

File No. SR-EMCC-2003-02

Securities and Exchange Commission
Washington, D.C. 20549

Form 19b-4

Proposed Rule Change

By

EMERGING MARKETS CLEARING CORPORATION

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change.

(a) The text of the proposed rule change consists of revisions to Emerging Markets Clearing Corporation's ("EMCC" or the "Corporation") to modify the clearing fund deposit requirement for certain EMCC members and is attached hereto as Exhibit A.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization.

(a) The proposed rule change has been approved by the Board of Directors of EMCC.

(b) Contact regarding questions and comments:

Karen L. Saperstein (212) 855-3203.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

(a) One of the purposes of the proposed filing is to modify the clearing fund deposit requirement for certain EMCC members. The proposed change would establish a fixed amount (\$50 Million) to be deposited by members who are Inter-Dealer Brokers or whose only business with EMCC is to clear for Inter-Dealer brokers. EMCC would continue to calculate the clearing fund requirements for each of these members. To the extent that the calculated amount exceeds the fixed amount for any day, the difference between the calculated amount and the fixed amount would be required to be paid by the other EMCC members pro-rata based on their average clearing fund requirements over the previous 30

calendar day period. The calculated amount, however, would continue to be used by the Corporation for the purposes of determining pro-rata loss obligations of any Member whose deposit is fixed at \$50 million and the difference amounts paid by other members would not be included in determining their pro-rata loss obligations.

The function of an IDB is to bring together principals in transactions on a matched anonymous basis while taking no principal risk themselves. If every dealer who interacted with an IDB were a member of EMCC, the IDB (or its clearing firm) would have to deposit only a minimal clearing fund amount. To the extent that one side of an IDB trade is not an EMCC member, the clearing fund requirements for the IDB (or its clearing firm) are based only on one side of the matched transaction. This one sided calculation could (and does) create a clearing fund obligation of a significant financial amount for the IDB (or its clearing firm). EMCC believes it is appropriate, given the role of IDBs to the functioning of the market place (i.e. to provide liquidity), to establish a fixed clearing fund requirement for such firms or their clearing firm and have the difference between the fixed amount and the calculated amount deposited by the other EMCC members. EMCC has concerns that if this modified requirement is not established, the IDB's will no longer submit their transactions to EMCC and thus the dealer market will lose the benefits of the risk management process currently provided by EMCC.

While EMCC has determined that it is appropriate to set a fixed clearing fund amount for such Members, it does not want this fixed amount to alter the status quo among members in the event that a pro-rata charge must be imposed pursuant to Section 11(c) of Rule 4. Consequently, the rules will provide that the calculated amount and not the fixed amount will be

used in determining the pro-rata liability of any affected Member. Further, any amount required to be paid by other members, where the calculated amount is greater than the \$50 million, will similarly not be taken into account when determining their pro-rata charges.

A second purpose of the filing is to modify the time when EMCC novates transactions and change the clearing fund formula to eliminate the "look back" feature. Currently EMCC novates transactions at different times depending on whether the trade is received and compared on trade date or thereafter. Since under the current rules EMCC would (unless it ceased to act for a member,) novate transactions received on trade date before EMCC had the opportunity to collect additional margin, the clearing fund required of members was always the greater of the calculated requirement or the highest requirement over the previous two months. It was hoped that by "looking back" EMCC would have sufficient clearing fund deposits so long as the member's current trades were similar to the trading which occurred over the prior two months. While this methodology provided EMCC with adequate collateral in most cases EMCC could never be certain it would always be fully protected. To remedy this, EMCC has determined to require members to submit trades earlier on trade date, calculate margin based on these trades and, if a deficit exists, collect the deficit on trade date. The rules will be changed to provide that novation of trades will not occur until the margin requirements are received (to the extent required) from both sides to the trade. This will apply to trades included in the afternoon calculation as well as trades covered by the morning calculation. As before, EMCC will do an afternoon and morning clearing fund calculation, only now, payments will be due after each calculation. Since EMCC will now be timely collecting margin to cover the exposure it will no longer need to collect the highest margin calculation

over the prior two months and thus the "look back" feature of the requirement will be eliminated.

It is expected that by removing the "look back" feature, members' requirements will decrease. This decrease will help offset any additional requirements any member may be required to make under Addendum I. Since we will be collecting funds in the afternoon there can no longer be an overnight exposure cap. Accordingly, all references to calculations based on this are also being deleted.

(b) The proposed rule change is consistent with the requirements of the Securities Exchange Act of 1934, as amended (the "Act"), and the rules and regulations thereunder, since it will permit the equitable allocation of charges among participants.

4. Self-Regulatory Organization's Statement on Burden on Competition.

EMCC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others.

No written comments relating to the proposed rule change have been solicited or received.

6. Extension of Time Period for Commission Action.

EMCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Act for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2).

(a) Not applicable.

(b) Not applicable.

(c) Not applicable.

(d) EMCC requests accelerated effectiveness so that it may give the benefit of this change to existing members as soon as possible.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission.

The proposed rule change is not based on a rule either of another self-regulatory organization or of the Commission.

EXHIBIT A

Underlined, boldface text indicates additions.
~~[Strikethrough and Bracketed]~~ text indicates deletions.

* * *

DEFINITIONS AND DESCRIPTIONS

Rule 1. Unless the context requires otherwise, the terms defined in this Rule shall, for all purposes of these Rules, have the meanings herein specified.

* *

FedWire

The term "FedWire" means the Federal Reserve Wire Transfer System for securities movements or for funds-only movements, as the context requires.

~~[Final]~~ Margin Report

The term "~~[Final]~~ Margin Report" shall have the meaning set forth in Rule 4, Section 5 (B)(ii).

Final Net Settlement Obligation

The term "Final Net Settlement Obligation" means for any Insolvent Member, the sum (whether positive or negative) of all Net Settlement Obligations and unpaid Transaction Adjustment Payments for such Insolvent Member in respect of all Covered EMCC Eligible Instruments.

* *

Old Trades

The term "Old Trades" shall mean, with respect to a defaulting Member, those unsettled guaranteed trades which have been reported on an Accepted Trade Report, and not deleted by a contra party to such a trade or the Corporation in accordance with these Rules~~[-other than the Accepted Trade Report containing trades which resulted in the calculation of an Overnight Exposure Cap Violation].~~

~~[Overnight Exposure Cap~~

~~The term "Overnight Exposure Cap" shall mean the lesser of (A) the amount by which a Member's preliminary Required Fund Deposit may exceed its Clearing Fund deposit without penalty, which amount shall be based upon the percentage of a Member's capital published by the corporation from time to time, or (B) U.S. \$20 million.]~~

~~[Overnight Exposure Cap Violation~~

~~An "Overnight Exposure Cap Violation" occurs when a Member's preliminary Required Fund Deposit exceeds its Clearing Fund deposit in an amount greater than such Member's Overnight Exposure Cap.]~~

* *

~~[Preliminary Margin Report~~

~~The term "Preliminary Margin Report" shall have the meaning set forth in Rule 4, Section 5 (B)(i).]~~

* *

Required Fund Deposit Deadline

The term "Required Fund Deposit Deadline" means, as regards a particular Business Day, the later of ~~[11:30 AM NY Time of such day]~~ **such times as specified by the Corporation from time to time** or 1 hour after the Corporation has issued a notice pursuant to Rule 4 of the need to make an additional deposit to the Clearing Fund.

* * *

CLEARING FUND, MARGIN AND LOSS ALLOCATION

Rule 4. SEC. 1. General

Each Member shall make, and maintain so long as such Member is a Member, a deposit to the Clearing Fund. Deposits shall be held by the Corporation or its designated agents, to be applied as provided in this Rule. Except as otherwise provided in Section 3 of this Rule, the amount of the Member's required deposit (the "Required Fund Deposit") shall be equal to the sum of (A) the Margin Amount plus (B) the additional deposits required pursuant to Section 4 of this Rule; provided, however, that the Required Fund Deposit shall not be less than the amount specified in Section 2 of this Rule.

* *

SEC. 2. Minimum Required Fund Deposit

The minimum Required Fund Deposit for each Member shall be U.S. \$3,000,000. Subject to Section 8 of this Rule regarding the use of Letters of Credit, at least 5% of the Required Fund Deposit for each Member, up to a maximum of \$1,000,000 shall be in cash.

