

functions for CCOS. Sharing office space and staff among clearing agencies and contracting out certain clearing agency functions is not unusual.⁷⁶

The standards established for registration of a clearing agency that hires a facility manager to perform data or other processing functions requires the clearing agency to maintain appropriate procedures to insure the prompt and accurate clearance and settlement of securities transactions.⁷⁷ The clearing agency also should assure itself that the facilities manager complies with all of the appropriate safeguards set forth in the Standards Release. The Standards Release also requires any such clearing agency to assure itself that its facility manager will cooperate fully with clearing agency auditors, Commission examiners, independent public accountants, and any other appropriate regulatory agency to the same extent as a clearing agency which conducts its own processing functions.

The Commission's experience with facilities management arrangements is that the Commission can carry out its clearing agency oversight responsibilities through its jurisdiction over the clearing agencies. Facilities managers cannot, for example, unilaterally make systems changes that would alter the rules of the clearing agency or the rights and obligations of clearing agency participants without having those changes filed by the clearing agency with the Commission.⁷⁸ To the extent that the Commission needs access to a facilities manager's premises or personnel, the Commission expects and has found clearing agencies and their facilities managers to be cooperative with Commission staff.⁷⁹

Regarding commenters' concerns about the need for uniform federal oversight, in granting its application for

exemption the Commission is requiring CCOS to meet basically the same standards as those registered clearing agencies must meet, and believes that CCOS has set forth a plan to enable it to meet those standards.⁸⁰ CCOS recognizes that it must comply with the regulatory standards governing the operations of clearing agencies in a manner consistent with its operational structure and with the specific services it will offer. CCOS has represented that it intends to comply fully with all relevant regulatory requirements applicable to other clearing agencies.⁸¹

3. Fair Competition

Some commenters believe that the approval of CCOS's application will not promote fair competition among clearing agencies as contemplated by Section 17A of the Act because CCOS will have exclusive access to cross-margining with BOTCC with respect to government securities. The Commission recognizes that to promote competition among clearing agencies, the benefits of CCOS's operations (e.g., greater access to the government securities market by persons other than primary dealers, the development of improved systems capabilities and new services, and perhaps lower prices to participants) must not "impose any burden on competition not necessary or appropriate in furtherance of the purposes" of the federal securities laws.⁸²

Since approval of the first cross-margining program in 1988,⁸³ the Commission repeatedly has found that cross-margining programs are consistent with clearing agency responsibilities under Section 17A of the Act. As the Commission has previously noted, cross-margining programs, among other things, tend to enhance clearing member and systemic liquidity both in times of normal trading and in times of stress.⁸⁴ Under routine trading, clearing

members that participate in cross-margining programs have lower margin requirements which help clearing members manage their cash flows by increasing available cash to be used for other purposes. In times of market stress and high volatility, lower margin requirements could prove crucial in maintaining the liquidity of clearing members and thus could enhance liquidity in the market as a whole. By enhancing market liquidity, cross-margining arrangements remove impediments to and help perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.⁸⁵

Because CCOS and BOTCC have proposed a cross-margining plan between themselves, the Commission has encouraged CCOS, BOTCC, and GSCC to create and implement a cross-margin arrangement so that fair competition in the clearing of government securities will exist. The Commission believes that competition among clearing agencies should not be based on margin levels but should be based on technology, services, or product types offered by the competing clearing agencies. Therefore, the Commission views the implementation of a cross-margining arrangement among CCOS, BOTCC, and GSCC as vital to the satisfaction of the statutory goals of Section 17A of the Act. Towards this end, CCOS, BOTCC, and GSCC have entered into negotiations regarding cross-margining and linkage agreements. However, because such an agreement has not yet been finalized, the Commission believes it is appropriate to allow CCOS to begin operations with certain limits in place prior to the implementation of cross-margining and linkage agreements.⁸⁶

D. Conditions

This Order exempts CCOS from registration as a clearing agency under Section 17A of the Act subject to certain conditions which the Commission believes are appropriate for an entity operating under an exemptive framework. As explained in detail below, these conditions include:

⁸⁵ Shortly after the 1987 market break, then Treasury Secretary Nicholas F. Brady referred to the clearance and settlement system as the weakest link in the nation's financial system and noted that improvements to the clearance and settlement system, such as those provided by cross-margining arrangements, would "help ensure that a securities market failure does not become a credit market failure." *The Market Reform Act of 1989: Joint Hearings on S. 648 before the Subcomm. on Securities and the Senate Comm. on Banking, Housing and Urban Affairs*, 101st Cong., 1st Sess. 225 (Oct. 26, 1989) (statement of Nicholas F. Brady, Secretary of the Treasury).

⁸⁶ *Supra* note 45.

⁷⁶ In 1988, GSCC began operations with a facilities management agreement with NSCC whereby NSCC provides GSCC with the necessary administrative and technical services. GSCC continues to share staff and office space with its affiliates, NSCC and International Securities Clearing Corporation. In fact, NSCC and GSCC do not operate their own clearance and settlement systems; instead, they contract that function out to the Securities Industry Automation Corporation.

⁷⁷ *Standards Release*, *supra* note 53.

⁷⁸ As discussed below, because CCOS will operate under an exemption from registration as a clearing agency, it will not file rule changes under the Section 19(b) process. Rather, CCOS will have to file amendments to its Form CA-1 exemption application and request modification of its exemptive order to change its rules or procedures.

⁷⁹ The Commission generally has not required that facilities management contracts specifically grant the Commission unlimited access to a facilities manager's premises. If in the future the Commission perceives a need for express authority for such access, it will revisit the issue at that time.

⁸⁰ *Id.*

⁸¹ Letters from John C. Hiatt, President and Chief Executive Officer, BOTCC, to Jonathan G. Katz, Secretary, Commission (May 23 and June 22, 1994).

⁸² 15 U.S.C. 78q-1(b)(3)(i) (1988).

⁸³ Securities Exchange Act Release No. 26153 (October 3, 1988), 53 FR 39567 (approving nonproprietary cross-margining program between OCC and ICC).

⁸⁴ E.g., Securities Exchange Act Release Nos. 30413 (February 26, 1992), 57 FR 7830 (order approving OCC/Kansas City Board of Trade Clearing Corporation cross-margining program for proprietary positions); 29991 (November 26, 1991), 56 FR 61458 (order approving expansion of OCC/CME cross-margining program to include positions held for market professionals); 29888 (October 31, 1991), 56 FR 56680 (order approving OCC/BOTCC cross-margining program for proprietary positions); 27296 (September 26, 1989), 54 FR 41195 (order approving OCC/CME cross-margining program for proprietary positions).