[40] Standard & Poor's, ''Morgan (J.P.) & Company Inc.,'' *Bank Ratings Analysis,* April 1997, at 1.

[41] Moody's Investor Service, ''Opinion Update: Morgan Guaranty Trust Company of New York,'' *Global Credit Research,* February 7, 1997, at 2.

[42] Euroclear maintains a Financial Institution Bond (''FIB'') in an amount of $155,000,000 per loss up to an annual aggregate maximum of $310,000,000 to cover losses of securities on premises or in transit. A separate companion policy written concurrently with the FIB covering electronic and computer crime (''crime policy'') is subject to the same per loss and aggregate coverage. For losses exceeding the FIB and the crime policy, Euroclear maintains an exceed J-Form Bond in an amount of $340,000,000. For physical loss or forgery of securities on premises or in transit, Euroclear maintains coverage in an amount of $500,000,000 per occurrence. Euroclear also maintains various mail, air courier, and messenger insurance policies.

[43] Euroclear has provided the Commission with a written copy of its back-up recovery plan.

[44] In 1995, contingency procedures were further enhanced by the implementation of a remote dual copy facility that provides for immediate update of data at both the production and contingency computer centers.

(v) Other Operational Safeguards

Euroclear has substantially similar subcustodian, recordkeeping, and auditing policies and procedures as those utilized by registered clearing agencies.[45] Regarding the safekeeping of securities, Euroclear deposits all securities deposited in the Euroclear System with a network of depositories (subcustodians), which consists of major banks, CSDs and central banks, and some MGT branches.[46] The depositories either maintain actual possession of security certificates or with the prior consent of Euroclear deposit them in local CSDs or central banks. The standard Euroclear depository agreement requires the subcustodians to physically segregate any securities certificates held for Euroclear from any securities certificates held for their own account or for other customers.[47]

c. *U.S. and Other Regulatory Oversight.* In its capacity as operator of the Euroclear System, MGT-Brussels is a division of the foreign branch of a U.S. bank and accordingly is subject to the comprehensive supervision and regulation of the Federal Reserve Board. The Federal Reserve Bank of New York conducts annual on-site examinations in Brussels and otherwise regulates MGT-Brussels' operations, including its operation of the Euroclear System. MGT-Brussels also is subject to the comprehensive supervision of the New York State Banking Department and the Belgian Banking and Finance Commission and is authorized as a Service Company by the Securities and Investments Board under the U.K. Financial Services Act, 1986.

2. Fair Representation

Section 17A(b)(3)(C) of the Exchange Act requires that the rules of a clearing agency provide for fair representation of the clearing agency's shareholders or members and participants in the selection of the clearing agency's directors and administration of the clearing agency's affairs.[48] This section contemplates that users of a clearing agency have a significant voice in the direction of the affairs of the clearing agency.

Although Euroclear participants do not have the right to appoint MGT directors or members of Euroclear management, they have the right to become members of the Belgian Cooperative and can use this membership to influence the range of Euroclear services and the level of fees charged to them by Euroclear. The board of directors of the Belgian Cooperative consists of 23 voting members which are nominated from Euroclear participant organizations representing various financial sectors and geographical regions. Euroclear's goal was to fashion a board with a cross-functional composition in order to ensure that important strategic and policy issues are viewed with a broad market perspective.

The board meets four times a year with Euroclear management to discuss major policy and operational issues regarding the Euroclear System, including new product development and the level of fees. Moreover, Euroclear's participants are some of the world's leading banks, brokers, central banks, and other professional investors which are able to analyze the risks and benefits of clearing and settling transactions in the Euroclear System. Accordingly, the Commission believes that the method in which the Belgian Cooperative's directors are selected and interact with Euroclear's management adequately addresses the requirements of fair representation under Section 17A(b)(3)(C) of the Exchange Act.