SEC. 3. Initial Required Fund Deposit

The Initial Required Fund Deposit of each Member, shall be set by the Corporation using the formulas set forth in this Rule based upon the expected nature and level of such Member's activity, and the Member's Required Fund Deposit shall not be less than the Initial Required Fund Deposit until the first Business Day of the second calendar month after the month in which the Member initiates use of the Corporation's services.

SEC. 4. Additional Deposits

The Corporation may require a Member to deposit additional amounts to the Clearing Fund pursuant to Rule 13, such additional amounts to be in such form and deposited at such time as specified by the Corporation. Such amounts shall be part of the Member's Required Fund Deposit.

SEC. 5. (A) Margin Amount

A Member's Margin Amount shall equal the **sum of (i) Daily Margin Amount and (ii) the Excess Amount required to be paid under Addendum I** ~~[greater of such Member's (i) Minimum Margin Amount and (ii) Daily Margin Amount. The "Minimum Margin Amount" shall equal the largest single final Daily Margin Amount computed for a Member for the month during which such Margin Amount calculation is being performed and the previous calendar month⁴. The "Daily Margin Amount" for a Member shall be equal to:~~

$$((\text{Mark to Market Amount}) + (\text{Volatility Amount})) \times (\text{Event Factor}) \times (\text{Global Holiday Factor})$$

- I. The **Mark to Market Amount** shall equal, the sum of the following amounts calculated with respect to each (A) pending Receive and Deliver Obligation including (i) those for which the Scheduled Settlement Date is the day on which such calculation is being performed and for which the Corporation has not received notice that such Obligation has settled from a Qualified Securities Depository and, (ii) those for which the Scheduled Settlement Date is after the day on which such calculation is being performed, and (B) Fail Receive or Fail Deliver Obligation for which the Corporation has not received notice that such Obligation has settled from a Qualified Securities Depository:

$$\text{Value of Position}^2 - \text{Contract Value}^3$$

¹ ~~[Provided, however, that the Minimum Margin Amount applicable to an Inter Dealer Broker Member may be adjusted by the Corporation as follows: Where an Inter Dealer Broker Member has deposited additional margin on any Business Day due to a contra party's failure to timely submit one or more trades, then once such trades have been compared or settled, the Corporation may, in its discretion, reduce the Inter Dealer Broker Member's Minimum Margin Amount to an amount which excludes such additional margin.]~~

² For purposes of the Mark to Market Amount calculation relating to any particular ISIN, "Value of Position" equals the product of the quantity of the net EMCC Eligible Instrument position in such ISIN and the Current Market Price of such ISIN, with Deliver Obligations having a negative value and Receive Obligations having a positive value.

³ ~~[For the purposes of calculating an Inter Dealer Broker's Margin Amount in connection with its preliminary Required Fund Deposit, uncomparated EMCC Eligible Instrument transaction data received by the Corporation which (i) has been submitted by the Inter Dealer Broker, (ii) names a Member as a contra party, and (iii) involve transactions for which the trade date is indicated as being the date on which this calculation is being performed, shall be deemed to be "comparated"; furthermore, (a) to the extent such transactions are sell trades, they shall be deemed to be "Deliver Obligations", (b) to the extent such transactions are buy trades, they shall be deemed to be "Receive~~

If the Mark to Market Amount is a negative number, such Member's Mark to Market Amount shall equal the absolute value of such number. If the Mark to Market Amount is a positive number, the Mark to Market Amount with respect to such Member shall equal zero.

- II. The **Volatility Amount** shall equal the following, which, (A) with respect to the preliminary Required Fund Deposit, shall be calculated with respect to each (i) pending Receive and Deliver Obligation including (x) those for which the Scheduled Settlement Date is the day on which such calculation is being performed and for which the Corporation has not received notice from a Qualified Securities Depository that such Obligation has settled, (y) those for which the Scheduled Settlement Date is after the day on which such calculation is being performed, and (ii) Fail Receive or Fail Deliver Obligation for which the Corporation has not received notice that such Obligation has settled from a Qualified Securities Depository, and (B) with respect to the final Required Fund Deposit, shall be calculated with respect to each (i) Receive and Deliver Obligation for which the Scheduled Settlement Date is on or after the day on which such calculation is being performed (regardless of whether or not such transaction has settled), and (ii) pending Fail Receive or Fail Deliver Obligation (determined as of the day prior to the day on which such calculation is being performed, regardless of whether such Fail Receive or Deliver Obligation has since settled):

(1) The sum of the absolute value of: Value of Position⁴ X Illiquid Percentage, with respect to each net position in an EMCC Eligible Instruments having a Liquidity Category of L4.

PLUS

(2) The sum of the larger of (A) or (B), calculated with respect to L1, L2 and L3 EMCC Eligible Instruments in each country in which the Member has a net position in an EMCC Eligible Instrument, of:

~~Obligations" and (c) the settlement day as indicated in such data shall be deemed to be the "Scheduled Settlement Date." To the extent any transaction meets the requirements of clauses (i) and (ii) of the preceding sentence due to a systems failure of a contra-party that results in the contra-party being unable to submit any transactions to the relevant Locked-In Trade Source, clauses (a) through (c) of the preceding sentence shall apply to such transactions.]~~

⁴For purposes of the Volatility Amount calculation relating to any particular ISIN, "Value of Position" equals the sum of the Contract Values of Receive and Deliver Obligations and Fail Receive and Fail Deliver Obligations relating to such ISIN.

(A) The absolute value of the sum of the following:

(i) For each net Long Position in an L1 or L2 EMCC Eligible Instrument:

Value of Position X 2 SD

PLUS

(ii) For each net Long Position in an L3 EMCC Eligible Instrument:

Value of Position X 4 SD

PLUS

(iii) For each net Short Position in an L1 or L2 EMCC Eligible Instrument:

Value of Position X 2 SD X smallest Correlation Coefficient⁵
between any EMCC Eligible Instrument in which such Member
has a net Short Position and any EMCC Eligible Instrument in
which such Member has a net Long Position

PLUS

(iv) For each net Short Position in an L3 EMCC Eligible Instrument:

Value of Position X 1 SD X smallest Correlation Coefficient
between any EMCC Eligible Instrument in which such Member
has a net Short Position and any EMCC Eligible Instrument in
which such Member has a net Long Position

OR

(B) The absolute value of the sum of the following:

(i) For each net Short Position in an L1 or L2 EMCC Eligible Instrument:

⁵The Corporation shall calculate, based on price data for a period of one year furnished by a Qualified Financial Information Provider, a pairwise correlation coefficient (the "Correlation Coefficient"), to the extent available, for each pair of EMCC Eligible Instruments, other than Liquidity Category L4 Instruments, within the same country.

Value of Position X 2 SD

PLUS

(ii) For each net Short Position in an L3 EMCC Eligible Instrument:

Value of Position X 4 SD

PLUS

(iii) For each net Long Position in an L1 or L2 EMCC Eligible Instrument:

Value of Position X 2 SD X smallest Correlation Coefficient
between any EMCC Eligible Instrument in which such Member
has a net Long Position and any EMCC Eligible Instrument in
which such Member has a net Short Position

PLUS

(iv) For each Long Position in an L3 EMCC Eligible Instrument:

Value of Position X 1 SD X smallest Correlation Coefficient
between any EMCC Eligible Instrument in which such Member
has a net Long Position and any EMCC Eligible Instrument in
which such Member has a net Short Position.

The Corporation shall assign one of the following Liquidity Categories⁶ for each EMCC Eligible Instrument based upon the average bid/offer spread for each such EMCC Eligible Instrument:

Liquidity Category 1 ("L1"): having an average monthly bid/offer spread equal to or less than 3/8 of a point;

Liquidity Category 2 ("L2"): having an average monthly bid/offer spread equal to or less than 3/4 of a point;

Liquidity Category 3 ("L3"): having an average monthly bid/offer spread equal to

⁶The Corporation may assign a liquidity category ("Liquidity Category") to an EMCC Eligible Instrument based on a factor other than the average bid/offer spread, as it so determines from time to time in order to protect the interests of the Corporation and its Members.

or less than 2 points; and

Liquidity Category 4 ("L4"): (i) having an average monthly bid/offer spread greater than 2 points or (ii) those EMCC Eligible Instruments for which the Corporation has received reports of no trading activity (based on such criteria as the Corporation may determine from time to time) and for such time period as the Corporation may determine from time to time.

