

meaning, administration, or enforcement of an existing rule. At any time within 60 days of the filing of such proposed 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. 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-CBOE-2005-03 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2005-03. 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, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. 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-CBOE-2005-03 and should be submitted on or before February 8, 2005.

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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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51018; File No. SR-FICC-2004-14]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Membership Requirements

January 11, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on July 14, 2004, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2004-14. On July 15, July 30, August 20, and November 10, 2004, FICC filed amendments 1, 2, 3, and 4 respectively. On January 3, 2005, FICC filed amendment 5 and withdrew amendments 1, 2, 3, and 4. The proposed rule change, as amended, 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 persons.

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

FICC proposes to amend the rules of its Government Securities Division ("GSD") and Mortgage-Backed Securities Division ("MBSD") regarding membership requirements for non-U.S. applicants and members.

#### 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 below. FICC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.<sup>2</sup>

#### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### 1. Annual Audited Financial Statements

Currently, GSD requires non-U.S. members and applicants to submit financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") "whenever necessary and feasible." MBSD requires non-U.S. members and applicants to submit financial statements prepared in accordance with U.S. GAAP. Both divisions review such financial statements as part of their credit risk management program.

FICC proposes to amend these requirements uniformly across both divisions to enable non-U.S. members and applicants to submit financial statements that are prepared according to any other generally accepted accounting methodology ("non-U.S. GAAP").

In order to lessen the risk associated with accepting financial statements prepared in accordance with non-U.S. GAAP, FICC would increase the existing minimum financial requirements of each applicant and member based on which non-U.S. GAAP was used to prepare the audited financial statement in the following manner:

(a) For applicants and members whose financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"), the Companies Act of 1985 ("U.K. GAAP"), or Canadian GAAP, the minimum financial requirements would be one and one-half times the applicable requirements.

(b) For applicants and members whose financial statements are prepared in accordance with a European Union country GAAP ("EU GAAP") other than U.K. GAAP, the minimum financial requirements would be five times the applicable requirements.

(c) For applicants and members whose financial statements are prepared in accordance with any other type of GAAP, the minimum financial requirements would be seven times the applicable requirements.<sup>3</sup>

<sup>2</sup> The Commission has modified the text of the summaries prepared by FICC.

<sup>3</sup> In order to determine the appropriate premiums, FICC's risk management staff compiled all the U.S. GAAP and non-U.S. GAAP equity capital figures of financial institutions that filed SEC Form 20-F or 40-F for their 2002 and/or 2003 fiscal year ends to identify the largest absolute differences between U.S. GAAP and non-U.S. GAAPs. The staff found that approximately 50% was the largest difference when the U.S. GAAP figures were compared to IFRS, U.K. GAAP, and Canadian GAAP. The largest

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

<sup>11</sup> 5 U.S.C. 78s(b)(1).

For example, currently under the GSD's rules, the minimum financial requirement for a bank netting member is equity capital of US\$100 million. This will continue to be the requirement for all such members (both U.S. and non-U.S. members), whose financial statements are prepared in accordance with U.S. GAAP. If such a member's financial statements were prepared in accordance with IFRS, U.K. GAAP, or Canadian GAAP, the member's minimum financial requirement would be US\$150 million. If such a member's financial statements were prepared in accordance with an EU country GAAP other than U.K. GAAP, the member's minimum financial requirement would be US\$500 million. If a member's financial statements were prepared in accordance with any other type of GAAP, the member's minimum financial requirement would be US\$700 million.

FICC would retain the requirement that annual audited financial statements submitted by members and applicants be certified without qualification. The proposed rule change would make clear that annual audited financial statements must be prepared in accordance with generally accepted accounting principles. In addition, all information submitted to FICC would have to be in English or would have to be a fair and accurate English translation if the information had been translated into English. Additionally, in order to accommodate this change for members other than banks, the proposed rule change provides that specific references to the term U.S. regulatory capital should be deemed to refer to the general term of "regulatory capital."

The proposed rule changes would be applied to current members as well as applicants.

## 2. Material Regulatory Filings

As part of its credit risk management, FICC requires applicants and members to submit interim financial data. In the case of U.S. bank and broker-dealer members, the GSD and the MBSD are able to obtain this financial information through regulatory reports. Non-U.S. MBSD members are required to submit unaudited monthly financial statements to MBSD. Non-U.S. GSD netting members are required to submit certain

difference was approximately 528% when the U.S. GAAP figures were compared to EU country GAAP figures. Finally, approximately 400% was the largest difference when the U.S. GAAP figures were compared to all other non-U.S. GAAPs. (FICC staff determined that it would be prudent to apply a premium of seven times the existing requirement.) FICC staff will assess these premiums annually and will report to Commission staff on its findings.

quarterly financial information to GSD. The GSD rules also currently require non-U.S. members and applicants to also submit all "material regulatory filings" that the entity makes with its primary regulator in its home jurisdiction. However, FICC cannot specifically identify all such material regulatory filings for non-U.S. members and applicants with confidence.

