

Commission has never exercised its authority to exempt an applicant entirely from the requirements of Section 17A, it has granted newly registered clearing agencies narrowly drawn, temporary exemptions from specific statutory requirements imposed by Section 17A in a manner that achieves those statutory goals.⁴⁹

The market break in October 1987 and the markets' decline in October 1989 demonstrated the central role of clearing agencies in U.S. securities markets in reducing risk, improving efficiency, and fostering investor confidence in the markets.⁵⁰ In light of the foregoing, the Commission believes it is appropriate for applicants requesting exemption from clearing agency registration to meet standards substantially similar to those required of registrants in order to assure that the fundamental goals of Section 17A (*i.e.*, safe and sound clearance and settlement) will be achieved.

Because the Commission believes that CBB and CCOS will promote innovation in the trading and clearing of government securities and will further the integration of the futures and government securities markets, it is approving CCOS's application for exemption in order that CCOS may begin limited operations without meeting the entire panoply of clearing agency registration requirements.⁵¹ Although, as described below, CCOS is being held to substantially the same standards as other registered clearing agencies, certain areas of CCOS's

operation require further development before CCOS can be considered for registration under Section 17A of the Act. The Commission believes that granting CCOS an exemption from registration subject to the regulatory requirements and Commission oversight on CCOS during the exemptive period should allow CCOS to further develop its system for clearing and settling government securities in a safe and sound manner before it seeks full registration as a clearing agency. In granting CCOS an exemption from clearing agency registration, the Commission believes that such an exemption is consistent with the requirements of Section 17A and that the framework of the exemption is such that the Commission retains adequate regulatory power and oversight to ensure that CCOS's services do not pose a threat to the stability of the government securities markets.

The Commission is imposing significant limits on CCOS as set forth below.⁵² Should CCOS determine that a change in its operations or procedures is necessary, CCOS will be required pursuant to this exemptive order to amend its CA-1 and request that the Commission modify the exemptive order. The Commission's oversight of CCOS, in conjunction with the CFTC's oversight responsibilities of BOTCC, should help nurture the establishment of safety mechanisms, such as cross-margining, that further the goals of competition and integration in the government securities and futures markets. Furthermore, as competition leads to innovation and progress, the Commission believes CCOS's entry into the clearance and settlement of government securities should be a positive step towards the continued development of the world's largest government securities market.

2. Registration Standards

Before granting registration to a clearing agency, Section 17A of the Act requires that the Commission make a number of determinations with respect to the clearing agency's organization, capacity, and rules. Paragraphs (A) through (F) of Section 17A(b)(3) set forth general criteria which a clearing agency must satisfy in order to be registered. Congress reserved to the Commission the task of making specific determinations as to whether an applicant's organization, capacity, and rules satisfy the general criteria. In Securities Exchange Act Release No. 16900, the Division set forth its views

and positions concerning satisfaction of the general criteria ("Standards Release").⁵³

These statutory standards are designed to assure the safety and soundness of the clearance and settlement system. As previously stated, the Commission, in granting CCOS's exemption is requiring CCOS to meet in substantial form these same statutory standards and is satisfied that CCOS's operation will not be a threat to the safety or soundness of the national market system. Furthermore, the Commission will continue to monitor CCOS's operations to assure its soundness in the clearance and settlement of government securities.

a. Safeguarding of Securities and Funds

Sections 17A(b)(3) (A) and (F) of the Act require a clearing agency be organized and its rules designed to facilitate the prompt and accurate clearance and settlement of securities transactions for which it is responsible and to safeguard securities and funds in its custody or control or for which it is responsible.⁵⁴ The Commission believes that CCOS meets these standards. Among other things, CCOS will maintain appropriate audit and internal controls⁵⁵ and will make available

⁵³ Securities Exchange Act Release Nos. 16900 (June 17, 1980), 45 FR 41920 (announcement of standards for the registration of clearing agencies) and 20221 (September 23, 1983), 48 FR 45167 (omnibus order granting full 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).

Refer also to Section 19 of the Act, 15 U.S.C. 78s (1988), and Rule 19b-4, 17 CFR 240.19b-4 (1992), setting forth certain procedural requirements for registration and continuing Commission oversight of clearing agencies and other self-regulatory organizations.

⁵⁴ 15 U.S.C. 78q-1(b)(3) (A) and (F) (1988).

In addition to BOTCC's responsibilities as facilities manager, CCOS must assure itself that BOTCC complies with all of the safeguards, as appropriate, set forth in the section of the Standards Release regarding the safeguarding of securities and funds and prompt and accurate clearance and settlement of securities transactions; and that these operations will be subject to examination by CCOS's independent public accountant, the Commission and the appropriate regulatory agency to the same extent as in the case of a clearing agency which carries out its own processing. Standards Release, *supra* note 53.

⁵⁵ Clearing agencies should have an audit committee which selects or makes recommendations to the Board of Directors of the clearing agency regarding the selection of the clearing agency's public accountant. CCOS Rule 213 requires the establishment of an audit committee consisting of at least three nonmanagement directors of CCOS. The committee will, among other things, make recommendations to the Board of Directors regarding the selection of CCOS's independent public accountants.

⁴⁹ *E.g.*, in the Commission's order approving GSCC's temporary registration as a clearing agency, the Commission temporarily exempted GSCC from compliance with the statutory standards of Sections 17A(b)(3)(B) and 17A(b)(4)(B) of the Act regarding a clearing agency's rules designating classes of participants and the standards used by the clearing agency to determine participation. The Commission also exempted GSCC from Section 17A(b)(3)(C) regarding fair representation of clearing agency participants in the selection of its directors. Securities Exchange Act Release No. 25740 (May 24, 1988), 53 FR 19839.

⁵⁰ Gerald Corrigan, President of the Federal Reserve Bank of New York ("FRBNY"), noted: "[T]he greatest threat to the stability of the financial system as a whole [during the 1987 market break] was the danger of a major default in one of these clearing and settlement systems." Luncheon Address: Perspectives on Payment System Risk Reduction by E. Gerald Corrigan, President, FRBNY, reprinted in *The U.S. Payment System: Efficiency, Risk and the Role of the Federal Reserve* 129-30 (1990).

⁵¹ Section 17A, as amended by the Market Reform Act, directs the Commission to use its authority to facilitate the establishment of linked or coordinated facilities for clearance and settlement of transactions in securities, securities options, contracts of sale for future delivery and options thereon, and commodity options. [Market Reform Act of 1990, § 5, amending § 17A(a)(2) of the Securities Exchange Act of 1934, 15 U.S.C. 78q-1 (1990)].

⁵² The limits are described in Section III., Part D., Conditions.