For purposes of the above calculations, the term "SD" shall refer to the higher of two standard deviation calculations relative to each EMCC Eligible Instrument, one over a time interval of 1 year and the other over a time interval of 3 months. In each case the Corporation shall calculate a standard deviation based on the following formula over each time interval:

$$\ln \left(\frac{P_{x+5}}{P_x} \right)$$

where P_x is the price of the EMCC Eligible Instrument on any day and P_{x+5} is the price of the EMCC Eligible Instrument 5 trading days later.

The number of SDs applied in each of the above calculations may be changed by the Corporation from time to time in order to protect the interests of the Corporation and its Members. Such changes may be made on an overall, Member-by-Member, EMCC Eligible Instrument-by-EMCC Eligible Instrument or position-by-position basis.

- III. The **Event Factor** shall equal 1.25 or such other factor as the Corporation may from time to time determine is appropriate for a particular Member or all Members, in order to protect the interests of the Corporation and its Members.
- IV. The **Global Holiday Factor** shall be a multiple, determined by the Corporation from time to time to be necessary to protect the interests of the Corporation and its Members, in the event that banks in the U.S. are closed on a day on which EMCC Eligible Instruments may be traded.

(B) Payment of Required Fund Deposit Amounts:

~~{(i)}~~ At such times s as determined by the Corporation, the Corporation shall make available to each Member a Report which indicates ~~[a preliminary]~~ the Required Fund Deposit and the amount, if any, which the Corporation may require to be paid to the Corporation (the "~~[Preliminary]~~ Margin Report"). {

~~_____ (ii) During the morning of each Business Day, the Corporation shall make available to each Member a Report stating the final Required Fund Deposit (the "Final Margin Report").~~ If the difference between the Required Fund Deposit and the Members actual Clearing Fund Deposit is less than U.S. \$100,000, the ~~[Final]~~ Margin Report shall indicate that the Member has no additional obligation to make a payment to the Corporation. If the difference between the Required Fund Deposit and the actual Clearing Fund Deposit is U.S. \$100,000 or greater, the ~~[Final]~~ Margin Report shall indicate the amount of such difference and the Member shall be required to pay the amount of such difference to the Corporation ~~[on such Business Day]~~ **by such times as required by the Corporation.**

(iii) A Member that has a payment obligation, pursuant to this Rule, shall cause such payment to be received by the account of the Corporation at a depository institution designated by the Corporation to receive such payment, in immediately available funds or, **with respect to payment obligations required to be paid prior to 3 PM New York City time,** in Eligible Treasury Securities (as provided in Section 8 of this Rule), by no later than ~~[the later of 11:30 a.m. New York City time]~~ **such times as specified by the Corporation from time to time** or one hour after ~~[the Final]~~ Margin Report listing such obligation is made available to the Member on such Business Day, unless the Member provides notice to the Corporation within such time period of its election to terminate its membership with the Corporation. Notwithstanding the foregoing, the Corporation, in its discretion, may require a Member to make any such payment in immediately available funds.

SEC. 6. Liability of a Member

Each Member shall pay, or reimburse the Corporation, for all losses, costs, expenses, and charges (including attorneys' fees) incurred by the Corporation as the result of any failure of such Member to fulfill its obligations to the Corporation pursuant to this Rule. ~~[In addition, the Corporation may fine a Member for an Overnight Exposure Cap Violation.]~~

If a Member fails to pay to the Corporation in a timely manner any portion of a Margin Amount as required pursuant to this Rule (hereinafter, the "Unpaid Balance"), the Corporation, in its sole discretion, may apply to payment of the Unpaid Balance all or a portion of any monies owing by the Corporation to such Member, and/or all or a portion of such Member's deposits to the Clearing Fund or other collateral of such Member held by the Corporation. If the Corporation satisfies all or a portion of the Unpaid Balance through use of the Corporation's own funds or funds borrowed from third parties, such Member shall be liable, in addition to the amount of the Unpaid Balance, for the costs of any such borrowing, including, without limitation, interest from the Business Day on which the failure to pay the Unpaid Balance occurred until and including the Business Day on which the Member pays to the

Corporation the Unpaid Balance (or, if later, the Business Day on which funds borrowed from a third party are repaid by the Corporation to such party). The interest rate applicable to funds advanced by the Corporation pursuant to this Section shall be the Federal Funds Rate plus one percent.

If the Board, in its sole discretion, determines that a Member has, without good cause, failed to pay to the Corporation in a timely manner pursuant to this Rule a Margin Amount, it may impose a fine upon such Member. As used in this Section, "good cause" means a causal event or occurrence that the Board, in its sole discretion, determines was beyond the reasonable control of a Member; depending upon the specific circumstances, this may include an extended failure of FedWire or the inability to gain access to FedWire by a depository institution acting on behalf of either a Member or the Corporation.

SEC. 7. Surveillance Status

The Corporation may require a Member that has been placed on surveillance status by the Corporation, as provided for below, to make and maintain a deposit to the Clearing Fund over and above the amounts determined in accordance with Sections 3, 4 and 5 above of this Rule, which additional deposit shall be part of the Member's Required Fund Deposit.

A Member shall be placed on surveillance status by the Corporation if one or more of the following factors is present:

- (a) member fails to meet any financial conditions set forth in Rule 2;
- (b) any element of its capital position falls below that which would be required in Rule 2 if it were applying to become a Member;
- (c) it temporarily experiences either an inability to meet its money settlement obligations to the Corporation in a timely fashion or another significant cash flow problem;
- (d) it temporarily experiences an inability to meet its securities settlement obligations in a timely fashion;
- (e) there occurs a significant reorganization or change in control or management of the Member that, in the judgment of the Board, is likely to impair the Member's ability to meet its money settlement obligations or securities settlement obligations to the Corporation; or
- (f) it has been placed on a special surveillance status by another Self-Regulatory Organization, or for Non-U.S. Registered Broker-Dealers and Non-U.S. Banks,

comparable regulatory organization.

In addition, a Member may be placed on surveillance status by the Corporation if one or more of the following factors is present:

(g) it temporarily experiences a significant operational problem;

(h) any position of the Member is significantly disproportionate to its usual activity, in light of current industry conditions;

(i) the Corporation receives (i) a notification from a Member's Designated Examining Authority or Appropriate Regulatory Agency, or (ii) for Non-U.S. Registered Broker-Dealers and Non-U.S. Banks, notification from a comparable regulatory organization of a pending administrative action regarding, or investigation of, the Member that could call into question the Member's ability to meet its obligations to the Corporation; or

(j) it experiences any condition that could materially affect its financial or operational capability so as to potentially increase the Corporation's exposure to loss or liability.

SEC. 8. Form of Deposit

Subject to the provisions of Section 2 of this Rule governing the computation of deposits, and the limitations of this Section 8, a Member's deposits to the Clearing Fund may be in the form of:

(a) cash, or

(b) an open account indebtedness fully secured by Eligible Treasury Securities and/or Eligible Letters of Credit.

Cash deposits to the Clearing Fund shall be made in immediately available funds.

Eligible Treasury Securities that are used to secure an open account indebtedness must be pledged to the Corporation on such terms and conditions as it may require, and be delivered to either the Corporation or to a depository institution approved by the Corporation that shall hold the securities on the Corporation's behalf. The valuation of such Eligible Treasury Securities shall be at 95% of current market value, which shall be determined by the Corporation periodically.

Upon appropriate notice to the Corporation, pursuant to procedures that the

Corporation establishes for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Member may substitute and/or withdraw securities from pledge and deposit, provided that the Member has, effective immediately prior to the withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit a substitution or withdrawal on a given Business Day later than one hour or less prior to the close of the securities FedWire on such Business Day. Any interest on securities deposited by a Member to secure a Clearing Fund open account indebtedness that is received by the Corporation shall be credited to the Member's cash deposits to the Clearing Fund, except in the event of a default by a Member in payment of any of its obligations to the Corporation, in which case the Corporation may first liquidate such securities and apply all or a portion thereof, including any interest thereon, as provided in Section 10 of this Rule.

