

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54969; File No. SR-FICC-2006-15)

December 19, 2006

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Modify its Rules to Diversify and Standardize Clearing Fund Collateral Requirements Across the Divisions to Improve Liquidity and Minimize Risk for its Members

I. Introduction

On October 4, 2006, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2006-15 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 November 9, 2006.² A correction and extension of the comment period was published in the Federal Register on November 22, 2006.³ No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change as amended.

II. Description

FICC seeks to modify the rules of both of the Government Securities Division (“GSD”) and the Mortgage-Backed Securities Division (“MBSD”) (collectively, “Divisions”) to diversify and standardize Clearing Fund⁴ collateral requirements across the Divisions in order to improve liquidity and minimize risk for FICC and its members.

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 54682 (November 1, 2006), 71 FR 65855.

³ Securities Exchange Act Release No. 54682A (November 17, 2006), 71 FR 67667. The correction addressed a typographical error in the original release.

⁴ The GSD Rules refer to member collateral deposits as the “Clearing Fund” while the

Presently, both GSD and MBSD members may satisfy their Clearing Fund requirements with cash deposits. Members may also satisfy a portion of their Clearing Fund requirements with an open account indebtedness fully secured by certain types of securities and/or letters of credit. FICC is modifying its rules to: 1) expand the types of securities members may deposit to satisfy their Clearing Fund requirements (“Eligible Clearing Fund Securities”); 2) establish concentration limits with regard to members’ use of Eligible Clearing Fund Securities; 3) create a correlating range of haircuts to be applied to the expanded types of Eligible Clearing Fund Securities; and 4) eliminate letters of credit as a generally acceptable form of collateral securing members’ open account Clearing Fund indebtedness.

A. Revised Clearing Fund Components

(1) Cash

Currently the rules of GSD require that the greater of \$100,000 or ten percent of a member’s Clearing Fund requirement with a maximum of \$500,000 be made in the form of cash.⁵ The rules of MBSD currently do not contain a minimum cash requirement. For both Divisions, the proposed new cash collateral component will be the lesser of \$5,000,000 or ten percent of a member’s Clearing Fund requirement with a minimum of \$100,000.

MBSD rules refer to these deposits as the “Participants Fund.” The term “Clearing Fund” in this order will refer to both.

⁵ GSD Rule 4, Section 2(b)(ii).

(2) Securities

Currently each Division of FICC accepts different types of securities as Clearing Fund collateral. For example, GSD accepts Agency securities but not mortgage-backed securities, and MBSD accepts mortgage-backed securities but not Agency securities. In addition, there are currently no concentration limits placed on securities deposited as Clearing Fund collateral at either Division. In an effort to standardize the securities that are eligible as Clearing Fund collateral across the Divisions, FICC is modifying the rules of both Divisions by adding a definition, “Eligible Clearing Fund Securities” (for GSD) and “Eligible Participants Fund Securities” (for MBSD) to each Division’s rules.⁶ As defined, Eligible Clearing Fund Securities and Eligible Participants Fund Securities will be unmatured bonds which are either an “Eligible Clearing Fund Agency Security,” an “Eligible Clearing Fund Mortgage-Backed Security” or an “Eligible Clearing Fund Treasury Security.”⁷ “Eligible Clearing Fund Agency Security” would be defined as a direct obligation of those U.S. agencies or government sponsored enterprises as FICC may designate from time to time that satisfies the criteria set forth in notices issued by FICC from time to time. “Eligible Clearing Fund Mortgage-Backed Security” would be defined as a mortgage-backed pass through obligation issued by those U.S. agencies or government sponsored enterprises as FICC may designate from time to time that satisfies the criteria set forth in notices issued by FICC from time to time. “Eligible Clearing Fund Treasury Security” would

⁶ Initial eligibility criteria for each type of Eligible Clearing Fund Securities and Eligible Participants Fund Securities will be announced to members through an Important Notice prior to the effective date of this proposed rule change. Any future changes to the eligibility criteria will also be announced to members through Important Notices in advance of such changes becoming effective.

