

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

The foregoing rule change has become effective upon filing pursuant to section 19(b)(3)(A)(iii) of the Act<sup>7</sup> and Rule 19b-4(f)(4)<sup>8</sup> thereunder because the proposed rule does not significantly affect the respective rights or obligations of the clearing agency or persons using the service and does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible. At any time within sixty days of the filing of such rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

### 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-FICC-2004-02. 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of such filing also will be available for

inspection and copying at the principal office of FICC and on FICC's Web site at [www.ficc.com](http://www.ficc.com).

All submissions should refer to File No. SR-FICC-2004-02 and should be submitted by February 26, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49158; File No. SR-FICC-2003-03]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change To Amend the Criteria Used To Place Members on Surveillance Status

January 30, 2004.

#### I. Introduction

On March 20, 2003, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") and on June 3 and 18, 2003, amended the proposed rule change SR-FICC-2003-03 pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on October 30, 2003.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### II. Description

Under the current rules of both the Government Securities Division ("GSD") and the Mortgage-Backed Securities Division ("MBSD") of FICC, management has the ability to place a member in a surveillance status class depending on whether the member satisfies one or more of the enumerated financial and operational criteria in the specific class. Once placed on surveillance status, FICC closely monitors the member's condition. The current criteria for placing members on surveillance status are broadly written and capture many FICC members that pose minimal financial or operational risk to FICC. This creates administrative burdens for FICC staff, who must more closely monitor these members that

pose minimal risk, that is not necessary to protect FICC.

To remedy this problem, FICC has developed new criteria for placing members on surveillance. Specifically, all domestic broker-dealers and banks<sup>3</sup> that are GSD netting members and/or MBSD clearing members will be assigned a rating that is generated by entering financial data of the member into a matrix ("Matrix") developed by credit risk staff.<sup>4</sup> Those members with a "weak" rating (deemed to pose a relatively higher degree of risk to FICC) will be placed on an internal "watch list" and will be monitored more closely by credit risk staff.<sup>5</sup> The consequences of being put on the "watch list" will be the same as is currently the case with surveillance status in the GSD's rules and will include possibly requiring the member on "watch list" status to submit additional financial reports and data and/or make additional clearing or participants fund deposits.<sup>6</sup>

All other categories of netting and clearing members, including non-U.S. netting members and comparison-only members, will not be included in the Matrix process because these members possess characteristics that prevent use of the Matrix to effectively evaluate their risk to FICC. However, these members will be monitored by credit risk staff using financial criteria deemed relevant by FICC.<sup>7</sup> Based on this

<sup>3</sup> The following categories of GSD members will receive ratings: Category 1 and 2 Dealer Netting Members, Category 1 and 2 Inter-Dealer Broker Netting Members, and Bank Netting Members. At MBSD, Comparison and Clearing System Participants that are either banks or broker-dealers will be rated. Domestic broker-dealers and domestic banks are the only member types to which the Matrix will be applicable because (i) they represent the majority of the members of FICC and (ii) their financial reports contain information that lends them to the Matrix approach.

<sup>4</sup> FICC's approach to the analysis of members is based on a thorough quantitative analysis. A broker-dealer member's rating on the Matrix will be based on factors including size (*i.e.*, total excess net capital), capital, leverage, liquidity, and profitability. Banks will be reviewed based on size, capital, asset quality, earnings, and liquidity.

<sup>5</sup> Members will also be evaluated based on their compliance with certain "parameter breaks" which will be determined based on applicable monthly and/or quarterly exception reports generated by credit risk staff. A member may be placed on the "watch list" for parameter breaks in areas such as excess net capital, excess liquid capital, aggregate indebtedness, leverage ratio, or other financial requirements.

<sup>6</sup> The MBSD's rules do not currently provide for surveillance status, but the MBSD has the right under certain circumstances to require additional financial reports and increased participants fund contribution.

<sup>7</sup> Credit risk staff will monitor these members by reviewing similar criteria as the criteria used for members included in the Matrix. FICC will file a proposed rule change should it decide to use a more applicable Matrix process to evaluate these members.

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>8</sup> 17 CFR 240.19b-4(f)(4).