With regard to Eligible Letters of Credit that secure a Clearing Fund open account indebtedness issued on behalf of a Member pursuant to this Rule:

- (a) such letters of credit must be delivered to either the Corporation or to a depository institution designated by the Corporation to hold such letters on the Corporation's behalf;
- (b) the Corporation shall have the right, to refuse to approve, or to revoke its approval of, any institution as an Approved Letter of Credit Issuer, at any time when, in the judgment of the Corporation, such action, in light of its statutory responsibility, is necessary or appropriate;
- (c) the open account indebtedness secured by letters of credit may constitute no more than 70 percent of a Member's Required Fund Deposit; provided, however, that ten percent of the Member's Required Fund Deposit up to a maximum of U.S. \$1,000,000 is required to be in cash;
- (d) notwithstanding designation of a depository institution as an Approved Letter of Credit Issuer, the Corporation shall not accept a letter of credit from a Member that is issued by such Member or by an Affiliate of such Member;
- (e) the Corporation shall not accept a letter of credit issued by any institution if, as a result of such acceptance, more than 20 percent of the total Clearing Fund consists of letters of credit issued by that institution;
- (f) the Corporation, in its discretion, may not accept a letter of credit that it determines is not readily pledgeable by it in order to obtain credit in an amount as determined by the Corporation from time to time.

(g) letters of credit shall be valued at 95 percent of their stated value;

(h) letters of credit deposited in the Clearing Fund must expire at noon, New York time, on either the April 1 or October 1 immediately following the issuance thereof (whichever comes first) provided, however, that any letter of credit deposited during the months of March or September must expire on the following October 1 or April 1, respectively;

(i) a Member must obtain and deposit with the Corporation, not less than 10 calendar days prior to the expiration of any letter of credit securing an open account indebtedness to the Clearing Fund, either an amendment of such letter of credit extending its expiration date by six months but to no more than two years from the date of original issuance, a new letter of credit or such Member substitutes cash and/or Eligible Treasury Securities sufficient to maintain its Required Fund Deposit; and

(j) with respect to any letter of credit issued pursuant to this Rule, any amount drawn on such letter of credit by the Corporation shall be deposited into, and constitute an additional cash deposit to, the Clearing Fund and shall reduce the Member's open account indebtedness by a corresponding amount.

Upon appropriate notice to the Corporation, pursuant to procedures that the Corporation shall establish for such purpose, and subject to reasonable time constraints imposed by the Corporation based on its operational and administrative capacities, a Member may substitute and/or withdraw letters of credit from pledge and deposit, provided that the Member has, effective immediately prior to such substitution or withdrawal, taken appropriate action to maintain its Required Fund Deposit. Notwithstanding the above sentence, the Corporation may decline to permit on a given Business Day a substitution or withdrawal later than one hour or less prior to the close of the securities FedWire on such Business Day.

SEC. 9. Lien

As security for any and all obligations and liabilities of a Member to the Corporation, each such Member grants to the Corporation a first priority perfected security interest in all assets and property placed by a Member in the possession of the Corporation (or its agents acting on its behalf), including all securities and cash on deposit with the Corporation or its agents pursuant to this Rule. The Corporation shall be entitled to its rights as a pledgee under common law and as a secured party under Articles 8 and 9 of the New York Uniform Commercial Code with respect to such collateral.

SEC. 10. Use of Deposits and Payments

The use of the Clearing Fund deposits shall be limited to:

(1) satisfaction of losses or liabilities of the Corporation arising from the failure of a Member to satisfy an obligation to the Corporation; and

(2) providing the Corporation with a source of cash or collateral to meet the following temporary financing needs:

(A) financing the temporary receipt by the Corporation, pursuant to the Rules, of EMCC Eligible Instruments that cannot be redelivered to a Member due to the inability of the Member to pay for them, provided that such inability constitutes the failure by the Member to meet its securities settlement obligations to the Corporation (including, but not limited to, situations in which the Corporation has ceased to act for the Member);

(B) financing on an intra-day basis only, the receipt pursuant to the Rules of EMCC Eligible Instruments that will be redelivered to another Member at a Qualified Securities Depository, provided that no more than ten percent (10%) of the total Clearing Fund may be used for this purpose, and provided further that Eligible Letters of Credit shall be used for this purpose to the maximum extent practicable prior to the use of any Eligible Treasury Securities for this purpose and that cash shall not be used for this purpose;⁷ and

(C) temporarily financing the amount of any loss or liability allocated to a Member pursuant Section 11 of this Rule prior to such time as the Member's Clearing Fund is actually applied to such loss pursuant to this Section or the Member makes payment to the Corporation in the amount of the loss so allocated;

provided, however, that the financing set forth in clauses (A), (B) and (C) shall be at the discretion of the Corporation.

If the Corporation pledges, hypothecates, encumbers, borrows, or applies any part of the Clearing Fund deposits, or other collateral that it has received from Members to satisfy, in whole or in part, any single liability, obligation, or liquidity requirement, for more than 60 days, the Corporation, at the Close of Business on the 74th day (or on the first Business Day thereafter), shall consider the amount used to meet such financing as an actual loss to the

⁷This subparagraph (B) shall automatically expire, without any further action of the Corporation, on the date on which all Members are Netting Members.

Clearing Fund and immediately allocate such loss in accordance with Section 11 of this Rule.

If a loss or liability incurred by the Corporation is allocated to a Member pursuant to Section 11 of this Rule, the Corporation may apply the portion of the Member's deposit to the Clearing Fund necessary to satisfy such allocation. In this regard, the Corporation may apply any cash, draw against any letters of credit, and liquidate any securities deposited by the Member.

Any cash paid to the Corporation pursuant to this Rule may be partially or wholly invested in securities issued or guaranteed as to principal and interest by the United States Government or agencies or instrumentalities of the United States, repurchase agreements relating to the above securities, or otherwise pursuant to the investment policy adopted by the Corporation. To the extent not so invested, such cash funds shall be deposited by the Corporation in its name in a depository institution selected by the Corporation. Any investment income from cash deposits in the Clearing Fund shall accrue to the Corporation, until and unless the Board permits payment of such investment income to Members. Any investment income from cash deposits that is payable to Members pursuant to this Section, less an amount to compensate the Corporation for its handling costs, shall be paid to Members no less frequently than quarterly.

SEC. 11. Allocation of Loss or Liability Incurred by the Corporation

(a) Any loss or liability incurred by the Corporation as the result of the failure of a Member to fulfill its obligations to the Corporation shall be satisfied by application of any Clearing Fund deposits (including any other collateral held by the Corporation securing such Member's obligations to the Corporation) in accordance with the procedures set forth in this Section 11.

(b) If the aggregate of such losses do not exceed the defaulting Member's Clearing Fund deposit (including any other collateral held by the Corporation securing such Member's obligations to the Corporation), such losses shall be satisfied by application of any Clearing Fund deposits, and any other collateral held by the Corporation securing such Member's obligations to the Corporation.

(c) If the aggregate of such losses exceed the failing Member's Clearing Fund deposit, and any other collateral held by the Corporation securing such Member's obligations to the Corporation, then such losses shall be allocated as set forth below; provided, however, the Corporation may determine to apply the existing retained earnings of the Corporation or such lesser part thereof to such loss; provided, further, that in the event the Corporation determines to apply retained earnings, at least 25 percent of the existing retained earnings of the Corporation, or such greater percentage thereof as the Board determines to be

appropriate, shall first be applied to the loss.

I. If the defaulting Member was not an Inter Dealer Broker:

(i) The Corporation shall determine, with respect to such aggregate loss, the portion thereof attributable to Direct Transactions and the portion thereof attributable to Inter Dealer Broker Transactions.

(ii) The Clearing Fund deposit and any other collateral held by the Corporation securing such defaulting Member's obligations to the Corporation shall be applied to losses attributable to Direct and Inter Dealer Broker Transactions in the proportion that (A) the aggregate amount of losses attributable to Direct Transactions and (B) the aggregate amount of losses attributable to Inter Dealer Broker Transactions each bear to the total aggregate loss (such losses shall be collectively referred to hereinafter as the "Total Aggregate Loss" ~~]; provided, however, that if there was an Overnight Exposure Cap Violation with respect to such defaulting Member, then the "Total Aggregate Loss" shall only include losses attributable to Old Trades~~).

(iii) If ~~there was no Overnight Exposure Cap Violation or, if~~ there was insufficient Clearing Fund and other collateral to cover loss attributable to Old Trades then, after the Clearing Fund deposit and any other collateral held by the Corporation securing such defaulting Member's obligations to the Corporation has been applied to the Total Aggregate Loss pursuant to (ii) above, any remaining loss shall be allocated as set forth in (A) and (B) below.