⁷ In the MBSD Rules, these terms would be as follows: “Eligible Participants Fund Agency Security,” “Eligible Participants Fund Mortgage-Backed Security,” and “Eligible Participants Fund Treasury Security.”

be defined as a direct obligation of the U.S. government that satisfies the criteria set forth in notices issued by FICC from time to time.

(3) Security Concentration Provisions

FICC is also establishing security concentration limits for Clearing Fund deposits. A minimum of forty percent of a member's required Clearing Fund deposit will have to be in cash or Eligible Clearing Fund Treasury Securities. The remainder of a member's deposit can be secured by cash or the pledge of Eligible Clearing Fund Securities. However any deposits of Eligible Clearing Fund Agency Securities or Eligible Clearing Fund Mortgage-Backed Securities in excess of twenty-five percent of a member's required Clearing Fund deposit will be subject to an additional haircut equal to twice the percentage specified in the haircut schedule.

Furthermore, no more than twenty percent of a member's required Clearing Fund deposit can be secured by pledged Eligible Clearing Fund Agency Securities of a single issuer. Lastly, no member will be permitted to post as Clearing Fund collateral Eligible Clearing Fund Agency Securities for which it is the issuer.⁸

(4) Letters of Credit and Other Adequate Assurances

The provisions in the Divisions' Rules that pertain to Letter of Credit Issuers are being modified to reflect that letters of credit are no longer a generally accepted form of Clearing Fund collateral.⁹ Effective April 1, 2007 (the regular expiration date of letters of credit), members that

⁸ However, a member will be permitted to pledge Eligible Clearing Fund Mortgage-Backed Securities for which it is the issuer subject to a haircut specified in the haircut schedule. Initially the haircut will be fourteen percent. If the member exceeded the twenty-five percent concentration limit, the haircut initially will be twenty-one percent.

⁹ FICC has found that in practice letters of credit are not as liquid as cash and securities and therefore pose more risk to FICC and its members when pledged as Clearing Fund collateral. FICC is, however, reserving the right to require letters of credit from members in those instances where a particular member has been found, by FICC in its discretion,

have letters of credit posted as collateral (other than members, if any, that have been required to post letters of credit for legal risk), will be required to replace the portion of the Clearing Fund collateralized by letters of credit with either cash or Eligible Clearing Fund Securities.

(5) Implementation Timeframes

The foregoing rule changes will become effective thirty days after an Important Notice is issued to members informing them that FICC's systems are ready to accommodate such changes. The corresponding changes to FICC's rules will be made at that time. On April 1, 2007, changes pertaining to letters of credit will be made to FICC's rules.

(6) Alternative Proportions of Eligible Collateral

As is currently the case under FICC's rules, FICC continues to reserve the right to require different proportions of the Clearing Fund collateral components as necessary to address any heightened legal or insolvency risks presented by a member.¹⁰

III. Discussion

Section 19(b) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.¹¹ Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of

to present legal risk. GSD Rule 4, Section 2(o) and MBSD Rule 2, Section 4 of Article IV.

¹⁰ GSD Rule 4, Section 2(o) and MBSD Rule 2, Section 4 of Article IV.

¹¹ 15 U.S.C. 78s(b).

the clearing agency or for which it is responsible.¹² The Commission finds that FICC's rule change is consistent with these requirements because by revising its rules governing the acceptable forms of Clearing Fund collateral deposits to increase the liquidity of its Clearing Fund and to minimize risk to FICC and its members, the proposed rule change should better enable FICC to assure the safeguarding of securities and funds in its custody or control or for which it is responsible.¹³

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,¹⁴ that the proposed rule change (File No. SR-FICC-2006-15) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Florence E. Harmon
Deputy Secretary

¹² 15 U.S.C. 78q-1(b)(3)(F).

¹³ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).