

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51412; File No. SR-FICC-2004-13)

March 23, 2005

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Amend the Rules of the Mortgage-Backed Securities Division to Impose Fines on Members for Violations of Minimum Financial Standards and to Modify the Penalty Assessment Process for Failures of Members to Submit Requisite Financial Reports on a Timely Basis

I. Introduction

On June 24, 2004, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") and on February 2, 2005, amended proposed rule change SR-FICC-2004-13 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the Federal Register on February 16, 2005.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

FICC is seeking to amend the rules of its Mortgage-Backed Securities Division ("MBSD") to impose fines on members for violations of minimum financial standards and to modify the penalty assessment process for failures of members to submit requisite financial reports on a timely basis.

1. Violations of Minimum Financial Standards

The rules of the MBSD require clearing members to meet and maintain certain minimum financial standards at all times. While the majority of MBSD members consistently satisfy their

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

<sup>2</sup> Securities Exchange Act Release No. 51146 (February 7, 2005), 70 FR 7984.

minimum financial requirements, occasionally members breach these requirements and create undue risk for FICC and its members.

Currently, the MBSD rules do not impose specific margin consequences for falling out of compliance with minimum financial requirements but allow the Membership and Risk Management Committee in its discretion to impose conditions which can include an increase in the participant's minimum required deposits to the Participants Fund.

Under the proposed rule change, a violation of a minimum financial requirement by an MBSD clearing participant will result in the imposition on such member of a margin premium equal to the greater of (a) 25 percent of the member's unadjusted<sup>3</sup> Participants Fund requirement or (b) \$1,000,000 which will begin on the day the participant fell below its minimum financial requirement and will continue for ninety calendar days after the later of (i) the member's return to compliance with its applicable minimum financial standards or (ii) FICC's discovery of the violation.<sup>4</sup> In addition, such violation will result in (1) a report of the violation to the FICC Membership and Risk Management Committee at its next regularly scheduled meeting or sooner if deemed appropriate by FICC staff and (2) the placement of such member on FICC's watch list subjecting it to frequent and thorough monitoring. None of these consequences will preclude FICC from imposing any other margin consequences permitted by the MBSD rules.

## 2. Failure to Submit Requisite Financial Reports on a Timely Basis

Certain members that are required to provide monthly or quarterly financial data to FICC at times have violated MBSD's membership requirements by not providing such financial data in

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<sup>3</sup> "Unadjusted" means the standard calculation before any additional assessments.

<sup>4</sup> The required clearing fund deposit premium that will be assessed for violation of applicable minimum financial standards will be effective beginning on the day of the violation but will begin to be assessed on the date FICC becomes aware of the violation.

a timely manner. In such instances, management contacts the offending member and follows up with a letter.

Failure to receive required information in a timely manner hinders FICC's ability to appropriately assess the financial condition of such members and as a result creates risk to FICC. To encourage timely submission of required financial data, FICC has established a mechanism to fine delinquent participants.<sup>5</sup> FICC is now proposing two additional measures to enforce timely filing of financial information.

First, FICC will subject delinquent participants to a more stringent Participants Fund requirement. Specifically, FICC will now automatically impose a margin premium equal to the greater of (1) 25 percent of the member's unadjusted Participants Fund requirement or (2) \$1,000,000. The margin premium will be applied until appropriate financial data is submitted to FICC and reviewed for compliance purposes. In addition, delinquent members will be precluded from taking back any excess Participants Fund collateral to which they might ordinarily be entitled.

Second, participants that fail to submit requisite financial reports on a timely basis will also automatically be placed on FICC's watch list and subject to frequent and thorough monitoring.

### III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to facilitate the safeguarding of securities and funds which are in its custody or control or for

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<sup>5</sup> Securities Exchange Act Release No. 49947 (June 30, 2004), 69 FR 41316 [File No. SR-FICC-2003-01].

which it is responsible.<sup>6</sup> The Commission finds that FICC's proposed rule change is consistent with this requirement because it assures the safeguarding of such securities and funds by incentivizing participants to maintain their minimum financial standards and to submit their required financial reports on a timely basis. As a result, FICC's ability to monitor its participants and to maintain a financially sound participant base should be enhanced.

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2004-13) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>7</sup> 17 CFR 200.30-3(a)(12).