(A) The portion of such remaining loss attributable to Inter Dealer Broker Transactions shall be allocated pro rata among all Members based upon each Member's average ~~final~~ Daily Margin Amount calculated with respect to the 30 calendar days prior to the date on which the defaulting Member defaulted; and

(B) The portion of such remaining loss attributable to Direct Transactions shall be allocated to the original contra-parties to the Direct Transaction in an amount equal to the product of (A) the aggregate amount of the portion of such remaining loss attributable to Direct Transactions and (B) a fraction, the numerator of which shall equal the portion of the Total Aggregate Loss attributable to such contra-party's Direct Transactions with the defaulting Member and the denominator of which shall equal the portion of the Total Aggregate Loss attributable to Direct Transactions.

~~[(iv) If there was an Over Night Exposure Cap Violation with respect to such defaulting Member, then after the Clearing Fund Deposit and any other collateral held by the Corporation securing such defaulting Member's obligations to the Corporation has been applied to losses attributable to Old Trades, any remaining Clearing Fund deposits and other collateral shall be applied to losses attributable to New Trades⁸. Any loss attributable to New Trades⁹ remaining after application of the Clearing Fund Deposit and other collateral shall be allocated as follows:~~

~~(A) Remaining losses up to an amount less than or equal to the defaulting Member's Overnight Exposure Cap (the "Under the Cap Loss"), shall be allocated:~~

~~in the case of the portion of the Under the Cap Loss attributable to Direct Transactions, to each original contra-party to such Direct Transactions to the extent of the amount of the loss attributable to such Direct Transactions; and~~

~~in the case of losses attributable to Inter Dealer Broker Transactions, allocated pro rata among all Members based upon each Member's average final Daily Margin Amount calculated with respect to the 30 calendar days prior to the date on which the defaulting Member defaulted.~~

~~(B) Losses other than those covered in (A) above, shall be, (X) in the case of loss attributable to Direct Transactions, allocated to each original contra-party to such Direct Transactions to the extent of the amount of the loss attributable to such Direct Transaction¹⁰; and (Y) in the case of losses due to Inter Dealer Broker Transactions, allocated first to each Inter Dealer Broker who was the contra party to such transactions to the extent of the~~

⁸ ~~[These losses shall be determined EMCC Eligible Instrument-by-EMCC Eligible Instrument and the defaulting Member's Clearing Fund deposit shall be applied to losses from smallest to largest until the aggregate of such losses equals the Member's Overnight Exposure Cap.]~~

⁹ ~~[Calculations pursuant to this paragraph shall be performed on an EMCC Eligible Instrument-by-EMCC Eligible Instrument basis.]~~

¹⁰ ~~[Calculations pursuant to this subsection (X) shall be performed on an EMCC Eligible Instrument-by-EMCC Eligible Instrument basis.]~~

~~amount of the loss attributable to such Inter Dealer Broker Transactions up to a maximum allocation of \$3 million per Inter Dealer Broker. Losses in excess of \$3 million shall be allocated pro rata among Members who were on the opposite side of the market in the same EMCC Eligible Instrument, with the same settlement date, at approximately the same price in respect of the transactions with Inter Dealer Brokers who would have had allocated losses in excess of \$3 million.]~~

II. If the defaulting Member was an Inter Dealer Broker:

(i) ~~The Clearing Fund deposit and any other collateral held by the Corporation securing such defaulting Member's obligations to the Corporation shall be applied to all losses (such losses shall be collectively referred to hereinafter as the "Total Aggregate Loss" [; provided, however, that if there was an Overnight Exposure Cap Violation with respect to such defaulting Member, then the "Total Aggregate Loss" shall only include losses attributable to Old Trades]).~~

(ii) ~~If [there was no Overnight Exposure Cap Violation or, if] there was insufficient Clearing Fund and other collateral to cover loss attributable to Old Trades then, after the Clearing Fund deposit and any other collateral held by the Corporation securing such defaulting Member's obligations to the Corporation has been applied to the Total Aggregate Loss pursuant to (i) above, any remaining loss shall be allocated to the original contra-parties to the transactions giving rise to such loss in an amount equal to the product of (A) the aggregate amount of such remaining loss and (B) a fraction, the numerator of which shall equal the aggregate loss attributable to such contra-party's transactions with the defaulting Member and the denominator of which shall equal the Total Aggregate Loss.~~

~~[(iii) If there was an Over Night Exposure Cap Violation with respect to such defaulting Member, then after the Clearing Fund Deposit and any other collateral held by the Corporation securing such defaulting Member's obligations to the Corporation has been applied to losses attributable to Old Trades, any remaining Clearing Fund Deposit and other collateral shall be applied to losses attributable to New Trades.¹¹ Any loss attributable to New Trades remaining after application of the Clearing Fund deposit and other~~

¹¹ ~~[These losses shall be determined EMCC Eligible Instrument by EMCC Eligible Instrument and the defaulting Member's Clearing Fund deposit shall be applied to losses from smallest to largest until the aggregate of such losses equals the Member's Overnight Exposure Cap.]~~

~~collateral shall be allocated to each original contra-party to the transactions giving rise to such loss to the extent of the amount of the loss attributable to such transactions.]~~

(d) In addition to the foregoing, the Corporation may allocate any unintentional loss that is an extraordinary item under Generally Accepted Accounting Principles and is incident to the clearance and settlement business of the Corporation. Any such allocation shall be made (1) only if such loss adversely affects the cash or near-cash assets of the Corporation, (2) only after applying against such loss so much of the cash or near-cash assets of the Corporation as may, in the Corporation's judgement, prudently be applied without materially adversely affecting the ability of the Corporation to continue to function, and (3) on a pro rata basis in accordance with the formula set forth in (c)I.(iii)(A) of this Section.

SEC. 12. (a) If a Member, within 2 Business Days after receipt of notice of a charge pursuant to Section 11(c)I.(iii)(A) of this Rule, gives notice to the Corporation of its election to terminate its business with the Corporation, it shall nevertheless remain obligated for the charge; however, its obligation in respect of such charge shall be limited to the amount of its Required Fund Deposit, as fixed immediately prior to the time of the charge. In addition, such Member shall remain obligated for all other charges pursuant to Section 11 of this Rule. The Corporation may make additional charges attributable to the same loss or liability whether resulting from elections to terminate or because Members fail to fulfill their obligations under the Rules within 10 days of notice. In such instance the loss shall be allocated pro rata against all Members. Notwithstanding the foregoing limitations, the obligation of a Member who after receipt of notice of an additional charge elects to terminate its business with the Corporation, shall be limited in respect of any charge to the greater of (a) its Required Fund Deposit as fixed immediately prior to the time of the first charge, or (b) the amount of all prior charges, attributable to the same loss or liability in respect of which its right to limit such obligation, as provided above, has not been timely exercised. If the amount of the Member's actual deposit is less than its Required Fund Deposit and, accordingly, its actual deposit is insufficient to satisfy the charge as limited by this Section 12, it shall be obligated to make up the deficiency in its Required Fund Deposit notwithstanding the fact that it subsequently ceases to be a Member.

(b) If a Member does not elect to terminate its membership in the Corporation as provided for above, it shall make such deposits to the Clearing Fund, by the Close of Business on the Business Day on which the Member is obligated to make the payment provided for above, as are necessary to satisfy its Required Fund Deposit as of such Business Day. If the Member shall fail to take the action stated in (a) above, the Corporation shall cease to act generally with regard to such Member pursuant to Rule 15, and may take disciplinary action against the Member pursuant to Rule 35.

(c) A Member that elects to terminate its membership pursuant to this Section 12 in lieu of being liable to pay a pro rata charge amount above its Required Fund Deposit shall not be eligible to re-apply to become a Member unless, prior to submitting such application, it makes the payment to the Corporation provided for in Section 11 of this Rule together with interest on that amount at the average of the Federal Funds Rate plus one percent, calculated from the date on which the loss was incurred by the Corporation until the date of such payment. If a Member elects to terminate its membership, or if the Member fails to take any action, the Corporation will promptly make an additional assessment against the remaining Members, pro rata based on the size of the assessment made pursuant to Section 11 of this Rule to cover the amount not paid by the Member that made such election to terminate its membership.

