SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54964; File No. SR-FICC-2006-16)

December 19, 2006

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Replace the Government Securities Division Clearing Fund Calculation Methodology with a Yield-Driven Value-at-Risk Methodology

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),[1] notice is hereby given that on October 4, 2006, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission (“Commission”) and on November 14, 2006, amended the proposed rule change as described in Items I, II, and III below, which items have been prepared by FICC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

FICC is seeking to replace the Government Securities Division (“GSD”) margin calculation methodology with a value-at-risk (“VaR”) methodology.

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

In its filing with the Commission, FICC 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. FICC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.[2]

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1 15 U.S.C. 78s(b)(1).

2 The Commission has modified the text of the summaries prepared by FICC.

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

Netting members of FICC's GSD are required to maintain clearing fund deposits. Each member's required clearing fund deposit is calculated daily to ensure that enough funds are available to cover the risks associated with that member's activities.

The purposes served by the clearing fund are to: (i) have on deposit from each member clearing fund sufficient to satisfy any losses that may be incurred by FICC or its members resulting from the default by a member and the resultant close out of that member's settlement positions and (ii) ensure that FICC has sufficient liquidity at all times to meet its payment and delivery obligations.

FICC proposes to replace the current clearing fund methodology, which uses haircuts and offsets, with a VaR methodology that is expected to better reflect market volatility and more thoroughly distinguish the levels of risk presented by individual securities. Specifically, FICC is proposing to replace the existing GSD margin calculation methodology with a yield-driven VaR model. VaR is defined to be the maximum amount of money that may be lost on a portfolio over a given period of time within a given level of confidence. With respect to the GSD, FICC is proposing a 99 percent three-day VaR.[3]

The changes to the components that comprise the current clearing fund calculation compared to the proposed VaR methodology in relation to the risks addressed by the components are summarized below.

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[3] Category 2 Dealers and Category 2 Futures Commission Merchants will be subject to higher confidence levels than other Netting Members.

Existing Methodology	**Risk Addressed**	**Proposed Methodology**[4]
Receive/Deliver component using margin factors	Fluctuation in security prices	Interest rate or index-driven model, as appropriate[5]
Repo Volatility component	Fluctuation in repo interest rates	Repo index-driven model[6]
Funds Adjustment Deposit component (based on the average size of the member's 20 highest funds-only settlement amounts over the most recent 75 business days)	Uncertainty of whether a member will satisfy its funds-only settlement obligation	Margin Requirement Differential ("MRD") (a portion of which is based on the historical size of a member's funds-only settlement obligation)
Average Post Offset Margin Amount component (based on the 20 highest margin amounts derived from all outstanding net settlement positions over the most recent 75 business days)	Uncertainty of whether a member will satisfy its next clearing fund call	MRD (a portion of which is based on the historical variability a member's clearing fund requirement)
Not specifically covered	Intraday risk and additional exposure due to	Coverage Component (if necessary, applies

4 Under the current GSD rules, Category 1 Inter-Dealer Brokers are subject to a $5 million clearing fund requirement. This proposed rule change does not alter that requirement.

5 FICC would have the discretion to not apply the interest rate model to classes of securities whose volatility is less amenable to statistical analysis, which is usually due to a lack of pricing history. In lieu of such a calculation, the required charge with respect to such positions would be determined based on a historic index volatility model.

6 FICC is proposing a new definition for "Term Repo Transaction" to clarify the types of transactions covered by this component. As proposed, Term Repo Transaction would mean, on any particular Business Day, a Repo Transaction for which settlement of the Close Leg "is scheduled to occur two or more Business Days after the scheduled settlement of the Start Leg." In addition, the existing definition for "Term GCF Repo Transaction" is being revised to conform to the proposed language for "Term Repo Transaction" as the new definition provides greater clarity as to transactions covered.

	portfolio variation and potential loss in unlikely situations beyond the model's effective range	additional minimum charge to bring coverage to the applicable confidence level)

In addition, FICC may include in a member's clearing fund requirement a "special charge" as determined by FICC based on such factors as it determines to be appropriate from time to time such as price fluctuations, volatility, or lack of liquidity of any security.

The proposed VaR methodology, if approved, would necessitate a change to the risk management consequences of the late allocation of repo substitution collateral.[7] Because offset classes and margin rates will no longer be present in the GSD's rules as proposed, FICC would base the margining for such a generic CUSIP on the same calculation as that used for securities whose volatility is less amenable to statistical analysis.

The VaR methodology will not include calculations that are incorporated in the GSD's current cross-margining programs with The Clearing Corporation ("TCC") and the Chicago Mercantile Exchange ("CME"). In order to provide for continuity of cross-margining following the implementation of the VaR methodology and because certain key calculations required for cross-margining are unique to cross-margining, the GSD will continue to perform the applicable cross-margining calculations outside of the VaR model. The GSD would then adjust the cross-margining clearing fund calculation using a scaling ratio of the VaR clearing fund calculation to the cross-margining clearing fund calculation so that the clearing fund amount available for

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[7] Securities Exchange Act Release No. 53534 (March 21, 2006), 71 FR 15781 [File No. SR-FICC-2005-18]. This rule change created a generic CUSIP offset and applicable margin rate for determining clearing fund consequences for such late allocations.

cross-margining is appropriately aligned with the VaR model. The proposed changes described herein would necessitate amendments to FICC's cross-margining agreements with TCC and CME as follows:

1. The definition of FICC's "Margin Rate" in each of the agreements would be amended to reflect that the margin rate will no longer be based on margin factors published in the current rules (as these would no longer be applied under the VaR methodology). Instead, they would be determined based on a percentage that would be determined using the same parameters and data (e.g., confidence level and historic indices) as those used to generate margin factors in the current rules.
2. Section 5(a) of each cross-margining agreement would be amended to state that FICC's residual margin amount would be calculated as specified in the agreement and would be adjusted, if necessary, to correct for differences between the methodology of calculating the residual margin amount as described in the agreement and the VaR methodology. This change is necessary to account for the deletion of relevant margin factor and disallowance schedules (which, like the margin factors, are incorporated into the agreements by reference) from the GSD rules and to adjust for the possibility that the new VaR methodology could generate a charge that would otherwise allow for a cross-margining reduction that is greater than the margin requirement.

FICC believes that the proposed rule change is consistent with the requirements of

Section 17A of the Act[8] and the rules and regulations thereunder applicable to FICC because it should assure the safeguarding of securities and funds in FICC's custody or control or for which it is responsible by enabling FICC to more effectively manage risk presented by members' activity.

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

FICC does not believe that the proposed rule change would have any impact or impose any burden on competition.

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

Written comments have not been solicited with respect to the proposed rule change, and none have been received. FICC will notify the Commission of any written comments it receives.

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

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety 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.

[8] 15 U.S.C. 78q-1.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FICC-2006-16 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FICC-2006-16. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). 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, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of FICC and on FICC's Web site at http://www.ficc.com/gov/gov.docs.jsp?NS-query. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2006-16 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[9]

Florence E. Harmon
Deputy Secretary

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[9] 17 CFR 200.30-3(a)(12).