3. Participation Standards

Section 17A(b)(3)(B) of the Exchange Act enumerates certain categories of persons that a clearing agency's rules must authorize as potentially eligible for access to clearing agency membership and services.[49] Section 17A(b)(4)(B) of the Exchange Act states that a registered clearing agency may deny participation to or condition the participation of any entity that does not meet the financial responsibility, operational capability, experience, and competency standards set forth in the clearing agency's rules.[50] These criteria may not be used to discriminate unfairly among entities.[51]

Any organization that demonstrates it meets Euroclear's financial and operational criteria is eligible to become a Euroclear System participant. A prospective participant must demonstrate that it has adequate financial resources for its intended use of the Euroclear System and the ability to maintain this financial adequacy on an ongoing basis. It also must demonstrate that it has both the personnel and technological infrastructure to meet the operational requirements of the Euroclear System. Furthermore, it must show that it expects to derive material benefit from direct access to Euroclear and that it is a reputable firm. However, Euroclear does not require that a prospective applicant possess a particular regulatory status to become a Euroclear participant.[52]

Although Euroclear's admissions policy does not require regulatory status for its participants, entities enumerated in Section 17A(b)(3)(B) of the Exchange Act[53] may become Euroclear System participant if they meet Euroclear's operational and financial criteria. The Commission recognize that there is a wide variance in the level of regulatory control exerted upon Euroclear System participant by the various participants' home jurisdiction. Accordingly, even if Euroclear required a particular regulatory status as a condition to becoming a Euroclear System participant, there would be no assurances that this would provide more uniform admission or reliable protection for the Euroclear System, its participants, or investors because of the disparate levels of oversight. Because each of the enumerated categories of participants is eligible for Euroclear System membership and because Euroclear has accepted a wide range of participants based upon its standards of financial responsibility, operational capability, experience, and competence, the Commission is satisfied that

[45] For example, Euroclear is generally liable to Euroclear participants for its own negligent or willful misconduct.

[46] Generally, Euroclear depositories are liable to Euroclear for their negligent or willful misconduct and indemnify Euroclear for such liability. Euroclear is obligated to take steps that it reasonably deems appropriate to recover any loss to participants caused by the negligent or willful misconduct of any depository and pass on any recovery to the affected participants. But Euroclear does not warrant the performance of its network of depositories.

[47] In its application for exemption from clearing agency registration, Euroclear stated that in the nearly thirty years since Euroclear was established, there has not been a material loss or theft of securities from the Euroclear System. Euroclear also advised the Commission in its application that for its proposed activities involving U.S. government and agency securities, Euroclear will select a U.S. depository bank for such securities that is an adequately capitalized and well-managed clearing bank. The U.S. depository bank in turn would hold its positions through the Federal Reserve Bank of New York or a U.S. registered clearing agency.

[48] 15 U.S.C. 78q–1(b)(3)(C).

[49] 15 U.S.C. 78q–1(b)(3)(B). Section 17A(b)(3)(B) requires that the rules of a clearing agency provide that any (i) registered broker or dealer, (ii) other registered clearing agency, (iii) registered investment company, or (iv) other entities designated by the Commission may become participants in such clearing agency.

[50] 15 U.S.C. 78q–1(b)(4)(B).

[51] 15 U.S.C. 78q–1(b)(3)(H).

[52] As an exhibit to its application for exemption from clearing agency registration, Euroclear submitted a ''Participant Admissions Newsletter'' dated February 11, 1994 which stated that Euroclear has revised its admission criteria so as to not require that an applicant be regulated by a government securities for banking regulatory authority in order to become a Euroclear System participant. However, Euroclear also stated that it did not believe that the types of firms utilizing the Euroclear System would change significantly due to this revision.

[53] 15 U.S.C. 78q–1(b)(3)(B).

Euroclear's participants standards adequately address the requirements of Section 17A of the Exchange Act.

4. Dues, Fees, and Charges

Sections 17A(b)(3) (D) and (E) of the Exchange Act provide for the equitable allocation of reasonable dues, fees, and other charges among clearing agency participants and prohibits a clearing agency from imposing or fixing prices for services rendered by its participants.[54] Fees charged by Euroclear are generally usage-based, calculated on a sliding scale (where applicable), and are priced in a competitive environment with other entities that offer international clearance and settlement services. Euroclear does not fix any prices, rates, or fees for services rendered by its participants. Accordingly, the Commission is satisfied that the method by which Euroclear provides for the equitable allocation of reasonable dues, fees, and other charges among its participants and the fact that it does not fix the prices of the services rendered by its participants adequately addresses the Exchange Act requirements.

