

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

Margaret H. McFarland,  
*Deputy Secretary.*

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[Release No. 34-37148; File No. SR-PSE-96-02]

**Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Pacific Stock Exchange, Inc., Relating to the Composition of the Exchange's Options Listing Committee**

April 29, 1996.

**I. Introduction**

On January 16, 1996, the Pacific Stock Exchange, Inc. ("PSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposal to amend its rules relating to the composition of the Options Listing Committee ("OLC"). On March 11, 1996, the PSE amended its approval.<sup>3</sup>

The proposed rule change and Amendment No. 1 were published for comment in the Federal Register on March 25, 1996.<sup>4</sup> No comments were received on the proposed rule change.

**II. Description of the Proposal**

Currently, Commentary .01 to PSE Rule 11.10(d) provides that the OLC shall be comprised of (i) four floor

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> 17 CFR 240.19b-4 (1995).

<sup>3</sup> On March 11, 1996, the PSE provided additional information concerning the purpose of the proposal. Specifically, the PSE explained that the proposal is designed to make Commentary .01 to PSE Rule 11.10(d), "Options Listing Committee," easier to follow and to prevent legal appeals of Options Listing Committee ("OLC") decisions on the technical argument that the OLC was not authorized to act because its composition did not conform to the rigid requirements of PSE Rule 11.10(d), Commentary .01. According to the PSE, such an appeal could be made currently if, for example, a non-floor broker is placed in one of the floor broker slots on the OLC because of a shortage of floor brokers willing to serve on the OLC, or if a floor broker on the OLC becomes a market maker mid-year and the OLC decides to retain that member on the OLC. The PSE expects that, under the proposal, the OLC will be composed as specified in Commentary .01 under virtually all circumstances. The Exchange represents that it intends to comply with the spirit of the Commentary and anticipates departures from this general rule only in exceptionally rare circumstances. See Letter from Michael D. Pierson, Senior Attorney, Market Regulation, PSE, to Michael Walinskas, Branch Chief, Options Regulation, Division of Market Regulation, Commission, dated March 11, 1996 ("Amendment No. 1").

<sup>4</sup> See Securities Exchange Act Release No. 36984 (March 18, 1996), 61 FR 12126.

brokers; (ii) five market makers or lead market makers; and (iii) one member of the PSE or a general partner or officer of a member organization, or any other person who is considered to be qualified. The PSE proposes to amend PSE Rule 11.10(d), Commentary .01, to provide that the Exchange will attempt, but will not be required, to maintain the composition of the OLC as provided currently under Commentary .01. Specifically, the Exchange proposes to amend Commentary .01 by eliminating the phrase "shall be comprised of" and replacing it with a provision stating that "attempts shall be made" in order for the OLC to have a composition that includes those currently specified in subsections (i) through (iii).

The Exchange believes that Commentary .01 is overly restrictive and that the proposal is appropriate in order to allow for greater flexibility in the committee selection procedure and the process for replacing committee members who resign or change their floor status. The proposal is designed to make Commentary .01 easier to follow and to prevent members from appealing decisions of the OLC on the grounds that the OLC was not authorized to act because its composition did not conform to the requirements of Commentary .01. The PSE represents that the Exchange will make every effort to ensure that the OLC maintains the composition specified in Commentary .01. The Exchange expects that, under the proposal, the composition of the OLC will remain as specified currently in Commentary .01 in virtually all circumstances.<sup>5</sup>

**III. Discussion**

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(3) of the Act, in that the proposal provides for a fair representation of the Exchange's members in the administration of its affairs, and also with Section 6(b)(5) of the Act, in that the proposal is designed to protect investors and the public interest.<sup>6</sup>

The Commission believes that the proposal will allow greater flexibility in the composition of the OLC. Specifically, the proposal provides that the Exchange will attempt, but will not be required, to maintain the composition of the OLC as provided currently under PSE Rule 11.10(d),

Commentary .01. The PSE expects that the OLC will continue to be composed as provided currently in Commentary .01 in virtually all circumstances, and the PSE represents that the Exchange will attempt to ensure that the composition of the OLC remains as specified in Commentary .01.<sup>7</sup> Accordingly, the Commission believes that the proposal will provide flexibility in the composition of the OLC while ensuring that diverse interests are represented on the OLC. In addition, the proposal should simplify the process of replacing a member who resigns from the committee and allow the OLC to retain a member who changes his status (e.g., a floor broker who becomes a maker) during his service on the committee.