(d) If a loss occurs that requires the Corporation to make a pro rata assessment, the Corporation shall promptly notify each Member, and the SEC, of the amount involved and the reasons therefor. Any disciplinary action that the Corporation takes, or the voluntary or involuntary cessation of membership by a Member subsequent to the occurrence of the loss shall not, except as otherwise provided in this Rule, affect the obligations of the Member to the Corporation under this Rule or the Procedures thereof, or affect any remedy to which the Corporation may be entitled. If a loss charged to Members is afterward recovered by the Corporation in whole or in part, the net amount of the recovery shall be credited or paid to those Persons, other than a Member or other Person who caused in whole or part such loss, including the Corporation, against whom the loss was charged, in proportion to the amounts paid by them, whether or not they are still Members.

(e) Any loss allocated to a Member pursuant to this Rule and not satisfied within 30 days of the notice of such assessment pursuant to paragraph (d) above, shall be allocated to all other Members based upon each Member's average final Daily Margin Amount calculated with respect to the 30 calendar days prior to the date on which the defaulting Member defaulted.

SEC. 13. Payment of Initial Deposit/Other Matters

The initial Required Fund Deposit of a Member shall be required to be deposited into the Clearing Fund by the Close of Business on the Business Day immediately prior to the Business Day on which each such Person becomes a Member.

Unless a Member gives written notice to the Corporation as required by Section 5, the Member's obligations to the Corporation pursuant to Section 5, and in all events, the Member's obligation to the Corporation pursuant to Section 4 shall, as of the deadline for complying with the margin deposit, be determined in accordance with the increased Required Fund Deposit, whether or not the increased Required Fund Deposit has been made, and

shall not be affected either by the Corporation ceasing to act for the Member or the Member terminating its membership in the Corporation, which occurs after the margin payment deadline.

SEC. 14. Return of Deposits and Payments

No more frequently than once a month, may a Member be entitled to request the return of Clearing Fund in excess of its Required Fund Deposit. Upon the request of the Member, the Corporation shall cause to be returned to each such Member such excess provided, however, that after the return of such excess such Member's Clearing Fund Deposit in form and amounts shall continue to meet the requirements of this Rule; provided, further, that, at the discretion of the Corporation, some or all of such excess may not be returned if the Member has an outstanding payment obligation to the Corporation, if the Corporation determines that the Member's anticipated settlement positions over the next 60 calendar days may reasonably be expected to be materially different than during the prior 60 calendar days, or if the Member is on surveillance status.

SEC. 15. Ceasing to be a Member

If a Member gives notice to the Corporation pursuant to Section 12 of this Rule of its election to terminate its membership, the Member's deposits to the Clearing Fund in the form of cash or securities shall be returned to it within 30 calendar days thereafter, and the Member's deposits to the Clearing Fund in the form of letters of credit shall be returned to it within 90 calendar days thereafter, in each case provided that all amounts owing to the Corporation by the Member have been paid to the Corporation prior to such return and the Member has no remaining open settlement position. Any obligation of a Member to the Corporation pursuant to this Rule that is unsatisfied at the time it ceases to be a Member shall not be affected by such cessation.

SEC. 16. Corporation's Authority to Pledge and Assign

In furtherance of the rights of the Corporation pursuant to these Rules, the Corporation shall have full power and authority to pledge, repledge, hypothecate, transfer, create a security interest in, or assign any and all securities, repurchase agreements, deposits or other instruments in which cash deposits of Members are invested, and any securities or letters of credit pledged or deposited by any Member to secure an open account indebtedness to the Clearing Fund or otherwise to collateralize its obligations to the Corporation, for the purpose of securing loans made to the Corporation or other obligations incurred by the Corporation, in each case incident to the clearance and settlement business of the Corporation. Such loans

or obligations shall be on terms and conditions deemed necessary or advisable by the Corporation in its sole discretion, and may be in amounts greater, and extend for periods of time longer, than the obligations, if any, of any Member to the Corporation for which such property was pledged to or deposited with the Corporation. Notwithstanding the above, the Corporation shall remain obligated to each Member to return, and to allow substitution for or withdrawal of, cash, securities, and letters of credit pledged or deposited by a Member as Clearing Fund deposit or to secure an open account indebtedness to the Clearing Fund, or otherwise to collateralize such Member's obligations to the Corporation, under the circumstances and within the time frames specified in these Rules.

* * *

NOVATION AND GUARANTY OF OBLIGATIONS AND RECEIVE, DELIVER AND SETTLEMENT OBLIGATIONS

Rule 7. SEC. 1. Novation and Guaranty of Obligations.

~~[All transactions reflected on an Accepted Trade Report are guaranteed as follows: (i) transactions in respect of which a Preliminary Margin Report has been issued are guaranteed at the later of (a) midnight New York time and (b) one-half hour after such Preliminary Margin Report has been issued, and (ii) transactions in respect of which a Final Margin Report has been issued, are guaranteed at the later of (a) 1:00 p.m. New York time and (b) 2 ½ hours after such Final Margin Report has been issued, unless, in either case, the Corporation notifies the Members or has made information available to Members, prior to the deadlines specified above that it has ceased to act for the original contra party as identified on the applicable Accepted Trade Report;]~~ **Each transaction reflected on Accepted Trade Report is guaranteed only when the Corporation has received the Member's Required Fund Deposit and the Required Fund Deposit from the contra-party indicated for such transaction on the Accepted Trade Report** provided, however, that if an EMCC Eligible Instrument Transaction (the "Original Transaction") is changed or deleted and reflected as such on an Accepted Trade Report (for the purposes of this Rule the "Modified Accepted Trade Report"), at the time the Modified Accepted Trade Report is made available to Members, the Corporation's guarantee (i) in respect of the Original Transaction shall be terminated, and (ii) in respect of a changed transaction, shall be effective with respect to the changed transaction as reflected in the Modified Accepted Trade Report in accordance with the time frames set forth above.

At the time ~~[an Accepted Trade Report is made available, all deliver, receive, and related payment obligations in respect of]~~ **a trade is guaranteed by the Corporation** ~~transaction[s] reflected on the Accepted Trade Report [are]~~ **is** terminated and replaced by **an**

obligation[s] to the Corporation and an obligation[s] from the Corporation. The novation of [~~these~~] such transaction[s] places the Corporation between the original counterparties to the transaction.

SEC. 2. Receive and Deliver Obligations

(a) With respect to all EMCC Eligible Instrument transactions which have been reported on the Accepted Trade Report, Deliver and Receive Obligations of a Member shall be fixed at the time the Accepted Trade Report is made available by the Corporation to the Member; provided, however, that if the originally accepted EMCC Eligible Instrument transaction is reported as changed on a subsequent Accepted Trade Report, the Receive or Deliver Obligation that was previously fixed is terminated and a new Receive and Deliver Obligation relating to such changed transaction shall be fixed at the time such subsequent Accepted Trade Report is made available by the Corporation to the Member; provided, further, that if the originally accepted EMCC Eligible Instrument transaction is reported as deleted or canceled on a subsequent Accepted Trade Report, the Receive or Deliver Obligation that was previously fixed shall be extinguished.

(b) On the Scheduled Settlement Date to which a Netting Detail Report relates, the previously established Receive and Deliver Obligations relating to the transactions underlying the Netting Trades reflected on such Netting Detail Report shall be extinguished and replaced with one or more new Receive and/or Deliver Obligations with respect to each net position reflected on such Netting Detail Report.

(c) On Settlement Day, each Deliver Obligation and Receive Obligation relating to a non-Netting Trade shall be settled at the Settlement Value reported on the Accepted Trade Report for such obligation and each Receive and Deliver Obligation relating to a Netting Trade shall be settled at the Settlement Value indicated on the Netting Detail Report.

SEC. 3. Transaction Adjustment Payment

The Corporation will instruct each Netting Member's Qualified Securities Depository to debit and/or credit, as the case may be, such Netting Member's account on the Scheduled Settlement Date with an amount equal to the difference between the net consideration for the transactions underlying each net position reflected on the Netting Detail Report for such Scheduled Settlement Date and the Settlement Value of the Receive and Deliver Obligations relating to such net positions. Such difference shall be known as the "Transaction Adjustment Payment."

