

arrangement with GSCC could have positive effects on the government securities market, that the CBB/CCOS amended proposal could increase competition among market participants, that the CBB electronic trading system would provide government securities market participants with easier access to market information, and that the registration of CCOS as a clearing agency might lower the level of risk present in the government securities market. While the CFTC's comments were generally positive, it also reiterated its regulatory interests and the need to review the potential impact of the various arrangements on BOTCC's financial integrity and to assure compliance with the CEA.

The Commission recognizes the validity of the CFTC's concerns and understands the importance of coordinating efforts among all regulators concerned with the government securities market. The Commission will continue to coordinate with these regulatory agencies to safeguard one of the world's largest securities markets.

### III. Discussion

#### A. Overview

The Commission is granting CCOS's application for exemption subject to the conditions described below. The Commission believes such action is consistent with the Act including the goals of fostering cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, removing impediments to and perfecting the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and protecting investors and the public interest.

As noted above, CCOS proposes to provide clearing facilities in support of CBB's and CBOT's proposals. CBB's proposed automated trading system for government securities represents an effort to make government securities more readily available to CBOT members that trade futures on government securities and thereby improves the efficiency of arbitrage between the futures and cash markets and potentially increases liquidity in both of those markets. Traders in these markets often are called upon to accept position or market risks from participants in the market for government securities. The market for U.S. Treasury bonds, bills, and notes is the deepest, most liquid market in the world. While these securities are traded all over the world, the primary U.S. marketplace involves a core group of dealers, brokers' brokers, banks, and

institutional investors that trade extensively among themselves over-the-counter. These market participants often rely on futures markets, such as the CBOT, for their derivative products as a way to transfer to traders on these markets position and market risks related to U.S. government securities. Traders on the futures exchanges, in turn, must be able to buy and sell government securities to help manage their own risk and position exposures efficiently.

Approval of the CCOS application will allow CCOS and its parent, BOTCC, to provide the clearance and settlement services that are necessary to support the CBB and CBOT proposals. This in turn should help foster greater integration of clearing facilities that serve the futures market and the underlying cash markets and should facilitate the development of cross-margin facilities between those markets. BOTCC already has extensive arrangements with its clearing bank network to receive and deliver government securities among its clearing members, and its clearing members maintain government securities at those banks for their proprietary and customer accounts. As described above, CCOS plans to build on those arrangements in providing its services in support of CBB. Exempting CCOS from clearing agency registration should allow CBB to move forward with its proposal and should allow CCOS and BOTCC to obtain greater experience in managing risk exposures before taking on self-regulatory responsibilities that would otherwise accompany clearing agency registration.

Because many of CCOS's likely users are GSCC members and use GSCC's services to clear and settle trades among themselves, a linkage among CCOS, BOTCC, and GSCC to facilitate efficient clearance of trades is essential.<sup>44</sup> To this end, the Boards of Directors of GSCC, BOTCC, and CCOS have been requested to establish a joint user committee to settle the outstanding linkage and cross-margining issues and to report to the GSCC, BOTCC, and CCOS Boards the committee's proposal for linkage and cross-margining within three months of formation of the committee.<sup>45</sup>

<sup>44</sup> *Market Reform Act of 1990*, S. Rep. 101-300 at 58-62. President's Working Group on Financial Markets, Interim Report, Appendix D (May 1988).

<sup>45</sup> Letter from Richard R. Lindsey, Division Director, Commission, to John G. Macfarlane III, Chairman of the Board, GSCC, and David Johnson, Chairman of the Board, BOTCC (December 12, 1995). The Commission believes it is appropriate for CCOS to begin limited operations prior to the implementation of such arrangements because these arrangements, while important to coordinating

The Commission will monitor closely efforts in this regard and expects prompt action to implement linkages and cross-margin systems that are acceptable to the common membership so that appropriate linkages are in place when warranted. If it does not appear after six months that the parties are able to agree to establish appropriate linkage and cross-margining facilities, the Commission will consider whether to mandate the development of linkage and cross-margining facilities. If necessary, the Commission will use its authority under the Act to direct that the responsible parties act in their best interests to establish "linked or coordinated facilities for clearance and settlement of transactions in securities \* \* \* [and] contracts of sale for future delivery \* \* \*".<sup>46</sup>

Approval of the application also should help foster innovation in clearance and settlement of government securities. The CCOS proposal will provide central clearing facilities for dollar rolls, which represent a type of repurchase agreement transaction. CCOS's proposal was one of the first formal responses to the recommendations of the 1992 Joint Report on the Government Securities Market,<sup>47</sup> and the Commission believes that the CCOS proposal may well have encouraged others, including GSCC, to develop similar or wider services.

#### B. Section 17A of the Act

##### 1. Grant of Exemption

Section 17A(b)(1) of the Act authorizes the Commission to exempt applicants from some or all of the clearing agency requirements of Section 17A if the Commission finds such exemptions are 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.<sup>48</sup> While the

GSCC's and CCOS's systems, are not necessary for CCOS to commence operations.

<sup>46</sup> 15 U.S.C. §§ 78q-1 (a)(2)(A)(ii) and (d)(1) (1988).

<sup>47</sup> *Joint Report on the Government Securities Market*, issued by the Department of Treasury, the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System (January 1992) at 31 (recommending that an efficient processing system for government securities repo activity be developed).

<sup>48</sup> For legislative history concerning Section 17A of the Act, see, e.g., Report of Senate Comm. on Housing and Urban Affairs, Securities Acts Amendments of 1975: Report to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess., 4 (1975); Conference Comm. Report to Accompany S. 249, Joint Explanatory Statement of Comm. of Conference, H.R. Rep. No. 229, 94th Cong., 1st Sess., 102 (1975).