

non-custodial in that it does not hold its members funds or securities. GSCC relies on clearing banks to perform custodial services for Government securities, which are uncertificated, and for funds. It is reasonable for GSCC, which is member-owned and governed, and its members to agree among themselves through board approval of the proposed rule change and through the proposed rule change notice and approval process to agree and to contract with one another in a cooperative arrangement as to how to allocate GSCC's liability among GSCC and themselves.

In its order granting temporary registration as a clearing agency, the Commission expressed concern that GSCC's failure to perform accurately and timely the comparison service could adversely affect the ability of GSCC members to deliver securities and effect trade settlements. Considering the size of the Government securities market and the next-day time frame for trade settlements, the Commission deemed it appropriate that GSCC amend its standard of care to an ordinary negligence standard of care in performing all functions affecting member settlements of Government securities.¹² The Commission, recognizing that GSCC's members are best suited to allocate GSCC's rights and liabilities, has determined and finds that, given the non-custodial nature of GSCC's services, the extensive and rigorous financial and operational regulatory oversight to which GSCC is subject,¹³ and GSCC's exemplary level of performance,¹⁴ a gross negligence standard of care is appropriate for GSCC.

The Commission has given thoughtful and careful consideration to the

comment letter of AGC and finds that AGC's concerns about the performance level of GSCC operating under a gross negligence standard of care and limitation of liability are addressed by the extensive regulatory oversight to which GSCC is subject as a registered clearing agency and the fact GSCC is not changing its financial and operational standards with the adoption of a gross negligence standard of care and limitation of liability.¹⁵

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR-GSCC-2002-10) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48200; File No. SR-GSCC-2002-11]

Self-Regulatory Organizations; Government Securities Clearing Corporation; Order Approving Proposed Rule Change To Reduce the Permitted Use of Letters of Credit to Twenty-Five Percent of a Member's Required Clearing Fund Deposit

July 21, 2003.

I. Introduction

On October 10, 2002, the Government Securities Clearing Corporation ("GSCC")¹ filed with the Securities and

Exchange Commission ("Commission") proposed rule change SR-GSCC-2002-11 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").² Notice of the proposal was published in the **Federal Register** on June 17, 2003.³ For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

The purpose of the proposed rule change is to reduce the permitted use of letters of credit ("LCs") to twenty-five percent of a member's required clearing fund deposit. One of GSCC's most important risk management tools is its maintenance of clearing fund collateral. GSCC's clearing fund is comprised of cash, certain netting-eligible securities, and eligible LCs. The purposes served by the clearing fund are (1) to have on deposit from each netting member assets sufficient to satisfy any losses that may be incurred by GSCC as the result of the default by the member and the resultant close-out of that member's settlement positions and (2) to ensure that GSCC has sufficient liquidity at all times to meet its payment and delivery obligations.

Currently, GSCC's rules permit up to 70 percent of a member's required clearing fund deposit to be in the form of LCs. Although GSCC believes that it will always receive funds from the presentment of an LC for payment, GSCC has recognized that in a period of market crisis there is the potential that GSCC might not receive the funds on a timely basis. To ensure that GSCC can always meet its liquidity needs on a timely basis in the unlikely event of a member default and in times of market crisis, GSCC is reducing the permitted use of LCs to 25 percent of a member's required clearing fund deposit. Thus, the minimum level of cash and securities required to be maintained on deposit will increase from 30 percent to 75 percent of a member's required clearing fund deposit.⁴

succeeded to the GSCC proposed rule change upon the merger of MBSCC and GSCC. To avoid confusion and maintain consistency with the Notice, in this Order we will continue to refer to GSCC as such. Securities Exchange Act Release No. 47015 (December 17, 2002), 67 FR 78531 [File Nos. SR-GSCC-2002-09 and SR-MBSCC-2002-01].

² 15 U.S.C. 78s(b)(1).

³ Securities Exchange Act Release No. 48016 (June 11, 2003), 68 FR 35925.

⁴ The new LC limitation will not affect the requirement that certain non-US GSCC members post additional collateral in the form of LCs to protect GSCC against legal risk presented by the insolvency laws in those members' home countries. These members will not be required to increase the amount of their deposit that is in the form of cash and securities from 30 percent to 75 percent of their required clearing fund deposit.

approval of temporary registration as a clearing agency to the International Securities Clearing Corporation, the Commission indicated that historically it has left to user-governed clearing agencies the question of how to allocate losses associated with noncustodial, data processing, clearing agency functions and has approved clearing agency services embodying a gross-negligence standard of care. Securities Exchange Act Release No. 26812 (May 12, 1989), 54 FR 21691.

¹² Securities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19639.

¹³ GSCC must have its rule changes approved by the Commission and is the subject of frequent Commission examinations for compliance with its rules and those of the Commission. As directed by Congress, the Commission cannot approve GSCC's proposed rule changes if they are inconsistent with Section 17A of the Act, including being inimical to the public interest or the protection of investors.

¹⁴ Over the past 15 years, GSCC has demonstrated a high level of responsibility in performing its non-custodial functions and has had appropriate standards in place to ensure adequate performance. As a result, GSCC has operated without financial loss to its members or third parties arising from its failure to perform.

¹⁵ The Commission notes that the rule change does not alleviate GSCC from liability for violation of the Federal securities laws where there exists a private right of action and therefore is not designed to adversely affect GSCC's compliance with the Federal securities laws and private rights of action that exist for violations of the Federal securities laws.

¹⁶ 17 CFR 200.30-30(a)(12).

¹ On January 1, 2003, MBS Clearing Corporation ("MBSCC") was merged into GSCC under New York law, and GSCC was renamed the Fixed Income Clearing Corporation ("FICC"). The functions previously performed by GSCC are now performed by the Government Securities Division ("GSD") of FICC, and the functions previously performed by MBSCC are now performed by the Mortgage-Backed Securities Division ("MBSD") of FICC. The GSD