

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, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of DTC and on DTC's Web site at <http://www.dtc.org>. 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-DTC-2004-09 and should be submitted on or before October 13, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50392; File No. SR-FICC-2003-14]

### 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

September 15, 2004.

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>

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.

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.

#### 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

<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.

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

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

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

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

<sup>7</sup> 17 CFR 200.30-3(a)(12).

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

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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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50389; File No. SR-FICC-2003-06]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to the Assessment of Funds-Only Settlement Obligations

September 15, 2004.

#### I. Introduction

On July 11, 2003, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2003-06 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 February 23, 2004.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

#### II. Description

The proposed rule change for the most part eliminates the complex manual adjustments currently made by FICC's Operations Department with

regard to the forward margin debit obligations and credit entitlements of repo broker members of the Government Securities Division ("GSD") of FICC.<sup>3</sup> When GSD initially implemented its blind-brokered repurchase agreement ("repo") service, it operated a system whereby the majority of members submitted trade data in a single batch file at the end of each day. The batch file submission process made it virtually impossible for repo brokers, that expect to net out of their position as middlemen in brokered repos, to timely determine the existence of trades on which they had positions, contact the appropriate counterparties, and correct trade details. As a result, any erroneous submissions on the part of a dealer counterparty resulted in a forward margin assessment to the repo broker. Realizing that a repo broker should always be flat from a net-settlement position perspective, FICC granted repo brokers relief from the forward margining process by providing a look through to the dealer counterparties for purposes of assessing forward margin obligations.<sup>4</sup> However, the look through involves a manual adjustment process that requires complex calculations inconsistent with FICC's overall management policy.<sup>5</sup>

FICC has determined that it will no longer provide a look through to relieve repo brokers from forward margin

<sup>3</sup> Forward margin is a component of a netting member's daily funds-only settlement obligation. Forward margin is a mark-to-market payment on forward-settling positions. It is passed through in the form of cash from the debit side to the credit side. The amounts are reversed on the following day with interest collected from the credit side and paid through to the debit side.

<sup>4</sup> FICC, in a prior rule filing, amended its rules to allow management to look through brokered repo transactions in order that repo brokers were not left with debit or credit obligations caused by erroneous submissions on behalf of the dealers. Securities Exchange Act Release No. 38603 (May 9, 1997), 62 FR 27088 (May 16, 1997) (File No. SR-GSCC-96-12). In accordance with FICC's risk strategy at the time, the risk management process worked most effectively if a repo broker was netted out of its positions as a middleman. However, with the advent of real time trade matching and the ready ability of brokers to rectify dealer submission errors, GSD believes that risk management initiatives are better served by using the parameters outlined in this filing.

<sup>5</sup> On each business day, the Operations Division routinely adjusts the overall funds-only settlement obligation of a repo broker that has a forward margin debit or credit. If the repo broker has an overall credit forward margin, GSD will reduce its aggregate funds-only credit obligation or increase its aggregate funds-only debit entitlement by an amount equal to the forward margin credit. Conversely, if the repo broker is in an overall debit forward margin position, GSD will reduce its aggregate funds-only debit obligation or increase its funds-only credit entitlement by an amount equal to the debit; however, it then will apply that amount to the uncomparated dealer (the dealer who failed to submit or submitted erroneously).

obligations. Subsequent to the events of September 11, 2001, FICC decided to eliminate all operations functions that require complex manual adjustment or input as a way to reduce risk in all operations processes. In addition, almost all repo broker activity is now submitted to FICC on an interactive, real-time basis that allows brokers to readily rectify any outstanding data submission errors during the day. For these reasons, FICC is proposing to modify the forward margin adjustment process to require the repo brokers to satisfy their forward margin obligations including both paying forward margin debits and receiving forward margin credits.

Going forward, FICC will apply the following parameters with respect to the forward margin obligations of repo brokers. Debits and credits up to a predetermined dollar amount cap will be automatically collected or paid as applicable by the repo brokers as is the case for all other netting members.<sup>6</sup> Debits and credits in excess of the cap will be subject to hybrid processing, whereby the dollar amount up to the cap will always be collected or paid in its entirety by the broker, amounts over the cap ("excess debits" or "excess credits") will be financed by GSD at the discretion of FICC.

The following is an example of hybrid processing for a broker with an excess debit. First, the Operations Department will request that the affected repo broker pay the excess debit to FICC. In the event that the repo broker is unable to pay the excess debit, the Operations Department, in consultation with the Credit Risk Department, will determine whether it is appropriate for FICC to finance the excess debit. If FICC finances the excess debit, the broker will be charged a financing fee, representing the interest amount that FICC will be charged by the clearing bank, and the member will be subject to an administrative fee.<sup>7</sup> GSD will collect the calculated interest amount from the repo broker on the subsequent business day. GSD will also reserve the right in certain situations to assess the forward margin amounts in excess of the dollar amount cap by looking through to the dealer, as is done by the current manual process.<sup>8</sup> All extensions of financing by

<sup>6</sup> The FICC Membership and Risk Management Committee will determine, based on historical data and risk considerations, what the debit and credit cap will be for forward margin debits and credits. The Committee has approved an initial cap of \$2 million.

<sup>7</sup> This fee will be designed to cover FICC's cost of arranging financing and will be filed before implementation.

<sup>8</sup> FICC will continue to look through to the dealer counterparty for purposes of assessing forward

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

<sup>10</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. 49242 (February 12, 2004), 69 FR 8251.