**IV. Conclusion**

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-PSE-96-02) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

Margaret H. McFarland,  
*Deputy Secretary.*

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[Release No. 34-37152; File No. SR-PTC-96-02]

**Self-Regulatory Organizations; Participants Trust Company; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Establishing on a Permanent Basis the Margin and Pricing Methodology for Collateralized Mortgage Obligations**

April 30, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on March 8, 1996, the Participants Trust Company ("PTC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change (File No. SR-PTC-96-02) as described in Items I and II below, which Items have been prepared primarily by PTC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

<sup>7</sup> See Amendment No. 1, *supra* note 3.

<sup>8</sup> 15 U.S.C. 78s(b)(2) (1988).

<sup>9</sup> 17 CFR 200.30-3(a)(12) (1995).

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>5</sup> See Amendment No. 1, *supra* note 3.

<sup>6</sup> 15 U.S.C. §§ 78f(b)(3) and (b)(5) (1988).

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

The proposed rule change establishes on a permanent basis the margin and pricing methodology utilized by PTC for collateralized mortgage obligations ("CMOs") that are eligible for deposit or that may become eligible for deposit at PTC.

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

In its filing with the Commission, PTC 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. Summaries of the most significant aspects of such statements are set forth in sections A, B, and C below.<sup>2</sup>

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

The purpose of the proposed rule change is to establish a permanent methodology to formulate the percentage (*i.e.*, margin) to be deducted from the market value of CMOs that are eligible for deposit or that may become eligible for deposit at PTC.<sup>3</sup> The proposed margin and pricing methodology is substantially the same as the current margin and pricing methodology except for one variation that is proposed as a result of PTC's research and analysis of additional data compiled in the period since the temporary approval was granted.

#### Margin under PTC's Rules

Under PTC's rules, a certain percentage ("applicable percentage") of the market value of securities is included in the computation of participants' Net Free Equity.<sup>4</sup> Net Free

Equity represents PTC's calculation of the amount of excess equity available in a participant's account which PTC may borrow against or liquidate in the event a participant's debit balance is not satisfied at the end of the day. Net Free Equity of zero or greater is required to be maintained by participants in each of its agency, pledge, or proprietary accounts in order for transactions to be processed.<sup>5</sup>

By including only a portion of the market value of securities in Net Free Equity, PTC attempts to limit the risk caused by fluctuations in the market value of these securities. For example, for Government National Mortgage Association ("GNMA") single-class securities other than construction, project, and mobile home securities, margin is set at five percent, which is a rate that exceeds these securities' largest historic consecutive two-day downward price movement. GNMA construction, project, and mobile home securities have a higher margin to reflect their reduced liquidity.<sup>6</sup>

#### CMO Margins

CMOs that are currently eligible for deposit at PTC are GNMA REMICs, Department of Veterans Affairs ("VA") REMICs, and certain Federal Home Loan Mortgage Corporation ("FHLMC") and Federal National Mortgage Association ("FNMA") REMICs. Unlike GNMA single-class securities, CMOs are multiple-class mortgage cash flow securities which redirect the cash flow from an underlying standard mortgage-backed security, such as a GNMA security, and which allow the CMO issuer to create classes or tranches with many different interest rates, average lives, prepayment sensitivities, and final maturities.