In order to enhance FICC's credit risk monitoring program, the proposed rule change, which would be adopted uniformly across both FICC divisions, would require non-U.S. members (other than those organized or established in the U.K. and regulated by the FSA) to provide specific monthly or quarterly financial data, as applicable, directly to FICC. FICC will provide the non-U.S. members with a form requesting specific financial data related to capital, assets, liabilities, revenue, pertinent ratios, and various capital requirements, as applicable.<sup>4</sup> Each non-U.S. member will be required to complete the form, have it signed by the entity's chief financial officer, chief executive officer, or similar high-ranking official, and return it to FICC by a prescribed deadline.

Broker-dealers and banks that are organized or established in the U.K. and regulated by the Financial Services Authority ("FSA") will be required to submit certain regulatory monthly or quarterly reports, as applicable, that are filed with the FSA.<sup>5</sup> Because FICC will be able to obtain the necessary financial data from these reports, these U.K. firms will not be required to complete and submit FICC's financial reporting form as are other non-U.S. members. The proposed rule change will provide that failure to submit the financial form or the U.K. regulatory reports, as applicable, to FICC within the timeframes required by FICC will subject a member to the same consequences, including a fine, as is currently provided for in FICC's rules.

FICC recognizes that certain regulatory filings provide warnings of possible concerns regarding a member's compliance with regulatory standards and its financial status. For example, under FICC's current rules, GSD's and MBSD's U.S. broker-dealer members are required to submit to FICC SEC Rule 17a-11 reports. GSD's netting members, MBSD's U.S. non-broker-dealer members, and all non-U.S. members must submit to FICC, concurrently with

<sup>4</sup> The proposed rule changes would replace the current financial documents required by the FICC membership agreements.

<sup>5</sup> Although FICC currently has no U.K. members, FICC is familiar with the regulatory reports filed by banks and broker-dealers that are organized or established in the U.K. and regulated by the FSA.

their submission to their relevant regulator, copies of regulatory notifications required to be made when a member's capital levels or other financial requirements fall below prescribed levels.<sup>6</sup> The proposed rule change would expand this to require members to submit to FICC any regulatory notifications required to be made when it does not comply with its financial reporting and responsibility standards set by its home country regulator and when it becomes subject to a disciplinary action by its home country regulator. In addition, the proposed rule change would make the late submission of any such filing subject to a fine and other related consequences that have been recently approved by or are pending with the Commission.<sup>7</sup> This proposed rule change would require that such filings be submitted to FICC in English or be in a fair and accurate English translation if they have been translated into English.

Finally, the proposed rule change would require MBSD non-U.S. regulated applicants to certify that they are in compliance with the financial reporting and responsibility standards of their home country. This requirement was recently added to GSD's rules.<sup>8</sup>

## 3. Legal Risk

FICC believes that members that are incorporated outside of the U.S. present FICC with increased legal risk in the event they become insolvent as compared to members incorporated within the U.S.<sup>9</sup> Notwithstanding the protections for clearing agencies contained in the U.S. federal laws<sup>10</sup> and the New York Banking Law (which is applicable to GSD foreign netting members with New York state-licensed branches and agencies), there is a risk that a U.S. court could determine not to apply New York law to the adjudication of FICC's rights against an insolvent non-U.S. member.<sup>11</sup> In such event, the

<sup>6</sup> Securities Exchange Act Release Nos. 49947 (June 30, 2004), 69 FR 41316 (July 8, 2004) [File No. SR-FICC-2003-01] and 49156 (Jan. 30, 2004), 69 FR 5881 (Feb. 6, 2004) [File No. SR-MBSCC-2001-06].

<sup>7</sup> Securities Exchange Act. Release No. 50659 (Nov. 15, 2004), 69 FR 67767 (Nov. 19, 2004) [File No. FICC-SR-2004-11] and FICC-SR-2004-13 (currently pending with the Commission).

<sup>8</sup> Securities Exchange Act Release No. 34-50617 (Nov. 1, 2004), 69 FR 64796 (Nov. 8, 2004) [File No. SR-FICC-2004-01].

<sup>9</sup> At this time, GSD will continue to only permit non-U.S. banks operating out of U.S. branches or agencies to be Foreign Netting Members.

<sup>10</sup> E.g., the Federal Deposit Insurance Corporation Improvement Act of 1991 and the U.S. Bankruptcy Code.

