

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56182; File No. SR-FICC-2006-19)

August 1, 2007

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of Proposed Rule Change Relating to Membership, Definitions, and the Electronic Pool Notification Service

I. Introduction

On December 13, 2006, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder² to restructure FICC’s Government Securities Division’s (“GSD”) membership standards and membership requirements, update various definitions, and make technical changes to GSD’s rules and to FICC’s Mortgage-Backed Securities Division’s (“MBSD”) Electronic Pool Notification (“EPN”) rules. The proposed rule change was published for comment in the Federal Register on March 29, 2007.³ No comment letters were received on the proposal. This order approves the proposal.

II. Description of the Proposal

A. Membership Rules

FICC is revising its rules concerning membership types, the membership application process, and the ongoing requirements of GSD members into a format that FICC believes will make such rules easier to locate and to understand by applicants and members. To accomplish this, FICC is amending current Rule 2 (retitled “Members”), is moving much of the content of current Rule 2 into a new Rule 2A (“Initial Membership Requirements”), and is revising Rule 3

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 55515 (Mar. 22, 2006), 72 FR 14839.

(retitled “Ongoing Membership Requirements”). Other rules and provisions are being modified to make technical corrections where necessary and to be in harmony with analogous rules of FICC’s affiliated clearing agency, the National Securities Clearing Corporation (“NSCC”).

1. Membership Types

FICC’s current Rule 2 (“Comparison-Only and Netting Members”) sets forth the types of GSD memberships, eligibility requirements, application procedures, and member reporting requirements. FICC is revising Rule 2 to establish each GSD membership type: Comparison-Only Members, Netting Members, Sponsoring Members, Sponsored Members, and Funds-Only Settling Bank Members. Substantially all other provisions contained in the current Rule 2 are being moved to either new Rule 2A or revised Rule 3.

One exception to this is that FICC is deleting current Rule 2, Section 4 (“Financial Reports by Netting Applicants”). FICC states that the rationale for such deletion is that FICC already advises applicants during the application process of the required financial reports depending on the category of membership for which is being applied and on the applicant entity type. In addition, FICC is setting forth in revised Rule 3 the financial reports that must be submitted by members to FICC on an ongoing basis.

FICC is also deleting Section 1(f) of Rule 2, which provides that applicants that have been approved for membership must execute and deliver to FICC a membership agreement. This provision is redundant with existing Rule 2, Section 3, which will now appear in new Rule 2A, Section 7.

2. Consolidation of Membership Standards and Requirements

Prior to this rule change, the membership qualifications, financial standards, and operational requirements for each membership type were set forth in Rule 2 (“Comparison-Only

and Netting Members”), Rule 3 (“Financial Responsibility, Operational Capability and Other Membership Standards of Comparison-Only and Netting Members”), and Rule 4 (“Clearing Fund, Watch List and Loss Allocation”). To consolidate this information, FICC is creating a new Rule 2A (“Initial Membership Requirements”) that will establish the initial membership eligibility requirements for all membership types and will set forth the process of membership application and evaluation. In addition, FICC is restructuring Rule 3 (“Ongoing Membership Requirements”) to contain all current GSD rule provisions regarding the continuing requirements of members.

The restructuring will encompass three substantive changes:

(a) Immediate Placement on the Watch List

FICC is deleting current Rule 3, Section 1(d)(iii) that automatically disqualifies an applicant from becoming member if the applicant is subject to any action or condition, the existence of which would require the applicant to be placed on FICC’s Watch List if it were already a member. FICC believes that eliminating such provision will not diminish FICC’s ability to deny membership to an unworthy applicant because FICC will still retain under other sections of its rules the discretion to deny membership based on the applicant’s underlying financial, operational, or character issues. Moreover, FICC’s credit risk matrix enables FICC to place such applicant directly on FICC’s watch list for closer monitoring.