5. Capacity To Enforce Rules and To Discipline Participants

Section 17A(b)(3)(A) of the Exchange Act requires a registered clearing agency to have the capacity to enforce compliance by its participants with its rules.[55] Furthermore, Sections 17A(b)(3) (G) and (H) require a registered clearing agency to have in place a system to discipline its participants for violations of its rules and that the procedures for applying such rules be fair and equitable.[56]

MGT-Brussels, as the operator of the Euroclear System, bilaterally contracts with each of Euroclear's participants to provide clearance and settlement and other securities services. Neither MGT nor MGT-Brussels is a self-regulatory organization (''SRO'') as the term is defined in Section 3(a)(26) of the Exchange Act.[57] In particular, MGT-Brussels does not have any disciplinary authority over Euroclear participants other than the commercial discipline of refusing to provide services to those participants that fail to satisfy the terms of their contractual arrangements with MGT-Brussels regarding the use of the Euroclear System.

MGT-Brussels contends that the burdens associated with operating as a clearing agency through an SRO structure as envisioned under the Exchange Act would outweigh the benefits of such structure to the U.S. investing public. MGT-Brussels argues that it is already subject to significant regulatory oversight by the Federal Reserve Board as a foreign branch of a U.S. bank and that additional regulation as a U.S. registered clearing agency would be unnecessarily duplicative without adding any meaningful investor protection. MGT-Brussels maintains that it would be extremely difficult for it, as a foreign branch of a U.s. bank to act as a U.S. SRO and to impose meaningful oversight of Euroclear's U.S. broker-dealer participants. Moreover, MGT-Brussels notes that it functions in a multi-currency, cross-border regulatory environment, with an emphasis on international rather than U.S. markets which decreases the utility of U.S. regulatory oversight for its operations.

The Commission is sensitive to the myriad of issues which could arise in connection with requiring MGT-Brussels, in its capacity as operator of the Euroclear System, to register as a clearing agency and to be an SRO. Although Euroclear does not have formal disciplinary authority over its participants, it can influence its participants' activities by its admissions and termination policies, as well as through the credit extension by MGT-Brussels, acting in its separate banking capacity. Furthermore, if Euroclear fails to assure adequate compliance by its participants with Euroclear's financial and operational requirements or if Euroclear or its participants operate in a way that endangers the safety and soundness of U.S. markets of U.S. market participants, the Commission can alter or withdraw Euroclear's exemption.

Therefore, the Commission is satisfied that the goals of Sections 17A(b)(3) (G) and (H) requiring registered clearing agencies to have in place systems to enforce their rules and to discipline their participants for violations of their rules are substantially fulfilled under Euroclear's current structure and by the grant of an exemption.

6. Filing of Proposed Rule Changes

Section 19(b) of the Exchange Act requires registered clearing agencies to file with the Commission copies of all proposed amendments or additions to the clearing agencies' rules prior to implementation of such rule changes.[58] The Commission is vested with the authority to approve or disapprove such rule proposals in accordance with Section 19(b) of the Exchange Act, which includes a procedure to solicit public comment on proposed rule changes. Because Euroclear will not be a registered clearing agency, it will not be subject to the Section 19(b) rule change process.

As discussed earlier, the relationship between Euroclear and each of its participants is governed by the Terms and Conditions, the Supplementary Terms and Conditions, and the Operating Procedures.[59] Participants agree to be bound by the provisions of these documents as a condition of their participation agreement with MGT-Brussels.

Euroclear may amend the Terms and Conditions and the Operating Procedures at any time upon notice to its participants. In the case of amendments that do no adversely affect participants, Euroclear participants are deemed to have agreed to such amendments effective immediately. All amendments that adversely affect participants are binding on participants ten business days after dispatch of the notice.[60] Euroclear also may amend the Supplementary Terms and Conditions at any time upon notice to participants. However, all amendments to the Supplementary Terms and Conditions, regardless of whether they adversely affect Euroclear's participants, are deemed effective ten days after notice is given to the Euroclear participants in accordance with the Terms and Conditions.