<sup>9</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> Securities Exchange Act Release No. 48689 (October 24, 2003), 68 FR 61844.

monitoring, such Members may also be placed on the "watch list" if they experience a financial change that presents risk to FICC. Some examples include failure to meet minimum financial requirements or experiencing a significant decrease in equity (for GSD members) or net asset value (for MBSD members). Members placed on the "watch list" in this way will also be monitored more closely by credit risk staff.

The GSD will continue, in accordance with its current procedures, to place GSD netting members on the "watch list" for failure to comply with operational standards and requirements.<sup>8</sup> MBSD expects to implement a similar provision, as outlined in these rule changes, soon.

### III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to facilitate the safeguarding of securities and funds which are in its custody or control or for which it is responsible.<sup>9</sup> The Commission finds that FICC's proposed rule change is consistent with this requirement because it will improve FICC's member surveillance process which will better enable FICC to safeguard the securities and funds which are in its 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 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, that the proposed rule change (File No. SR-FICC-2003-03) be and hereby is approved.

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

**Jill M. Peterson,**

*Assistant Secretary.*

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<sup>8</sup> The GSD currently monitors the comparison rates of members. Currently, low comparison rates can result in a member being placed on Class 1 surveillance status. Under the rule change, low comparison rates may result in a GSD member being placed on the "watch list." Both the GSD and the MBSD may monitor for other operational factors in the future such as failing to timely submit trade data on a frequent basis.

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(F).

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

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49141; File No. SR-ISE-2001-22]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the International Securities Exchange, Inc., To Establish a Solicited Order Mechanism

January 28, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 26, 2001, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On January 4, 2002, ISE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On June 26, 2002, ISE filed Amendment No. 2 to the proposed rule change.<sup>4</sup> On January 6, 2004, ISE filed Amendment No. 3 to the proposed rule change.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The ISE is proposing to amend its rules regarding solicited orders to establish a Solicited Order Mechanism for matching a member's unsolicited agency orders with orders the member solicits from other broker-dealers. The text of the proposed rule change, as amended, is set forth below. Brackets indicate material to be deleted. *Italics* indicate material to be added.

#### Rule 716. Block and Solicited Trades

\* \* \* \* \*

*(e) Solicited Order Mechanism. The Solicited Order Mechanism is a process*

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated January 3, 2002.

<sup>4</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division, Commission, dated June 25, 2002.

<sup>5</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division, Commission, dated January 5, 2004. Amendment No. 3 replaced the initial filing and Amendment Nos. 1 and 2 entirely. The changes proposed in Amendment No. 3 are incorporated in this notice.

by which an Electronic Access Member can attempt to execute orders of 500 or more contracts it represents as agent (the "Agency Order") against contra orders that it solicited. Each order entered into the Solicited Order Mechanism shall be designated as all-or-none.

(1) Upon entry of both orders into the Solicited Order Mechanism at a proposed execution price, a broadcast message will be sent to Crowd Participants, which will be given an opportunity to enter Responses with the prices and sizes at which they would be willing to participate in the execution of the Agency Order.

(2) At the end of the period given Crowd Participants to enter Responses, the Agency Order will be automatically executed in full or cancelled.

(i) If at the time of execution there is insufficient size to execute the entire Agency Order at an improved price (or prices), the Agency Order will be executed against the solicited order at the proposed execution price so long as, at the time of execution: (A) the execution price is equal to or better than the best bid or offer on the ISE, and (B) there are no Public Customer orders on the Exchange that are priced equal to the proposed execution price. If there are Public Customer orders on the Exchange on the opposite side of the Agency Order at the proposed execution price and there is sufficient size to execute the entire size of the Agency Order, the Agency Order will be executed against the bid or offer, and the solicited order will be cancelled. The aggregate size of all orders, quotes and Responses at the bid or offer will be used to determine whether the entire Agency Order can be executed. Both the solicited order and Agency Order will be cancelled if an execution would take place at a price that is inferior to the best bid or offer on the ISE, or if there is a Public Customer on the book at the proposed execution price but there is insufficient size on the Exchange to execute the entire Agency Order.

(ii) If at the time of execution there is sufficient size to execute the entire Agency Order at an improved price (or prices), the Agency Order will be executed at the improved price(s), subject to the condition in (i)(A), and the solicited order will be cancelled. The aggregate size of all orders, quotes and Responses at each price will be used to determine whether the entire Agency Order can be executed at an improved price (or prices).

(iii) When executing the Agency Order against the bid or offer in accordance with paragraph (i) above, or at an improved price in accordance with