SEC. 4. Delivery by the Corporation

With respect to novated Receive Obligations, the Corporation shall be obligated to deliver EMCC Eligible Instruments to ~~a~~**the** Member with a Receive Obligation as required by this Rule in order to settle such Receive Obligation; however, the Corporation shall not be obligated to attempt to make any such delivery or deliveries until the day on which the Corporation has received, as the result of a delivery to it from ~~a~~**the** Member with ~~a~~**the** Deliver Obligation, EMCC Eligible Instruments.

SEC. 5. Obligation to Make Settlement

Each Member shall be obligated to satisfy all of its EMCC Eligible Instruments settlement obligations pursuant to these Rules on each day on which a Qualified Securities Depository is open for business for each such EMCC Eligible Instrument, regardless of the days on which any third party, including a clearing bank or depository institution acting on behalf of such Member, is open for business.

* * *

COLLATERAL MANAGEMENT SERVICE

Rule 38. SEC. 1. The Corporation may participate in NSCC's Collateral Management Service which provides access to information (the "CMS Data") regarding clearing fund, margin and other similar requirements and deposits at the Corporation, other participating Registered Clearing Agencies and clearing organizations affiliated with or designated by contract markets trading specific futures products under the oversight of the Commodities Futures Trading Commission ("CFTC") (such Registered Clearing Agencies and CFTC recognized clearing organizations are referred to herein collectively as "Participating Clearing Entities"). Such service shall be known as the Collateral Management Service (the "CMS") and will be available in accordance with the provisions of this Rule.

SEC. 2. Each Member that desires access to the CMS shall complete and deliver to the Corporation appropriate documents for participation in the CMS in such form as the Corporation may from time to time require. A Member may request that EMCC exclude data relating to such participant from the CMS. Any such Member, however, shall complete and deliver to the Corporation appropriate documents to exclude data from the CMS in such form

as the Corporation shall require from time to time.

SEC. 3. The Corporation may, in its discretion, enter into agreements with one or more Participating Clearing Entities with respect to the collection and provision of CMS Data as well as other matters between the Corporation and Participating Clearing Entities relating to the CMS.

SEC. 4. The submission of CMS ~~Data~~**Data** to a Participating Clearing Entity shall not relinquish, extinguish or affect any regulatory or legal rights, remedies or obligations, if any, of the Corporation.

SEC. 5. The Corporation shall not be responsible for the completeness or accuracy of any CMS Data nor for any errors, omissions or delays which may occur relating to the CMS Data except as otherwise agreed to by the Corporation by specific agreement.

SEC. 6. The foregoing notwithstanding, this Rule is not intended to nor shall it be deemed to be in contravention or a limitation of the Corporation's obligation as a Self-Regulatory Organization to cooperate and share data with other regulatory and Self-Regulatory Organizations for regulatory purposes.

* * *

ADDENDUM C

STATEMENTS OF POLICY WITH RESPECT TO ADDITIONAL CLEARING FUND DEPOSITS

Section 4 of Rule 4 permits the Corporation to require a Member to deposit additional amounts to the Clearing Fund pursuant to Rule 13 and further provides that such amounts shall be part of the Member's Required Fund Deposit. The Corporation believes that the collection of any such additional amounts will depend on the particular facts and circumstances surrounding each case and that each Member should be in a position to help the Corporation make a full and complete determination of the facts and circumstances. Therefore, the Corporation is implementing the following policy:

- (1) At roughly the same times as the Corporation prepares ~~its Preliminary and Final~~the Margin Reports, the Corporation will compute a net overall position for each Member in EMCC Eligible Instruments of each country. The net overall position for each country (the "Net Country Position") will be equal to the sum of (a) the absolute value of the Member's Net Liquid Country Position, and (b) the absolute values of the Contract Values of each net position in each L4 EMCC Eligible Instrument of that country (the "Illiquid Country Position"). The "Net Liquid Country Position" shall equal the sum of the Contract Values (whether positive or negative) of all the Member's Long Positions and Short Positions in L1, L2 and L3 EMCC Eligible Instruments of that country.
 - (2) At the same time the Corporation will compute the net overall position in each geographical area (the "Net Geographical Area Position") which will be equal to (a) absolute value of the sum of the Net Liquid Country Positions (whether positive or negative) in each geographical area, plus (b) the Illiquid Country Positions in the geographical area. Initially, the geographical areas shall be: (a) Mexico, Central and South America, (b) Eastern Europe, (c) Asia and (d) Africa. Geographical areas shall also include such other areas as are announced from time to time by the Corporation in order to protect its Members.
 - (3) The Corporation will determine when:
 - (A) any Net Country Position exceeds
 - for Banks, 20% of net worth
 - for brokers or dealers, 50% of excess regulatory capital (either Excess Net Capital or Excess Financial Resources)
 - (B) any Net Geographical Area Position exceeds
 - for Banks, 30% of net worth
 - for brokers or dealers, 80% of excess regulatory capital (either Excess Net Capital or Excess Financial Resources)
- It is understood that these parameters are initial parameters and that as experience is gained, this Statement of Policy may be amended.
- (4) Members will be receiving telephone calls from EMCC Risk Management when these parameters are broken and must be able to answer the following questions (together with appropriate follow-up questions):

- What is the nature and magnitude of non-Brady exposure to the relevant countries/geographical areas?
 - How is total exposure hedged or offset? With what counter parties?
 - How can we confirm with counter parties? What is their domicile and financial status?
- (5) Members must provide primary and back-up contacts to EMCC Risk Management with respect to these questions.
- (6) If satisfactory answers cannot be provided to these questions (either because EMCC Risk Management cannot reach the relevant people, the appropriate information is not available or because the information is available but indicates unhedged, or not reliably hedged, exposures to a particular country or geographical area), then the Member may be subject to an increase in its Required Fund Deposit to cover the effect of an extreme market event in the relevant country or geographical area. It is important to note that the parameter breaks trigger questions rather than margin requirements. It is the Corporation's policy that if a Member has unhedged Net Country Positions or Net Geographical Area Positions that do not substantially exceed the parameters designated above and the Corporation can determine that the Member has no other significant exposure to the relevant countries or geographical areas, then the Member will not be subject to increases in its Required Fund Deposit sufficient to cover the effect of an extreme market event.
- (7) If there are any parameter breaks with respect to Net Country Positions or Net Geographical Area Position is computed concurrently with any Member's Preliminary Margin Report, and as a result the Member becomes subject to an increase in its Required Fund Deposit, such increase shall relate back to the Preliminary Margin Report and shall be deemed a part of the related preliminary Required Fund Deposit.

This Statement of Policy should not be understood to limit in any way the rights of the Corporation to require the deposit of additional amounts pursuant to Rule 4, Section 4 whenever the circumstances of Rule 13 may require or to limit in any way the obligation of Member's to make available to the Corporation any information relating to the Member or its businesses that the Corporation is otherwise entitled to under the Rules.

* * *

ADDENDUM G

~~INTER DEALER TEMPORARY MARGIN~~

~~AND LOSS ALLOCATION PROCEDURES~~¹ - RESERVED FOR FUTURE USE

~~A U.S. registered broker-dealer who is an Inter Dealer Broker or whose only business with EMCC in emerging market instruments consists of clearing for Inter-Dealer Brokers (hereinafter referred to as a “Special Member”), at the request of the Special Member, and in lieu of obligations to pay Margin Amounts pursuant to section 5 of Rule 4, will be subject to a constant base clearing fund requirement (“Base Requirement”) based on EMCC staff simulations of margin requirements.¹³ On each day that the calculation of the Daily Margin Amount for the Special Member results in an amount which exceeds the Base Requirement and this excess is greater than the lesser of 10% of the Special Member’s excess net capital or 15% of EMCC’s aggregate Clearing Fund, the amount of the excess (the “Additional Margin”) will be required to be paid as follows:~~

~~1) On each day the Special Member will produce a report, following a methodology approved by EMCC, that sets forth (a) the approximate percentage of leg-out transactions that are with dealers who have subscribed to, intend to subscribe to or purchased shares in EMCC (“Funding Non-Member Dealer Percentage”) and (b) the approximate percentage of leg-out transactions that are with others (“Firm Percentage”).~~

~~2) The Special Member will be required to pay that percentage of the Additional Margin equal to the Firm Percentage set forth in (a) above. The dealer Members of EMCC will be required to pay that percentage of the Funding Non-Member Dealer Percentage set forth in (b) above, on a pro-rata basis, based on their current Required Fund Deposit (exclusive of any amounts charged for increased event risk).~~