While these procedures are not the substantive equivalent of the rule filing procedures of the Exchange Act to which registered clearing agencies are subject, the Commission believes that it is important that Euroclear's participants receive notice of changes to the Terms and Conditions, the Supplementary Terms and Conditions, and the Operating Procedures. Also, as discussed below in Section IV.C. of this order, Euroclear will be required to provide the Commission with current copies of the Terms and Conditions, the Supplementary Terms and Conditions, and the Operating Procedures and notices of any changes thereto.

C. Scope of Exemption

This order exempts Euroclear from registration as a clearing agency under Section 17A of the Exchange Act subject to conditions that the Commission

[54] 15 U.S.C. 78q–1(b)(3) (D) and (E).

[55] 15 U.S.C. 78q–1(b)(3)(A).

[56] 15 U.S.C. 78q–1(b)(3) (G) and (H).

[57] 15 U.S.C. 78c(a)(26).

[58] 15 U.S.C. 78s(b).

[59] *Supra* note 9.

[60] This delay in effectiveness does not apply to Section 22 of the Operating Procedures, governing Euroclear's Securities Lending and Borrowing Program. All amendments to Section 22, whether or not they adversely affect participants, are deemed to have taken effect ten days after notice of the amendments is given to participants.

believes are necessary and appropriate in light of the statutory requirements of the Section 17A objective of promoting a safe and efficient national clearance and settlement system and in light of Euroclear's structure and operation. The limitations set forth below reflect the Commission's determination to take a gradual approach toward permitting an international, unregistered clearing organization, such as Euroclear, to perform clearing agency functions for transactions involving U.S. government and agency securities for U.S. participants. This exemptive order and the conditions and limitations contained within are consistent with the Commission's recent order granting Cedel a conditional exemption from clearing agency registration.[61]

1. Securities Covered by the Exemption

This order grants Euroclear the authority to provide clearance, settlement, and collateral management services for U.S. participants'[62] transactions in (i) Fedwire-eligible[63] U.S. government securities,[64] (ii) mortgage-backed pass through securities that are guaranteed by the Government National Mortgage Association (''GNMAs''),[65] and (iii) any collateralized mortgage obligation whose underlying securities are Fedwire-eligible U.S. government securities or GNMA guaranteed mortgage-backed pass through securities and which are depository eligible securities (collectively, ''eligible U.S. government securities'').[66] The Commission believes that this limitation is necessary and appropriate because it will allow Euroclear to remain an unregistered clearing agency but will allow it to process its U.S. participants' transactions in U.S. government and agency securities, which are extremely liquid and are the most desirable securities to be utilized as collateral to reduce credit and liquidity risks of international transactions. In addition, Euroclear may request that the exemption be broadened to provide securities processing services for securities other than eligible U.S. government securities.

2. Volume Limits

The Commission is placing a limit on the volume of transactions in eligible U.S. government securities conducted by U.S. participants that can be settled through the Euroclear System. Specifically, the average daily volume of eligible U.S. government securities settled through the Euroclear system for U.S. participants may not exceed five percent of the total average daily dollar value of the aggregate volume in eligible U.S. government securities.[67] For purposes of this order, eligible U.S. government securities transactions settled through the Euroclear System will include (i) internal settlements[68] of transactions involving eligible U.S. government securities if a U.S. participant is on at least one side of the transaction; (ii) Bridge settlements[69] with Cedel where a U.S. participant is on the Euroclear side of the transaction; and (iii) external settlements where a U.S. participation is on the Euroclear side of the transaction.[70] Transactions involving the return of securities collateral, securities substitutions in triparty repo or other collateral or financing arrangements, and securities realignments where the same U.S. participant is on both sides of the transaction will not be considered to be transactions settled through the Euroclear System and consequently will not be subject to the volume limit.[71]

The total average daily dollar value of eligible U.S. government securities volume will be determined semiannually as the sum of (1) the average daily transaction value of all Fedwire eligible book-entry transfers originated on Fedwire as provided to the Commission by the Federal Reserve Board, (2) the average daily value of all compared trades in eligible U.S. government securities as provided to the Commission by the Government Securities Clearing Corporation (''GSCC''),[72] (3) the average daily value

[61] *Supra* note 33.

