established at the execution of the trade, to their settlement value,[33] which will reflect gains or losses in the interim period, and CCOS will mark open positions that were previously marked to the prior day's settlement value to the new settlement value.

Trades executed from 1:30 p.m. through the 5:00 p.m. end of the day's trading session will be marked to the 3:00 p.m. settlement value, and the variation margin on the entire position will be calculated at the end of the day. Participants will pay or collect the second variation margin obligation the following morning at 7:40 a.m. CCOS will send delivery instructions for normal settlement of government securities transactions executed on T to the participants' settlement banks at 11:30 a.m. on T+1.[34]

3. Loss Allocation and Liquidity Sources

CCOS will begin operations with an initial capitalization of $2 million. Together with CCOS's earnings, BOTCC will commit to provide CCOS with additional capital as necessary to cover CCOS's continuing costs of operations. Because CCOS will rely on BOTCC for certain liquidity resources and because BOTCC's capital and credit lines are committed to its futures business, BOTCC has agreed to dedicate specific credit and financial resources to CCOS, and CCOS and BOTCC have established a framework for allocating losses arising from cross-margined accounts between the two entities.

With respect to liquidity, CCOS will establish a committed credit facility which will be guaranteed by BOTCC. The credit facility initially will be $5 million and will be increased in increments of $5 million for each $1 billion increase in CCOS's daily average net settlements of government securities transactions over a ninety day period. When the credit facility reaches $30 million as a result of daily average net settlements of government securities reaching $6 billion, CCOS will review the size of the credit facility in consultation with the Division staff.[35]

With respect to loss allocation, under the cross-margining arrangement between CCOS and BOTCC, all government securities positions cleared by CCOS will be maintained in a cross-margin account for which BOTCC and CCOS have agreed to assume joint responsibility in the event that a default or failure to settle occurs and there is a shortfall in that account. BOTCC and CCOS each are guaranteeing up to 50% of the obligations owed to each other with respect to a defaulting participant's cross-margin account after use of the original margin deposits of the participant and proceeds from the liquidation of the participant's positions. Therefore, CCOS will have adequate resources to protect itself and to fulfill its settlement obligations for a loss up to at least $60 million.[36]

II. Comment Letters

Public comment both supported and opposed CCOS's application.[37] More than sixty commenters, including several common members of the Government Securities Clearing Corporation (''GSCC'') and CCOS, supported the proposal. More than forty commenters opposed the proposal, raising three basic arguments as to why the Commission should deny the exemption request.[38] These arguments include the potential fragmentation of clearance and settlement facilities for the U.S. Treasury market the concern that exempting CCOS will mean ineffective and unequal regulation of clearing facilities for those securities, and the concern that approval of CCOS will not promote fair competition among clearing agencies. CCOS filed several responses to the comments.[39]

The Commission received two letters from the Commodity Futures Trading Commission (''CFTC'') regarding CCOS's application.[40] BOTCC, as a futures clearing organization, is subject to regulation by the CFTC under the Commodity Exchange Act (''CEA''); therefore, the Commission carefully considered the comments of the CFTC regarding CCOS's application. In its first letter to the Commission,[41] the CFTC noted that because of its position as the regulator of BOTCC, it would have to consider and address the potential impact of CCOS's activity on the financial integrity of BOTCC and on the futures market for which it clears. Specifically, the CFTC was concerned with BOTCC's role as a guarantor of CCOS's obligations and the impact on BOTCC's financial integrity of any minimum capitalization or other requirements imposed on CCOS by the Commission.[42] The CFTC also stated that any arrangements presenting cross-jurisdictional issues between the CFTC and the Commission would require approval by both agencies. This would include cross-margining programs, the imposition of clearing limits and/or minimum margin requirements, and futures/cash basis trades traded on the CBB and cleared through BOTCC and CCOS. The CFTC urged a cooperative effort between itself and the Commission to avoid duplicative or inconsistent regulation being imposed on the affected entities.

The CFTC's second letter[43] responded to CCOS's amended application in which CBOT set forth its intention to register CBB as a government securities broker and its willingness to enter into certain linkage arrangements with GSCC. The CFTC noted that the proposal to enter into a linkage

for failed deliveries, the seller will have to pay the incremental accrued interest for each day the fail continues. The daily variation margin payments will include this incremental accrued interest.

[33] Settlement values will reflect the settlement price established twice a day and will include accrued interest but will not include commissions and finance charges from dollar rolls.

[34] Participants may transact dollar rolls (with same-day settlement for the first leg) between 8:00 a.m. and 11:00 a.m. on T+1 to offset delivery obligations due to settle on T+1.

[35] As discussed below, $6 billion is the maximum average daily net settlements of transactions in government securities agreed to by CCOS and the Division during the exemptive period. Also as agreed to by CCOS and the Division, CCOS's operations will be limited to a maximum of $24 billion average daily net settlements of dollar rolls.

These limits represent approximately five percent or less of government securities and average daily volumes in dollar rolls. The Commission believes these limits are appropriate at this time in that they are large enough to allow CCOS to commence effective operations yet of a limited nature that allows the Commission to observe the effects of the CCOS clearing and settlement activities on the government securities market.

[36] *I.e.*, $30 million from CCOS's guaranteed credit facilities (repayment of which is guaranteed by BOTCC) plus $30 million from BOTCC under its guarantee of cross-margining losses.

[37] *Supra* note 5.

[38] Commenters raised additional issues in opposition to CCOS's application. These issues included the concern that the introduction of CCOS as another government securities clearing agency would result in an increase in costs for U.S. Treasury brokers and the concern that in the future decisions at GSCC will be made based on the fear of losing potential customers to CCOS rather than based on the best interest of the participants. With regard to the first point, the Commission believes that if in fact any increase in costs results from granting CCOS's exemption application, the benefits to the government securities market, such as innovation arising from competition, will outweigh any such costs. With regard to the second point, while the Commission believes that GSCC will continue in the future to base its decisions on what is in the best interest of its participants and the government securities market and not on any fear of losing current or potential participants, commenters should be comforted by the fact that GSCC is subject to Section 19(b) of the Act which requires SROs to file with the Commission any proposed changes to their procedures, operations, or rules.

[39] The comment letters and CCOS's responses are discussed in detail in the Discussion section of this order.

[40] Letters from Jean A. Webb, Secretary, CFTC, to Jonathan G. Katz, Secretary, Commission (July 23, 1993 and May 31, 1994).

[41] Letter from Jean A. Webb (July 23, 1993), *supra* note 40.

[42] Ultimately, this concern was alleviated by changing the general BOTCC guarantee to a guarantee of a limited committed credit facility. Refer to ''BOTCC Guarantee'' above.

[43] Letter from Jean A. Webb (May 31, 1994), *supra* note 40.