<sup>11</sup> This particular matter is currently being adjudicated in a case that will be argued before the Second Circuit involving a Serbian governmental

foregoing protections may not be available to FICC.

In order to mitigate this risk, FICC has required, and will continue to require, non-U.S. GSD netting and MBSD clearing applicants to submit non-U.S. legal opinions drafted by outside counsel from the jurisdiction in which the member is incorporated and/or primarily conducts its business. FICC will continue to make a case-by-case determination, based on its analysis of the legal opinion, as to the legal risks presented by the home country laws of such applicants. In doing so, FICC will retain U.S. outside counsel to review the opinions and to advise FICC of any risks presented. The proposed rule filing makes clear that, based on the review of the legal opinion, FICC will determine what, if any, protective measures will be required to mitigate any legal risks. Protective action may, for example, take the form of requiring the member to post additional collateral and/or requiring a member to post a certain percentage of its collateral requirement in a certain form (such as letters of credit).

FICC recognizes that some of its non-U.S. netting and clearing members have been members for some time. In order to protect itself against any adverse changes in home country law that may have arisen since the members submitted their legal opinions and in order to determine whether any positive developments in home country law would support eliminating or relaxing the collateral premiums currently imposed on certain members,<sup>12</sup> FICC is proposing to require all of its current non-U.S. members (except those members whose opinions have been issued within the past 18 months) to submit a current legal opinion from outside non-U.S. counsel addressing the non-U.S. legal issues or to provide a letter on their outside counsel's letterhead stating that no material changes have occurred in home country law since the date of the original legal opinions. FICC would require its current members to submit these updated legal

agency that has brought a U.S. Bankruptcy Code Section 304 proceeding seeking to have the disposition of the assets of certain Yugoslavian banks with New York state-licensed agencies be considered under home country law. See *Agency for Deposit Ins., Rehab., Bankr. & Liquidation of Banks v. Superintendent of Banks*, Case No. 03-CV-9320 (JSR), Case No. 03-CV-9321 (JSR), 2004 U.S. Dist. LEXIS 10848 (S.D.N.Y. June 2004).

<sup>12</sup> GSD currently has three non-U.S. netting members that are subject to increased clearing fund requirements due to past determinations of the heightened legal risk presented by the insolvency laws of their home jurisdictions. These members are currently posting 100 percent of their clearing fund requirement in the form of one or more letters of credit and an additional 30 percent in the form of cash and securities.

opinions (or letters) within three months of the approval of this filing by the Commission. FICC would then review with the assistance of its outside counsel all such revised legal opinions (and those original legal opinions that counsel indicates remain current) and determine whether protective measures need to be taken or whether the current increased collateral requirements should continue, be relaxed, or be eliminated.

The proposed rule change would also require all non-U.S. members to provide an annual update of their non-U.S. legal opinion or to provide a letter from their outside counsel stating that no material issues have arisen since the issuance of the opinion or the last update. FICC may impose such additional requirements on such members as described above based on review of such updated legal opinions.

#### 4. Additional Changes

Upon reviewing its membership rules for non-U.S. members, FICC has determined that certain rules applicable to both U.S. and non-U.S. applicants and members need to be updated. Specifically, the proposed rule change would delete all references to certifications by the chief executive officer, chief financial officer, or other that accompany financial statements, financial data, or regulatory reports. These certifications do not appear to be standard documentation, and FICC historically has not received such certifications. If a need to request a certification with respect to a particular member or applicant arises, FICC would have the authority to request it pursuant to the general authority that it has in both division's rules to seek additional information.

In addition, in a prior proposed rule change approved by the Commission, FICC amended its rules intending to give FICC the option to request that financial figures be submitted in U.S. dollar equivalents.<sup>13</sup> This proposed rule change deletes this option from FICC's rules as FICC performs these calculations itself, intends to continue doing so, and believes that the pending language has the potential for confusion.

In addition, the proposed rule change would amend the number of recent routine regulatory reports that a U.S. GSD netting or MBSD clearing applicant is required to submit to FICC to the number of such reports that the entity has filed during the preceding 12 months or a lesser period if the

applicant has been in business or has been registered or licensed for a lesser period. For example, a GSD U.S. broker-dealer applicant that is a monthly FOCUS filer would need to submit copies of all of its FOCUS reports filed during the preceding 12 months. With respect to 17a-11 reports, where the current rules do not specify the necessary time period, the proposed rule change requires U.S. broker-dealer applicants to submit all 17a-11 reports filed during the preceding 24 months.

FICC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act<sup>14</sup> and the rules and regulations thereunder because it will enhance FICC's assessment and surveillance of applicants and members and therefore help assure the safeguarding of securities and funds which are in its custody or control.

