

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50392; File No. SR-FICC-2003-14)

September 15, 2004

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change Relating to Amending Impractical or Inconsistent Rules and Adding Rules to Protect the Clearing Corporation and its Members

On November 17, 2003, 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”)<sup>1</sup> (File No. SR-FICC-2003-14) and on January 15, 2004, and March 3, 2004, amended the proposed rule change. Notice of the proposal was published in the Federal Register on March 23, 2004.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

## **I. Description**

The proposed rule change will eliminate and amend certain of FICC’s Government Securities Division (“GSD”) and Mortgage-Backed Securities Division (“MBSD”) rules that are inconsistent with current practice.

1. Remove the term “Clearing Agent Bank Member” and corresponding references to it in GSD’s rules.

This category of GSD membership no longer has any practical meaning and is not used. Entities that are clearing agent banks that wish to join the netting service would become bank netting members.<sup>3</sup>

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

<sup>2</sup> Securities Exchange Act Release No. 49421 (Mar. 16, 2004), 69 FR 13604.

<sup>3</sup> GSD Rule 1.

2. Amend GSD's Rules to remove outdated eligibility qualifications for comparison-only members.

Prior to this rule change, GSD's rules provided for the following types of entities to be eligible to become a comparison-only member: (i) a registered government securities broker or dealer, (ii) a clearing agent bank, or (iii) if neither (i) nor (ii), an entity that has demonstrated to FICC that its business and capabilities are such that it could reasonably expect material benefit from direct access to FICC's services.<sup>4</sup>

FICC believes that GSD's comparison system provides a riskless service whose use should be advantageous to any entity regardless that is an active market participant regardless of the entity's legal or regulatory structure. Accordingly, FICC believes that a better approach to the eligibility criteria for comparison-only entities which would also be consistent with the way that FICC's management views the purpose of comparison-only membership, would be to replace (i) and (ii) with the requirement that a comparison-only applicant be a legal entity that is eligible to apply to be a GSD netting member. FICC would maintain the current (iii) renumbered as (ii).

3. Clarify GSD's rule on voluntary termination of membership.

The proposed change will modify the language in GSD Rule 2, Section 11, to provide that: (i) a member must provide 10 days written notice of terminating its membership but GSD can accept such notice of termination within a shorter period, (ii) the requested termination of membership would not be effective until accepted by GSD, and (iii) GSD's acceptance would be evidenced by a notice to all members announcing the termination date of such member.

Paragraphs (ii) and (iii) are new.

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<sup>4</sup> GSD Rule 2, Section 1.

4. Add a provision to GSD's Rules to permit it to have access to the books and records of members.

Prior to this rule change, GSD's rules permitted GSD to access an applicant's books and records but not a member's books and records. Extending GSD's authority to review member's books and records is consistent with other clearing agencies' rules such as those of the National Securities Clearing Corporation.<sup>5</sup>

5. Add a provision to MBSD's Rules to provide for the confidential treatment of documents submitted by applicants as part of the application process.

This rule change will provide appropriate comfort to applicants and will make MBSD's rules consistent with GSD's rules.<sup>6</sup>

6. Add a new provision to MBSD's Rules that provides that at the request of FICC a non-domestic participant must provide an update of the legal opinion submitted by the foreign member or a written status report on FICC's rights under the relevant non-domestic law and add a similar new provision to GSD Rules.<sup>7</sup>

FICC believes that the old language of this MBSD rule is ambiguous and potentially burdensome for members. FICC believes that a better approach would be to provide that if FICC is alerted to a change in circumstances or to an issue of law that brings into question the reliability of the legal opinion previously submitted by a non-domestic participant, FICC will have the right to require the participant to revisit its legal opinion and to provide an update as to the status of FICC's rights under the relevant non-domestic law. FICC will add this provision to GSD's Rules as well.

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<sup>5</sup> New Section 13 of GSD Rule 2.

<sup>6</sup> New Section 11 of MBSD Rules, Article III, Rule 1.

<sup>7</sup> New language to subsection (g) of GSD Rule 2, Section 3; proposed new subsection (iii) of MBSD Article III, Rule 1, Section 14.

## II. Discussion

Section 17A(b)(3)(F) of the Act<sup>8</sup> requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds in its custody or control or for which it is responsible. The Commission finds that the proposed rule change is consistent with FICC's obligations under Section 17A(b)(3)(F) because clarifying FICC's rules relating to membership, books and records, and legal opinions will provide greater certainty as to FICC's participants' rights and obligations and will enhance FICC's ability to mitigate legal risk posed by non-domestic participants.

## III. 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 Act<sup>9</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2003-14) be, and hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>9</sup> 15 U.S.C. 78q-1.

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