(b) Additional Reporting Requirements

FICC is adding new language to proposed Rule 3, Section 2 (“Reports by Netting Members”) that will require members to provide FICC with (i) reports from their independent auditors on internal controls [in revised Rule 3, Section 2(b)(ii)] and (ii) a copy of any letter

granting an extension of time by a regulatory authority to a member with respect to the submission of a report [in revised Rule 3, Section 2(h), para. 2].

(c) Annual Audited Financial Statements

FICC is removing the current requirement in Rule 2, Section 4(a) that audited annual financial statements submitted by netting members be “without qualification.” FICC believes that a qualification in an annual audited financial statement should not warrant automatic denial of membership because a qualification may not always be material. In addition, the event that triggered a qualification may have been corrected by the applicant or member by the time the applicant or member submits its financial statement for review by FICC. Going forward, FICC will analyze qualifications in GSD netting member financial statements on a case-by-case basis.

Other conforming and non-substantive changes are being made within the rules to accommodate this restructuring and to update cross-references where applicable.

B. Non-Substantive Changes and Technical Corrections

1. Definition of “Person”

FICC is amending the current definition of Person contained in GSD Rule 1 (“Definitions”) to indicate that the term will be used throughout the rules to mean a partnership, corporation, limited liability corporation, or other organization, entity, or individual.

2. Definition of “Eligible Security”

FICC is amending the definition of Eligible Security to make clear that any security of an issuer that is on the Office of Foreign Assets and Control’s (“OFAC”) Specially Designated Nationals list or a security from a country that is subject to OFAC sanctions may not be an eligible security at GSD. FICC is making the same change to the definition of Eligible Security in MBSD’s Clearing and EPN rules.

3. Definition of “Bond Market Association”

The Bond Market Association is now known as the Securities Industry and Financial Markets Association. GSD is removing the definition of and references to The Bond Market Association from its rules and is replacing it with a definition for and references to The Securities Industry and Financial Markets Association.

4. Governing Law Provision

FICC is clarifying the Governing Law provision contained in GSD’s and MBSD’s Clearing and EPN rules to state that the Clearing and EPN rules of GSD and MBSD are subject to New York law as applicable to contracts executed and performed in New York.

5. Insurance Company Netting Member Eligibility Requirements

FICC is removing from GSD’s rules the eligibility requirements for Insurance Company Netting Members because GSD does not currently have any such members. FICC will, however, retain the definition of Insurance Company Netting Member in its rules in the event that such an entity applies for membership in the future. Appropriate eligibility requirements would be reviewed at that time and proposed as additions to the rules.

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 registered clearing agency. In particular, the Commission believes the proposal is consistent with the requirements of Section 17A(b)(3)(F),⁴ which, among other things, requires the rules of a clearing agency be designed to assure the safeguarding of securities and funds that are in the custody or control of the clearing agency or for which it is responsible. In addition to making the rules more logically structured,

⁴ 15 U.S.C. 78q-1(b)(3)(F).

more consistent with the rules of FICC's clearing agency affiliate, and less redundant, the proposal should improve FICC's ability to responsibly administer its membership application process by providing FICC with a more flexible and risk-based approach to review applications for membership. Although FICC is eliminating certain factors that would previously have resulted in the automatic disqualification of an applicant, FICC has retained explicit rights to deny membership to an unworthy applicant based upon FICC's qualitative review, based in part on new required documentation, of an applicant's underlying financial, operational, or character issues. Accordingly, the proposed rule change is consistent with FICC's obligation to assure ability to safeguard securities and funds in its possession or control or for which it is responsible.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act⁵ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁶ that the proposed rule change (File No. SR-FICC-2006-19) be, and hereby is, approved.⁷

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁸

Florence E. Harmon
Deputy Secretary

⁵ 15 U.S.C. 78q-1.

⁶ 15 U.S.C. 78s(b)(2).

⁷ 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).

⁸ 17 CFR 200.30-3(a)(12).