

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50617; File No. SR-FICC-2004-01)

November 1, 2004

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Amend the Government Securities Division and the Mortgage-Backed Securities Division Membership Rules

I. Introduction

On January 9, 2004, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) and on April 28, 2004, amended proposed rule change SR-FICC-2004-01 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on September 23, 2004.² No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

FICC is amending the membership rules of its Government Securities Division (“GSD”) and its Mortgage-Backed Securities Division (“MBSD”) to (1) eliminate the requirement that the conversion to U.S. dollars be made by the applicant or member prior to submitting financial information to FICC unless such conversion is specifically requested by FICC, (2) eliminate the requirement that FICC make a determination as to the adequacy of an applicant’s personnel, physical facilities, books and records, accounting systems, or internal procedures, (3) require that a non-U.S. applicant represent to FICC in writing that it is regulated in a way that is generally comparable to the way in which domestic FICC members are regulated, (4) add a requirement to

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 50402 (September 16, 2004), 69 FR 57111.

the GSD's rules that a non-U.S. netting applicant represent in writing that it is in compliance with the financial reporting and responsibility standards of its home country, and (5) eliminate the requirement that GSD comparison-only applicants submit financial information to FICC.

1. Amend the Rules of the GSD and MBSD that Require Financial Information Submitted by an Applicant to be in Dollar Equivalents

When FICC receives financial information from non-U.S. members and applicants, FICC's credit risk staff will perform the conversion to U.S. dollars whenever it is necessary. The credit risk staff will perform the conversion as of the date of the financial statements. Therefore, FICC is eliminating the current requirement that the conversion to U.S. dollars be made by the applicant or member prior to submitting financial information to FICC unless such conversion is specifically requested by FICC.

2. Amend the Operational Capability Requirement Contained in the Rules of the GSD and the MBSD

FICC's current operational capability rules are too broad and impose upon FICC an obligation to make determinations with respect to the operational capability of an applicant or member that FICC staff is not equipped or trained to make.³ Such determinations are more appropriately left to the applicant or member's designated examining authority. The operational capability aspect that is relevant to FICC and upon which FICC must make a determination is the ability of an applicant or member to send input to FICC and to receive output from FICC on a timely and accurate basis. Therefore, FICC is eliminating the requirement that it make a

³ For example, the GSD rules currently require that a determination be made with respect to whether the membership applicant has adequate personnel, physical facilities, and accounting systems, among other things, to satisfactorily handle transactions.

determination as to the adequacy of an applicant's personnel, physical facilities, books and records, accounting systems, or internal procedures.

3. Amend the Comparability Requirement of the GSD's Rules for Non-U.S. Members

The GSD rules currently provide that a non-U.S. entity shall be eligible to become a netting member if FICC has determined that the entity is regulated in its home country in a way that is generally comparable to the way in which similar domestic members are regulated. The comparability determination has been difficult to make because there is no objective set of guidelines that FICC can use to confirm the comparability requirement. As a result, comparability determinations have necessarily become judgment calls made by FICC staff using information provided by the applicant.

Because the netting service is a guaranteed service and because FICC only accepts regulated entities as members, FICC should focus on making sure that its non-U.S. members (as is the case with its domestic members) are regulated by a financial regulatory authority in their home country in certain key areas as opposed to being concerned with "comparability" of regulation. These key areas are maintenance of relevant books and records, regular inspections and examinations, and minimum financial standards. Therefore, FICC is amending the comparability requirement to require that the applicant represent to FICC in writing that it is regulated in these key areas.⁴ In conjunction with this change, FICC is adding a requirement to the GSD's rules that a non-U.S. netting applicant represent in writing that it is in compliance with the financial reporting and responsibility standards of its home country.⁵

⁴ This approach is currently used by the Emerging Markets Clearing Corporation ("EMCC").

⁵ Id.

4. Amend the GSD's Rules that Require Comparison-Only Applicants and Members to Submit the Same Financial Information as Netting Applicants and Members

The GSD's comparison-only service is not a guaranteed service. Comparison-only members do not have minimum financial requirements and are not required to make clearing fund deposits. Therefore, FICC is eliminating the requirement that GSD comparison-only applicants submit financial information to FICC. The GSD's rules will continue to give FICC the ability to require comparison-only members to submit financial information.

In addition to these proposed rule changes, FICC is making a technical change to the rules of the MBSD to move language relating to cross-guaranty agreements to a more appropriate place in the rules.

III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to remove impediments to the perfection of a national system for the prompt and accurate clearance and settlement of securities transactions and must not be designed to permit unfair discrimination in the admission of participants or among participants in the use of FICC.⁶ The Commission finds that FICC's proposed rule change is consistent with these requirements because it refines and improves FICC's rules and procedures with regard to applicants and members.

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.

⁶ 15 U.S.C. 78q-1(b)(3)(F).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2004-01) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland
Deputy Secretary

⁷ 17 CFR 200.30-3(a)(12).

