

[FR Doc. 05-8916 Filed 5-3-05; 8:45 am]

BILLING CODE 8010-01-C

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51623; File No. SR-FICC-2004-17]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of a Proposed Rule Change To Modify the Assessment Process for Late Submissions of Collateral Made Through the GCF Repo Service and To Increase the Types of Securities Available To Satisfy Collateral Allocation Obligations

April 28, 2005.

#### I. Introduction

On August 13, 2004, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") and on March 14, 2005, amended proposed rule change File No. SR-FICC-2004-17 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposed rule change was published in the **Federal Register** on March 29, 2005.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is now granting approval of the proposed rule change.

#### II. Description

FICC is amending the rules of the Government Securities Division ("GSD") of FICC to modify the assessment process for late submissions of collateral allocations made through its GCF Repo service and to increase the types of securities that can be used by a member in satisfaction of collateral obligations.<sup>3</sup>

##### 1. Assessment Process for Late Submissions of Collateral Allocations Made Through the GCF Repo Service

On October 30, 1998, the Commission granted approval to FICC's predecessor, the Government Securities Clearing Corporation, to implement its GCF Repo service, which is a significant alternative financing vehicle to the

delivery versus payment and tri-party repo markets.<sup>4</sup> That approval included a fine schedule for failure to adhere to relevant timeframes. The fine schedule was not implemented because of certain events.<sup>5</sup> More recently, FICC has shifted the service from an interbank service to an intrabank service in order to address certain payment system risk issues that have arisen and that have resulted in decreased volumes.<sup>6</sup> FICC believes, given the lower volumes and likely forthcoming changes to the service to address the payment system risk issues, that the original fine schedule should be replaced.

Specifically, FICC is implementing a late fee schedule to replace the late fine schedule. FICC believes that late fee schedules are appropriate in situations where the member's lateness causes an operational burden on FICC but does not result in risk to FICC or its members.<sup>7</sup> In addition, in order to encourage members to make their collateral allocations on a timely basis, there will now be one late fee targeted to the most significant time frame surrounding the service. Specifically, if a dealer does not make the required collateral allocation by the later of 4:30 p.m. (New York time) or 1 hour after the actual close of Fedwire GCF repo reversals, the dealer will be subject to a late fee of \$500.00. Finally, in order to alleviate the potential operational and administrative burdens caused by late collateral allocations, FICC is amending the GCF Repo rules to provide that FICC will process collateral allocation obligations that are received after 6 p.m. on a good faith basis only. This 6 p.m. deadline will replace the 7 p.m. final cutoff for dealer allocations of collateral to satisfy obligations.

##### 2. Types of Collateral Used To Satisfy Collateral Allocation Obligations

Currently, GSD Rule 20 provides that a collateral allocation obligation may be satisfied with "comparable securities," Treasury securities, and/or cash. "Comparable securities" are defined to include any securities that are represented by the same generic CUSIP

<sup>4</sup> Securities Exchange Act Release No. 40623 (October 30, 1998), 63 FR 59831 (November 5, 1998) [File No. SR-GSCC-98-02].

<sup>5</sup> As a new and complex service, members had difficulty adhering to the time frames. In addition, the initial rate of participation was very low, and there was a need to encourage growth in the service.

<sup>6</sup> Securities Exchange Act Release No. 48006 (June 10, 2003), 68 FR 35745 (June 16, 2003) [SR-FICC-2003-04].

<sup>7</sup> In a GCF Repo transaction, a borrower does not receive the funds borrowed until it makes the required collateral allocation. The lender maintains control of the funds until the allocation is made. The transaction does not produce a risk of loss to FICC, the lender, or other members.

number as the securities in question. Therefore, in the event that a member does not have enough of the collateral securities or the "comparable securities," the only collateral that can be used is Treasury securities and/or cash.

GSD members have approached FICC and have asked that it amend rules to add certain additional collateral options. In response, FICC is amending its rules as set forth below:

(a) Ginnie Mae adjustable-rate mortgage obligations can be satisfied with Ginnie Mae fixed-rate mortgage backed securities and

(b) Fannie Mae and Freddie Mac adjustable-rate mortgage obligations can be satisfied with: (i) Fannie Mae and Freddie Mac fixed-rate mortgage-backed securities, (ii) Ginnie Mae fixed-rate mortgage-backed securities, and (iii) Ginnie Mae adjustable-rate mortgage obligations.

#### III. Discussion

Section 17A(b)(3)(F) of the Act requires among other things that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>8</sup> The Commission finds that by allowing FICC's members additional collateral options with which to meet GCF collateral allocation obligations and by implementing a fee schedule that should incentivize members to allocate collateral on a timely basis, FICC's proposed rule change should promote the prompt and accurate clearance and settlement of GCF Repo transactions. As such, FICC's proposed rule change is consistent with Section 17A(b)(3)(F) of the Act.

#### 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,<sup>9</sup> that the proposed rule change (File No. SR-FICC-2004-17) 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.*

[FR Doc. E5-2165 Filed 5-3-05; 8:45 am]

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

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<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. 51413 (March 23, 2005), 70 FR 15960.

<sup>3</sup> The proposed rule change also amends GSD's rules to clarify that where a collateral allocation obligation is satisfied by the posting of U.S. Treasury Bills, notes, or bonds, such securities must mature in a time frame no greater than that of the securities that have been traded except if such traded securities are U.S. Treasury Bills, such obligations must be satisfied with the posting of "comparable securities" and/or cash only.