To establish margins for CMOs, PTC uses a model which takes into account

the Participants Fund which are allocated to that account (optional deposits to the Participants Fund are deposits that exceed the minimum deposit required pursuant to PTC's rules and procedures); and (d) 20% of the mandatory deposits to the Participants Fund for the master account (mandatory deposits to the Participants Fund are minimum deposits required to be deposited into such fund pursuant to PTC's rules and procedures) minus (e) "reserve on gain." Reserve on gain means (1) the contract value credited to the cash balance of a delivering participant or limited purpose participant over the market value of securities credited to the transfer account associated with the account of the receiving participant or (2) the market value of securities credited to the transfer account associated with the account of a receiving participant over the contract value credited to the cash balance of the delivering participant or limited purpose participant.

<sup>5</sup> PTC Rules, Article II, Rule 13, "Transfers of Securities."

<sup>6</sup> Securities Exchange Act Release No. 33840 (March 31, 1994), 59 FR 16672 [File No. PTC-93-04] (order approving proposed rule change).

the unique characteristics of each tranche to predict its potential price movement. The parameters of the model include the current price of the security, the prepayment assumptions, and the corresponding Treasury yield curve. PTC subjects each CMO tranche to a stress test to determine its response to yield changes in order to assign each tranche an appropriate margin.

Currently, margins are based on a fifty basis point upward movement in the yield of the underlying Treasury securities for CMO tranches that exhibit positive effective duration (*i.e.*, tranches which rise in value with falling interest rates) or a fifty basis point downward movement in the yield of the underlying Treasury security for CMO tranches that exhibit negative effective duration (*i.e.*, tranches which decline in value with falling interest rates). CMO tranches that are not modeled by PTC's pricing vendors are margined at one hundred percent, and the minimum margin for any CMO tranche is five percent.

All margins are reevaluated at least quarterly. In addition, margins are reevaluated any time there is a shift of one hundred basis points or more on any point of the Treasury yield curve for the applicable CMOs and for any CMOs that experience a one-day price decrease in excess of fifty percent of the assigned margin.

#### Proposed New Margin Methodology

Because PTC anticipates that additional issues of FHLMC and FNMA CMOs may become eligible for deposit at PTC, it has extended its analysis of historical shifts in Treasury yield decreases. As a result of this analysis, PTC proposes to increase the basis points used for margin calculation for CMOs that exhibit negative effective duration from fifty basis points to one hundred basis points.<sup>7</sup> Therefore, PTC has requested permanent approval of its methodology to establish margins for CMOs based upon the maximum percentage decrease resulting from a fifty basis point upward movement in the yield of the underlying Treasury security for CMO tranches that exhibit positive effective duration or a one hundred basis point downward movement in the yield of the underlying Treasury security for CMO tranches that exhibit negative effective duration.

<sup>7</sup> One hundred basis points corresponds to the largest actual decrease in Treasury yields over the most current ten year period. The largest actual decrease in Treasury yields over the most current ten year period occurred when the two-year Treasury yield declined 99.5 basis points between the days before and after the stock market break on October 19, 1987 (comparing Friday, October 16, 1987, with Tuesday, October 20, 1987).

<sup>2</sup> The Commission has modified the text of the summaries prepared by PTC.

<sup>3</sup> PTC's current CMO margin and pricing methodology was approved by the Commission on a temporary basis through April 30, 1996, in order to allow PTC to make technical enhancements that enabled PTC to use and compare data from two pricing vendors and also enabled PTC to further evaluate the results of the CMO pricing and margin methodology as enhanced. Securities Exchange Act Release No. 35641 (April 24, 1995), 60 FR 21228 [File No. SR-PTC-95-03] (order approving proposed rule change on an accelerated basis).

<sup>4</sup> As set forth in PTC Rules, Article II, Rule 9, Net Free Equity is calculated as the sum of (a) the cash balance in the account; (b) the market value of securities in the account less the applicable percentage; (c) the value of the optional deposits to

The increase in the basis points used for CMOs that exhibit negative effective duration does not affect the margins of the CMOs currently on deposit at PTC because the CMO tranches that would decline in value assuming a one hundred basis point decline in the yield of the underlying Treasury security are interest only ("IO") tranches or tranches which have IO like characteristics. These securities are not currently priced by PTC's pricing vendors and accordingly are assigned a value of zero on PTC's system.<sup>8</sup> However, PTC anticipates that as additional issues become depository eligible at PTC and PTC's pricing vendors are able to provide prices for such issues, some of these issues may include tranches which are sensitive to a one hundred basis point decline.

