

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54487; File No. SR-FICC-2005-17)

September 22, 2006

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change Relating to Assumption of Blind Brokered Fails by its Government Securities Division

I. Introduction

On September 30, 2005, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) and on November 28, 2005, amended proposed rule change SR-FICC-2005-17 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 March 8, 2006.² On August 15, 2006, FICC filed an amendment to the proposed rule change.³ No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

The purpose of the proposed rule change is to clarify the practice of the Government Securities Division (“GSD”) of FICC of assuming certain blind brokered repo fails and of obtaining financing as necessary in connection with such assumptions. The settlement of the start leg of a same-day starting repo has always been and continues to be processed outside of the GSD. In the evening of the day of a same-day starting brokered repo, FICC will assume responsibility from the broker for the settlement of such start leg if the repo dealer has not delivered securities to the broker to start the repo (i.e., the start leg has failed). This may involve

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 53396 (March 2, 2006), 71 FR 11694.

³ The August 15, 2006, amendment, as noted below, is not substantive and did not require republication of notice.

FICC's receipt of securities from the repo dealer for redelivery to the reverse repo dealer or FICC's netting or pairing off of the settlement obligation arising from the start leg against the settlement obligation arising from the close leg of the same or another repo.

FICC will also assume a blind brokered repo fail that arises in the close leg of a blind brokered repo transaction. For example, if the start leg of the transaction settles outside of FICC in normal course but one side of the close leg does not compare (for any reason that would cause a trade to not compare such as the erroneous submission of trade data), the broker will have a net settlement position at FICC rather than netting flat. If that transaction fails to settle, FICC will assume the broker's fail.

FICC assumes the fails in these instances in order to decrease risk to itself and to its members.⁴ By assuming the fail, FICC removes the broker, which acts as an intermediary and which expects to net out of every transaction and not have a settlement position, from the settlement process.⁵ FICC is therefore adding a provision to its Rules to expressly provide for its practice of assuming blind broker repo fails and therefore to make its Rules consistent with its current and longstanding practice.⁶

In the assumption of such broker fails, the need for financing might arise, such as in the situation where the repo dealer delivers securities near the close of the securities Fedwire and the broker is unable to redeliver them to the reverse repo dealer. The GSD's Rules already contain a

⁴ FICC has engaged in the practice of assuming broker fails since the inception of its blind brokered repo service.

⁵ FICC filed its August 15, 2006, amendment to the proposed rule change to make explicit its policy that in all cases where FICC assumes a fail from a broker, the counterparty remains responsible for its obligations with respect to the transaction.

⁶ Specifically, new Section 5, "Assumption of Blind Brokered Fails," is being added to GSD Rule 19.

provision, Section 8 of Rule 12, that addresses the GSD's need to obtain financing in general. This provision contemplates the need for financing in order to allow the GSD to facilitate securities settlement generally. It is important to note that such financing is part of the GSD's normal course of business, and the GSD's ability to obtain such financing is necessary for it to be able to complete securities settlement. Section 8 of Rule 12 provides that if FICC deems it appropriate to obtain financing to provide its securities settlement services, FICC may create security interests in eligible netting securities delivered by a netting member in order to obtain such financing. The provision requires that members not take any action to adversely affect this process. The provision also states that such security interests may be created to obtain financing in an amount greater than the obligation of a member to FICC relating to such eligible netting securities. Thus, clearing fund securities may also be used to collateralize such financing. Also, Section III.C of the GSD's fee structure provides the formula that the GSD uses to charge members for the cost of any financing obtained by GSD.

FICC interprets Section 8 of Rule 12 and Section III.C. to apply to financing that might arise because of FICC's assumption of blind brokered fails. FICC does not believe that actual changes to this rule is necessary for this clarification.

III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of transactions and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.⁷ The Commission finds that FICC's proposed rule change is consistent with this requirement because the change, which is designed to clarify FICC's practice

⁷ 15 U.S.C. 78q-1(b)(3)(F).

of assuming failed blind brokered repo transactions, will facilitate the settlement of blind brokered repo fails and as such will facilitate the prompt and accurate clearance and settlement of these transactions. By facilitating the settlement of these fails, FICC will also reduce settlement risk, which will better enable it to assure the safeguarding of securities and funds which are in FICC's custody or control or for which it is responsible.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change, as amended, 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,⁸ that the proposed rule change, as amended, (File No. SR-FICC-2005-17) be and hereby is approved.

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

Nancy M. Morris
Secretary

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).