[62] For purposes of this order, ''U.S. participant'' means any Euroclear System participation having a U.S. residence, based upon the location of its executive office or principal place of business, including, without limitation, (i) a U.S. bank (as defined by Section 3(a)(6) of the Exchange Act), (ii) a foreign branch of a U.S. bank or U.S. registered broker-dealer, and (iii) any broker-dealer registered as such with the commission even if such broker-dealer does not have a U.S. residence.

In the Euroclear notice, the Commission proposed that transactions of eligible U.S. government securities involving ''affiliates'' of U.S. participants be counted towards the volume limit. For this purpose, an affiliate was deemed to be any Euroclear System participant having an arrangement with a U.S. entity that is known to Euroclear which will prevent a settlement or credit default with respect to the Euroclear System participant. This provision was intended to parallel the Cedel exemptive order. But because Euroclear's operational structure makes it unlikely that Euroclear System participants would utilize such arrangements, the Commission believes that it is not necessary to employ the affiliate concept in the context of this order.

[63] Fedwire is a large-value transfer system operated by the Federal Reserve Board that supports the electronic transfer of funds and of book-entry securities.

[64] For purposes of this order, ''U.S. government securities'' shall include all ''government securities'' as defined in Section 3(a)(42) of the Exchange Act, 15 U.S.C. 78c(a)(42), except that it shall not include any (i) foreign-targeted U.S. government or agency securities or (ii) securities issued or guaranteed by the International Bank for Reconstruction and Development (*i.e.*, the ''World Bank'') or any other similar international organization.

[65] GNMAs, unlike the mortgage-backed securities guaranteed by the Federal National Mortgage Association (''Fannie Maes'') and by the Federal Home Loan Mortgage Association (''Freddie Macs''), are issued in certificated form and therefore cannot be transferred over Fedwire.

[66] The definition of ''eligible government securities'' as set forth in this order is intended to parallel the definition of that term as used in the Cedel exemptive order. The definition as set forth here is also intended to clarify that, for purposes of both the Cedel and Euroclear exemptions from clearing agency registration, the Commission does not intend to capture those transactions involving securities that technically may fall within the definition of eligible U.S. government securities, but are securities which trade principally in non-U.S. markets, such as foreign-targeted government and agency securities and securities issued by organizations such as the World Bank.

[67] In the orders granting Cedel and CCOS exemptions from clearing agency registration, the Commission imposed volume limits on those entities. The CCOS exemptive order contained volume limitations of US $6 billion average net daily settlement for U.S. government securities and US $24 billion average net daily settlements for repurchase agreements in U.S. government securities. At that time, the CCOS volume limits were designed to limit CCOS's activity to approximately five percent of the average daily dollar value of transactions in U.S. government securities and in repurchase agreements involving U.S. government securities. In the Cedel exemptive order, the Commission determined that a percentage-based formula was more appropriate. Consequently, Cedel's volume limitation is 5% of the total average daily dollar value of the aggregate volume in eligible U.S. government securities.

[68] *Supra* Section II.A.

[69] *Id.*

[70] Pursuant to the reporting requirements described below, the Commission expects to receive, among other things, gross transactional volumes regarding all transactions in eligible U.S. government securities processed by the Euroclear System (*i.e.*, whether or not a U.S. participant is involved). In addition, the Commission expects to monitor the effects such transactions may have on U.S. markets and U.S. market participants.

[71] The delivery of eligible U.S. government securities in either a new or an open triparty repo, collateral, or financing transaction (collectively, ''repo transactions''), will be treated as a ''substitution'' and therefore will not be subject to the volume limit unless it is the first delivery of such securities. Accordingly, if eligible U.S. government securities are delivered at the opening of any repo transaction, the initial delivery will count towards the volume limit but subsequent substitutions of eligible U.S. government securities will not. Similarly, if other securities are delivered at the opening of a repo transaction and eligible U.S. government securities are later substituted for such securities, the initial delivery of such eligible U.S. government securities will count towards the volume limit, but subsequent substitutions of eligible U.S. government securities will not.