~~In the event of a failure of a Member, other than a Special Member, all Direct Transactions with a Special Member shall be considered Inter Dealer Broker Transactions if they can be paired up with offsetting transactions with dealers who have subscribed to, intend to subscribe to, or purchased shares in EMCC.~~

~~Deposits made by dealer Members pursuant to (b) above shall be deemed to be part of the dealer Member’s Required Fund Deposit in the event of the failure of the dealer Member. Deposits made by dealer Members pursuant to (b) above shall, for the purposes of determining amounts belonging to the Special Member in the event of the failure of the~~

¹² ~~[Addendum G automatically expires on earlier of (i) September 30, 1999 or (ii) the date on which Daiwa Securities America Inc. (“Daiwa”) ceases to perform clearing functions for inter-dealer brokers.]~~

¹³ ~~[The Base Requirement is related to a particular market share and size in which the uncollected margin calculation would be unusual. To the extent market share and/or size changes in favor of the Special Member, and uncollected Daily Margin Amounts cease to be unusual, the Base Requirement may be increased in the discretion of EMCC. To the extent market share and/or size changes against the Special Member, the Base Requirement may be decreased in the discretion of EMCC.]~~

~~Special Member, be deemed to be part of the Required Fund Deposit of the Special Member and shall be applied against losses of the Special Member after the application of the Special Member's Required Fund Deposit and prior to any assessments against other Members pursuant to the provisions of Section 11 of Rule 4.~~

~~For the purposes of calculating the pro rata loss allocation pursuant to Section 11 of Rule 4, in the event of the failure of a Member of EMCC, the average daily margin calculation for each Member shall be determined without regard to the Temporary Margin Procedures contained in this addendum except that any daily margin calculation for a Special Member that exceeds the firm's Base Requirement shall be considered equal to the Base Requirement.~~

~~Nothing in this Addendum G shall be construed to prevent normal surveillance procedures from applying to any Special Member, including, without limitation, those set forth in Addendum C. In addition, nothing in this Addendum G shall be construed to prevent EMCC from requiring additional Clearing Fund deposits (not specified in this Addendum) pursuant to Rule 13 or Section 4 of Rule 4.]~~

* * *

ADDENDUM I

A US registered broker-dealer who is an Inter-Dealer Broker or whose only business with EMCC consists of clearing for Inter-Dealer Brokers (hereinafter referred to as a "Special Member"), at the request of the Special Member, and in lieu of obligations to pay Margin Amounts pursuant to section 5 of Rule 4, will be subject to a Daily Margin Amount of \$50 million. On each day that the calculation of the Daily Margin Amount for the Special Member results in an amount in excess of \$50 million, the excess amount shall be prorated among all Members which are not Special Members based on the following formula:

Each Member's average Daily Margin Amount over the prior 30 calendar days

All Members (excluding the Special Member) average Daily Margin Amounts over the prior 30 calendar days.

All prorated amounts shall be part of each Member's (other than the Special Member's) Required Fund Deposit.

Notwithstanding the foregoing, the calculated amount for the Special Member shall be used for the purposes of allocating losses pursuant to Section 11 (c) of Rule 4 and limiting liability pursuant to Section 12 of Rule 4. Any amount paid by Members who are not Special Members, where the calculated amount is greater than \$50 million, shall not be included in calculating such Member's obligations pursuant to Section 11 (c) and 12 of Rule 4.

EXHIBIT B

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-EMCC-2003-02)

Proposed rule change by EMERGING MARKETS CLEARING CORPORATION ("EMCC") regarding modification to the clearing fund deposit requirement for certain EMCC members.

Comments requested within days after the date of this publication.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on , EMCC filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by EMCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change.

The proposed rule change consists of modifications to the clearing fund deposit requirement for certain EMCC members.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

In its filing with the Commission, EMCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. EMCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

(a) One of the purposes of the proposed filing is to modify the clearing fund deposit requirement for certain EMCC members. The proposed change would establish a fixed amount (\$50 Million) to be deposited by members who are Inter-Dealer Brokers or whose only business with EMCC is to clear for Inter-Dealer brokers. EMCC would continue to calculate the clearing fund requirements for each of these members. To the extent that the calculated amount exceeds the fixed amount for any day, the difference between the calculated amount and the fixed amount would be required to be paid by the other EMCC members pro-rata based on their average clearing fund requirements over the previous 30 calendar day period. The calculated amount, however, would continue to be used by the Corporation for the purposes of determining pro-rata loss obligations of any Member whose deposit is fixed at \$50 million and the difference amounts paid by other members would not be included in determining their pro-rata loss obligations.

The function of an IDB is to bring together principals in transactions on a matched anonymous basis while taking no principal risk themselves. If every dealer who interacted with an IDB were a member of EMCC, the IDB (or its clearing firm) would have to deposit only

a minimal clearing fund amount. To the extent that one side of an IDB trade is not an EMCC member, the clearing fund requirements for the IDB (or its clearing firm) are based only on one side of the matched transaction. This one sided calculation could (and does) create a clearing fund obligation of a significant financial amount for the IDB (or its clearing firm). EMCC believes it is appropriate, given the role of IDBs to the functioning of the market place (i.e. to provide liquidity), to establish a fixed clearing fund requirement for such firms or their clearing firm and have the difference between the fixed amount and the calculated amount deposited by the other EMCC members. EMCC has concerns that if this modified requirement is not established, the IDB's will no longer submit their transactions to EMCC and thus the dealer market will lose the benefits of the risk management process currently provided by EMCC.

While EMCC has determined that it is appropriate to set a fixed clearing fund amount for such Members, it does not want this fixed amount to alter the status quo among members in the event that a pro-rata charge must be imposed pursuant to Section 11(c) of Rule 4. Consequently, the rules will provide that the calculated amount and not the fixed amount will be used in determining the pro-rata liability of any affected Member. Further, any amount required to be paid by other members, where the calculated amount is greater than the \$50 million, will similarly not be taken into account when determining their pro-rata charges.

A second purpose of the filing is to modify the time when EMCC novates transactions and change the clearing fund formula to eliminate the "look back" feature. Currently EMCC novates transactions at different times depending on whether the trade is received and compared on trade date or thereafter. Since under the current rules EMCC would (unless it

ceased to act for a member,) novate transactions received on trade date before EMCC had the opportunity to collect additional margin, the clearing fund required of members was always the greater of the calculated requirement or the highest requirement over the previous two months. It was hoped that by "looking back" EMCC would have sufficient clearing fund deposits so long as the member's current trades were similar to the trading which occurred over the prior two months. While this methodology provided EMCC with adequate collateral in most cases EMCC could never be certain it would always be fully protected. To remedy this, EMCC has determined to require members to submit trades earlier on trade date, calculate margin based on these trades and, if a deficit exists, collect the deficit on trade date. The rules will be changed to provide that novation of trades will not occur until the margin requirements are received (to the extent required) from both sides to the trade. This will apply to trades included in the evening calculation as well as trades covered by the morning calculation. As before, EMCC will do an evening and morning clearing fund calculation, only now, payments will be due after each calculation. Since EMCC will now be timely collecting margin to cover the exposure it will no longer need to collect the highest margin calculation over the prior two months and thus the "look back" feature of the requirement will be eliminated.

It is expected that by removing the "look back" feature, members' requirements will decrease. This decrease will help offset any additional requirements any member may be required to make under Addendum I. Since we will be collecting funds in the afternoon there can no longer be an overnight exposure cap. Accordingly, all references to calculations based on this are also being deleted.

(b) The proposed rule change is consistent with the requirements of the Securities

Exchange Act of 1934, as amended (the "Act"), and the rules and regulations thereunder, since it will permit the equitable allocation of charges among participants.

(B) Self-Regulatory Organization's Statement on Burden on Competition.

EMCC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others.

Written comments from EMCC Members have not been solicited or received on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action.

Within 35 days of the date of publication of this notice in the Federal Register or such longer period (i) as the Commission may delegate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments.

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the rule filing that are filed with the Commission, and all written communications relating to the rule filing between the Commission and any person, other than those that may be withheld from the public in accordance with provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room in Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to the file number in the caption above and should be submitted within days after the date of this publication.

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

Jonathan G. Katz

Secretary

Dated: