

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54769; File No. SR-FICC-2006-10)

November 16, 2006

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Amend the Rules of its Mortgage-Backed Securities Division Regarding Membership Requirements for Unregistered Investment Pools

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> notice is hereby given that on June 9, 2006, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change that is described in Items I, II, and III below, which items have been prepared primarily 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 proposing to amend the rules of the Mortgage-Backed Securities Division (“MBSD”) regarding the membership requirements of “Unregistered Investment Pools.”<sup>2</sup>

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

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> As noted below, the term “Unregistered Investment Pool” would be a newly-defined term in the MBSD’s Rules.

below. FICC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>3</sup>

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

FICC is proposing to amend the rules of the MBSD regarding the membership requirements of “unregistered investment pools.” Currently, unregistered investment pools have essentially the same membership standards as other non-broker MBSD clearing members.<sup>4</sup> The size of the unregistered investment pool industry has grown, and unregistered investment pools and their advisers have become significant participants in the industry. FICC believes it is necessary to reexamine its treatment of participants that are unregistered investment pools and to enhance the clearing membership standards applicable to these entities.

FICC is proposing to adopt a definition for Unregistered Investment Pool, which will identify the entities that would become subject to the proposed enhanced membership requirements for such entities. Under the proposed rule, an Unregistered Investment Pool is an entity that holds a pool of securities and/or other assets that meets the following criteria: (i) it is not registered as an investment company under the Investment Company Act of 1940, (ii) it does not register its securities offerings under the Securities Act of 1933, and (iii) it has an investment advisor that is registered with the Commission under the Investment Advisers Act of 1940, or if the investment adviser is not registered, the entity has as lock-up period of two (2) years or greater.

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<sup>3</sup> The Commission has modified the text of the summaries prepared by FICC.

<sup>4</sup> Currently, a clearing applicant or participant that is an unregistered investment pool and whose financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) must satisfy a minimum financial requirement of \$10 million in net assets. In this filing, FICC is making a technical change to replace the term “net asset value” with the term “net assets” to more accurately state the financial requirement.

Under the proposed rule change, entities that meet the definition of Unregistered Investment Pool will be eligible to apply to become MBSD clearing participants only if they meet the new membership criteria set forth below.<sup>5</sup> The MBSD's current participants that meet the definition of Unregistered Investment Pool will have one year from the date of approval of this rule filing in which to conform to the new minimum financial and qualitative rating requirements.

The new membership requirements for Unregistered Investment Pools are as follows:

- (1) SEC Registration: As stated above, the investment advisor of the Unregistered Investment Pool must: (i) be registered with the Commission under the Investment Advisers Act of 1940 or (ii) if it is not registered with the Commission, the Unregistered Investment Pool that the investment adviser advises must have an initial lock-up period of two (2) years or greater.
- (2) Minimum Net Assets: The Unregistered Investment Pool will be required to have and maintain net assets of \$250 million or greater.<sup>6</sup> If the Unregistered Investment Pool does not meet the \$250 million net asset requirement, but the

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<sup>5</sup> It is important to note that entities that meet the MBSD's definition of Unregistered Investment Pool will be treated as such by the MBSD regardless of whether the entity considers itself to be an unregistered investment pool.

<sup>6</sup> The \$250 million net asset requirement is the requirement that will be applicable to Unregistered Investment Pools whose financial statements are prepared in accordance with U.S. GAAP. Those Unregistered Investment Pools whose financial statements are prepared using other types of GAAP will be subject to the higher minimum requirements as determined by Article III, Rule 1, Section 2 of the MBSD's Rules.

Unregistered Investment Pool has net assets of at least \$50 million<sup>7</sup> or greater, then the Unregistered Investment Pool will be eligible for MBSD clearing membership if its investment advisor has assets under management of at least \$1.5 billion and advises an existing MBSD clearing participant.

- (3) Qualitative Rating: The MBSD will require an Unregistered Investment Pool to obtain a minimum required rating of “above average” as a result of an FICC internal qualitative assessment. FICC believes it is important to consider qualitative factors in order to assess both Unregistered Investment Pool applicants and members.

Specifically, staff in the MBSD’s Risk Division will determine a qualitative rating for each Unregistered Investment Pool applicant. Risk staff will review qualitative ratings of Unregistered Investment Pool members on an annual basis. The assessment will include consideration of factors deemed relevant by the Risk Division, including management, capital, strategy and risk profile, and internal controls.<sup>8</sup> The assessment will assess the strengths and weaknesses of these factors and will assign a qualitative rating to the Unregistered Investment Pool. In order to qualify for membership, Unregistered Investment Pools must meet a

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<sup>7</sup> The \$50 million net asset requirement is the requirement that will be applicable to Unregistered Investment Pools whose financial statements are prepared in accordance with U.S. GAAP. Those Unregistered Investment Pools whose financial statements are prepared using other types of GAAP will be subject to the higher minimum requirements as determined by Article III, Rule 1, Section 2 of the MBSD’s Rules.

<sup>8</sup> Because responsibility for these factors with respect to a particular Unregistered Investment Pool may fall at the level of the Unregistered Investment Pool or at the level of the investment advisor or other third party service provider, or in some combination of these, Risk staff will perform the assessment for each factor at the level or levels deemed appropriate.

qualitative rating of at least “above average” as determined by the Risk Division’s staff.

FICC believes that the proposed change is consistent with Section 17A of the Act<sup>9</sup> and the rules and regulations thereunder applicable to FICC because it enhances certain membership requirements and as such, assures the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible.

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

FICC does not believe that the proposed rule change will 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 relating to the proposed rule change have not yet been solicited or received. FICC will notify the Commission of any written comments received by FICC.

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.

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<sup>9</sup> 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 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](mailto:rule-comments@sec.gov). Please include File Number SR-FICC-2006-10 in 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-2006-10. 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 filings also will be available for inspection and copying at the principal office of FICC and on FICC's Web site, [www.ficc.com](http://www.ficc.com). 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-2006-10 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.<sup>10</sup>

Nancy M. Morris  
Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).