[72] In the Cedel exemptive order, the Commission determined that the portion of the volume limit applicable to Cedel that is derived from GSCC's trade comparison data should be the average daily value of all compared trades less the netted value of such trades. This was done to avoid double-counting the netted transactions with those already accounted for in the reported Fedwire volume. After further study and discussions with industry

Continued

of all compared trades less the netted value of all such compared trades plus the average daily volume of all trade-for-trade transactions (*i.e.*, trades not included in the netting system) in eligible government securities as provided by MBS Clearing Corporation, (4) the average daily gross settlement value in eligible U.S. government securities as provided to the Commission by the Participants Trust Company, and (5) the average daily dollar value of compared trades in eligible U.S. government securities from any other source that the Division deems appropriate to reflect the aggregate volume in eligible U.S. government securities.

The Commission believes that the volume limit is appropriate in that it is large enough to allow Euroclear to commence operations in clearing and settling eligible U.S. government securities transactions involving U.S. participants and to allow the Commission to observe the effects of Euroclear's activities on the U.S. government securities market. Likewise, the Commission believes that the volume limit is sufficiently small in scope so that the safety and soundness of the U.S. government securities markets should not be compromised if Euroclear, MGT-Brussels, or any Euroclear participant experiences financial or operational difficulties.

3. Commission Access to Information

To facilitate the monitoring of compliance with the volume limit and the impact of Euroclear's operations on the U.S. government securities market under this order, Euroclear will be required to provide certain information to the Commission as a continuing condition of its exemption.[73] Specifically, Euroclear will be required to provide the Commission with quarterly reports, calculated on a twelve-month rolling basis, of (1) the average daily volume of transactions in eligible U.S. government securities for U.S. participants that are subject to the volume limit as described in Section IV.C.2. above and (2) the average daily volume of transactions in eligible U.S. government securities for all Euroclear System participants, whether or not subject to the volume limit.[74]

Furthermore, Euroclear is required to promptly provide to the Commission the following documents (''disclosure documents'') when made available to Euroclear System participants:

(1) any amendments to or revised editions of (a) the Terms and Conditions, (b) the Supplementary Terms and Conditions Governing the Lending and Borrowing of Securities through Euroclear, and (c) the Operating Procedures of the Euroclear System;

(2) the annual report to shareholders of the Belgian Cooperative; and

(3) the annual report on the internal controls, policies and procedures of the Euroclear System (''SAS–70 Report'').[75]

In addition, Euroclear will be required to file with the Commission amendments to its application for exemption on Form CA–1 if it makes any fundamental change affecting its clearance and settlement business with respect to eligible U.S. government securities as summarized in this order and in its Form CA–1 dated March 4, 1997, or in any subsequently filed amended Form CA–1, which would make the information in this order or in its Form CA–1 incomplete or inaccurate.[76] This method of notifying the Commission of proposed changes at Euroclear will assist the Commission in its overall review of Euroclear and its operations.[77]

As a continuing condition to the exemption, Euroclear is also required to notify the Commission regarding material adverse changes in any account maintained by Euroclear for its U.S. participants.[78] In addition, Euroclear will be required to respond to a Commission request for information about any U.S. participant about whom the Commission has financial solvency concerns, including, for example, a settlement default by a U.S. participant.[79]

4. Modification of Exemption

The Commission may modify by order the terms, scope, or conditions of Euroclear's exemption from registration as a clearing agency if the Commission determines that such modification is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.[80] Furthermore, the Commission may limit, suspend, or revoke this exemption if the Commission finds that Euroclear has violated or is unable to comply with any of the provisions set forth in this order if such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the

representatives, the Commission has found that a significant number of the GSCC netted transactions do not pass across Fedwire but rather are processed internally through clearing banks such as the Bank of New York and the Chase Manhattan Bank. Consequently, the Commission now believes that because the risk of double-counting is small, it is more appropriate to utilize GSCC's gross average daily value of all compared trades to calculate the volume limit for eligible U.S. government securities applicable to Euroclear. The Commission will amend the Cedel exemptive order in the near future to permit Cedel to calculate its volume limit in accordance with the method set forth in the order that is applicable to Euroclear.