#### 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

FICC has received comments on the proposed rule change orally and in writing from the Institute of International Banks, representing the GSD non-U.S. members and from one non-U.S. MBSD participant. All such comments have been forwarded to the Commission.

### 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.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing,

<sup>13</sup> FICC 2004-01, *supra* note 8. This proposed filing (*i.e.*, FICC-2004-14) proposes to delete the reference to U.S. dollar equivalents completely.

<sup>14</sup> 15 U.S.C. 78q-1.

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-2004-14 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. All submissions should refer to File Number SR-FICC-2004-14. 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, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at FICC's principal office and on FICC's Web site at <http://ficc.com/gov/gov.docs.jsp?NS-query=#rf>. 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-2004-14 and should be submitted on or before February 8, 2005.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-51021; File No. SR-FICC-2004-09]

**Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change Relating to Changes to Membership Requirements**

January 11, 2005.

On April 14, 2004, 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-2004-09) and on November 16, 2004, and January 3, 2005,<sup>2</sup> amended the proposed rule change. Notice of the proposal was published in the **Federal Register** on November 30, 2004.<sup>3</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

**I. Description**

FICC's Government Securities Division ("GSD") and Mortgage Backed Securities Division ("MBSD") rules will be changed in the following areas:

*A. Annual Audited Financial Statements*

Prior to this rule change, GSD's rules required U.S. applicants for GSD membership to submit annual audited financial statements for the preceding year and non-U.S. applicants to submit annual audited financial statements for the preceding three years. MBSD's rules used to require U.S. and non-U.S. membership applicants to submit annual audited financial statements for the preceding year.

Under the rule change, FICC will amend both divisions' rules to require GSD netting applicants and MBSD clearing applicants to submit two years of annual audited financial statements. However, if an applicant or member has not been in business for two years (*i.e.*, a newly-formed applicant or member<sup>4</sup>), FICC will permit such applicant or

member to submit annual audited financial statements for a lesser period and/or annual audited financial statements of a predecessor firm in the case of an applicant or member formed by a corporate transaction. If audited financial statements cannot be obtained, newly-formed applicants will be permitted to submit unaudited pro forma financial statements. If FICC accepts pro forma or consolidated financial statements, the following shall apply:

1. If an applicant is newly formed and does not have annual audited financial statements, the applicant shall be required to submit pro forma financial statements and, if it has filed any regulatory reports, such regulatory reports.<sup>5</sup> FICC will verify the applicant's capital base by reviewing evidence from a third party as to the applicant's capital at the time of application.<sup>6</sup>

2. If an applicant is newly formed as a result of a merger (or similar corporate transaction), the applicant shall be required to submit pro forma financial statements, the most recent annual audited financial statement of its predecessor firm if such statement is available, and if it has filed regulatory reports, such regulatory reports.

3. If the applicant does not have its own audited financial statements but is consolidated in its parent's audited financial statements and it has filed its own regulatory reports, the applicant shall be required to submit such regulatory reports in addition to the consolidated financial statements.

FICC believes the proposed rule change permitting less than two years of annual audited financial statements or unaudited pro forma financial statements is necessary and appropriate in order to accommodate entities that are newly-formed and those that are created as a result of a merger of existing entities or other similar corporate transaction. First, firms that are newly-formed do not have audited financials and in some instances can only provide pro forma financial statements. Second, the GSD's rules already contemplate the admission of entities with little or no business history, which often are of equal or even greater credit quality than more established entities. For example,

<sup>5</sup> Unregulated and non-U.S. entities will be required to produce specific information that FICC needs in order to develop a risk profile to evaluate creditworthiness. This information will be requested in a form provided to the firms by FICC and signed by a senior officer of the firm. This form, which was the subject of a proposed rule filing, SR-FICC-2004-14, replaced the requirement for the submission of regulatory reports by non-U.S. entities. Securities Exchange Act Release No. 51018 (Jan. 11, 2005).

<sup>6</sup> For example, FICC may request a bank statement to verify that cash has been deposited, thereby verifying that the applicant meets FICC's minimum capital requirement.

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

<sup>2</sup> Although the proposed rule change was amended after it was noticed for comment in the **Federal Register**, republication of the notice is not necessary because the post-notice amendment made only a technical change to the proposed rule change.

<sup>3</sup> Securities Exchange Act Release No. 50718 (Nov. 22, 2004), 69 FR 69653.

<sup>4</sup> A newly formed applicant includes a company with no business history or a company formed as a result of a corporate transaction such as a merger.

<sup>15</sup> 17 CFR 200.30-3(a)(12).