PTC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>9</sup> and the rules and regulations thereunder because it facilitates the prompt and accurate clearance and settlement of securities transactions and provides for the safeguarding of securities and funds in PTC's custody or control or for which PTC is responsible.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

PTC does not believe that the proposed rule change imposes any burden on competition.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

PTC has discussed the proposed margin methodology with its Risk Management Committee, which is comprised of participant representatives. PTC has neither solicited nor received written comments from participants or other interested parties on this proposed rule change.

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

Section 17A(b)(3)(F) of the Act<sup>10</sup> requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible. The Commission believes that the

proposed margin and pricing methodology utilized by PTC for CMOs is consistent with this obligation.

The Commission previously approved PTC's current margin and pricing methodology for CMOs on a temporary basis in order to allow PTC further time to evaluate the methodology and to take steps to address any concerns which existed with respect to the methodology. During the temporary approval period, PTC has provided information to the Commission describing the steps taken by PTC to improve the margin and pricing methodology including finalizing arrangements with a second pricing vendor for daily pricing and stress test analysis. Because PTC believes it has made all the changes that its research and analysis conducted during the temporary approval period revealed needed to be made, PTC has decided to request permanent approval of the margin and pricing methodology.

PTC's margin and pricing methodology helps ensure that in establishing CMO margins, PTC takes into account the unique characteristics of each CMO tranche. Furthermore, PTC's reliance on two pricing sources should provide PTC with timely and accurate price information. The resulting margins established for CMOs that are eligible for deposit or that may become eligible for deposit at PTC should afford PTC sufficient protection in the event it becomes necessary for PTC to borrow against or liquidate these assets to satisfy a participant's debit balance that is not satisfied at the end of the day. In addition, increasing the basis points used in calculating margins for CMOs that exhibit negative effective duration from fifty basis points to one hundred basis points should result in more conservative margins for these securities and thereby should help to limit PTC's risk resulting from fluctuations in the market values of these securities.

PTC has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of the filing. The Commission finds such good cause for so approving the proposed rule change because accelerated approval will allow PTC to continue employing its margin and pricing methodology without disruption of service prior to the expiration of the current temporary approval on April 30, 1996. Furthermore, the Commission did not receive any comment letters during the comment period before it granted temporary approval or during the temporary approval period and does not expect to receive any during the present

comment period. The staff of the Board of Governors of the Federal Reserve System ("Board of Governors") has concurred with the Commission's granting of accelerated approval.<sup>11</sup>

#### 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 proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of PTC. All submissions should refer to file number SR-PTC-96-02 and should be submitted by May 27, 1996.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-PTC-96-02) be and hereby is approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Margaret H. McFarland,

*Deputy Secretary.*

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## UNITED STATES SENTENCING COMMISSION

### Amendments to the Sentencing Guidelines for United States Courts

**AGENCY:** United States Sentencing Commission.

**ACTION:** Notice of submission to Congress of amendments to the sentencing guidelines.

**SUMMARY:** Pursuant to its authority under section 994(p) of title 28, United States Code, the United States

<sup>8</sup>Since temporary approval for the current CMO margin and pricing methodology was granted, PTC has completed the system enhancements necessary to use and compare data from two pricing vendors. CMO prices are established by defaulting to the lower of the two in the event of any discrepancy.

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(F) (1988).

<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(F) (1988).

<sup>11</sup> Telephone conversation between John Rudolph, Board of Governors, and Ari Burstein, Division of Market Regulation, Commission (April 15, 1996).

<sup>12</sup> 17 CFR. 200.30-3(a)(12) (1995).