[73] The Division also will have available to it the annual reports on Form 10–K and the quarterly reports on Form 10–Q filed with the Commission by J.P. Morgan & Co. Incorporated, MGT's parent. Furthermore, Euroclear has represented that the Commission will be permitted to observe Euroclear System operations and to talk to Euroclear personnel on-site if the Commission so requests.

[74] In the Euroclear notice, the Commission proposed that Euroclear provide monthly the aggregate volume of all transactions in eligible U.S. government securities. Under the terms of the Cedel exemptive order, the Commission also required Cedel to provide this information on a monthly basis. After reviewing Cedel's monthly reports, the Commission has determined that the average daily volume of eligible U.S. government securities, reported quarterly, would be a more useful reporting format and will provide the Commission with adequate information regarding transaction volumes for monitoring purposes. The Commission will amend the Cedel exemptive order in the near future to permit Cedel to provide average daily volume of transactions in eligible U.S. government securities on a quarterly basis in accordance with the reporting requirements set forth in this order that are applicable to Euroclear.

[75] Euroclear must amend its Form CA–1 with respect to any changes to the information reported at items 1, 2, and 3 of its Form CA–1 to the extent that such changes are not reported in the disclosure documents.

[76] Only that portion of the Euroclear application on Form CA–1 affected by any such change must be filed with the Commission as an amendment. A resubmission of the entire Form CA–1 is not required.

[77] Neither the requirement to submit the disclosure documents nor the requirement to amend its Form CA–1 will be applicable to MGT-Brussels in its separate banking capacity and not as operator of the Euroclear System.

[78] For purposes of this order, the term ''material adverse changes'' will include (i) the termination of any U.S. participant; (ii) the liquidation of any securities collateral pledged by a U.S. participant to secure an extension of credit made through the Euroclear System; (iii) the institution of any proceedings to have a U.S. participant declared insolvent or bankrupt; or (iv) the disruption or failure in whole or in part in the operations of the Euroclear System either at its regular operating location or at its contingency center.

[79] If an information request relates to a U.S. participant that is a ''bank,'' as such term is defined in Section 3(a)(6) of the Exchange Act, 15 U.S.C. 78c(a)(6), the Commission will, if necessary, coordinate with the ''appropriate regulatory agency,'' as such term is defined in Section 3(a)(34) of the Exchange Act, 15 U.S.C. 78c(a)(34).

[80] The exemption provided by this order is based upon representations by Euroclear, its officers and attorneys, facts contained in the Euroclear application, and other information known to the Commission regarding the substantive aspects of Euroclear's proposal (collectively, ''representations and facts''). Any changes in the representations or facts as presented to the Commission may require a modification of this order. Responsibility for compliance with all applicable U.S. securities laws rests with Euroclear and its U.S. participants, as appropriate. Euroclear also is advised that this order does not exempt Euroclear from the anti-fraud or anti-manipulation provisions of the Exchange Act or any of the rules promulgated thereunder.

Exchange Act for the protection of investors and the public interest.

V. Conclusion

The Commission finds that Euroclear's application for exemption from registration as a clearing agency meets the standards and requirements deemed appropriate for such an exemption.

It is therefore ordered, pursuant to Section 19(a)(1) of the Exchange Act, that the application for exemption from registration as a clearing agency filed by Morgan Guaranty Trust Company of New York, Brussels Office, as operator of the Euroclear System (File No. 601–01) be, and hereby is, approved subject to the conditions contained in this order.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–3997 Filed 2–17–98; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39641; File No. SR–NASD–98–06]

Self-Regulatory Organizations; Notice and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to SelectNet Fees

February 10, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on January 30, 1998, the National Association of Securities Dealers, Inc. (''NASD'') or ''Association'') through its wholly owned subsidiary, the Nasdaq Stock Market, Inc. (''Nasdaq'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. 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

Nasdaq is herewith filing a proposed rule change to lower the fees charged under NASD Rule 7010(l) for the execution of transactions in SelectNet.[2] Under the proposed new SelectNet fee structure, fees would be assessed in the following manner: (1) $1.00 will be charged for each SelectNet order entered and directed to one particular market participant that is subsequently executed in whole or in part; (2) no fee will be charged to a member who receives and executes a directed SelectNet order; (3) the existing $2.50 fee will remain in effect for both sides of executed SelectNet orders that result from broadcast messages; and (4) a $0.25 fee will remain in effect for any member who cancels a SelectNet order. The new fees are effective February 1, 1998, and continue through a 90-day trial period commencing the day Nasdaq's SelectNet fee filing is published in the **Federal Register.**

Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

7010. System Service

(a)–(k) No Change.

(l) SelectNet Service.

Effective February 1, 1998, [T]*t*he following charges shall apply to the use of SelectNet:

Transaction Charge $2.50/side
Directed Order Charge $1.00 (per execution, entering party only)
Cancellation Fee $.25/per order

(m)–(n) No Change.

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 NASD included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at places specified in Item IV below. The self-regulatory organization 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

Nasdaq is proposing to lower its SelectNet fees. Currently, both sides of a transaction executed in SelectNet are assessed $2.50 each.[3] Nasdaq, recognizing recent significant changes in SelectNet usage, is proposing a new fee structure that responds to this new trading environment and more closely aligns SelectNet fees with current market activity.

SelectNet transaction volume is at historic highs. In August 1997, more than 75,000 daily executions took place in SelectNet. This represented an almost fourfold increase in volume from average daily activity recorded in 1996. Since then, SelectNet volumes have remained at significantly increased levels, with more than 79,000 average daily transactions in November 1997 and over 88,000 in December 1997.

The growth in SelectNet usage can be attributed to a number of factors, most notably the introduction of the SEC Order Execution Rules (''Order Execution Rules'') in January of 1997[4] and market maker decisions to electronically communicate with each other, in lieu of the telephone. Nasdaq also used the SelectNet system to create the access linkage with each electronic communication network (''ECN'') that sought to display its prices in Nasdaq consistent with the requirements of the Order Execution Rules. Accordingly, SelectNet is the only means of accessing orders displayed in the Nasdaq quote montage by broker-dealers that are not subscribers to the ECN's own network. As such, growth in SelectNet utilization closely tracked the expansion in the number of Nasdaq stocks covered by the Order Execution Rules and the increased use of ECNs to display orders.

Responding to increased SelectNet activity, Nasdaq's new fees reduce SelectNet cost burdens on all users. For example, a directed, and subsequently executed, order under the new fee structure for directed orders will cost only $1.00, payable by the entering party. In contrast, the present SelectNet fee is $5.00 with $2.50 being assessed on both sides of the trade. The proposed $1.00 fee on the party entering a directed SelectNet order represents a 60% reduction in the fee charged only five months ago, and is 20% less than the current temporarily-reduced fee of $1.25.

Nasdaq has eliminated any execution fees for directed SelectNet orders

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

[2] This filing complements SR–NASD–97–98, which extended Nasdaq's temporary fee reduction to $1.25 per side for all SelectNet transactions until January 31, 1998. Due to an error in the computer disk version of the filing sent to the SEC, the extension of the temporary fee reduction was incorrectly reported in the **Federal Register** as continuing until March 31, 1998. *See* Securities Exchange Act Release No. 39555 (January 15, 1998), 63 FR 3595 (January 23, 1998). Thus, as of February 1, 1998, the temporary SelectNet fee reduction extended by SR–NASD–97–98 will lapse, and new and lower SelectNet fees will be assessed as described in this filing.

[3] This fee has been temporarily reduced to $1.25 per side since October 1, 1997. *See* Securities Exchange Act Release No. 39248 (October 16, 1997), 62 FR 55296 (October 23, 1997). The fee will revert to $2.50 per side on February 1, 1998, for any orders not covered by the fee reduction (*i.e.*, execution of broadcast orders will continue to be charged at $2.50 per side).

[4] *See* Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).