

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57281; File No. SR-FICC-2007-08)

February 6, 2008

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change as amended by Amendment No. 1 to Resume Interbank Clearing for the GCF Repo Service

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ notice is hereby given that on July 11, 2007, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2007-08. On August 28, 2007, the Commission published notice of the proposed rule change to solicit comments from interested parties.² On January 22, 2008, FICC submitted Amendment No. 1 to the proposed rule change. The proposed rule change, as amended by Amendment No.1, is described in Items I, II, and III below, which items have been prepared by FICC. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested parties.

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

FICC is seeking to resume interbank clearing for the GCF Repo service.

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

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 56303 (August 22, 2007), 72 FR 49339.

below. FICC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.³

(A) Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Background

The GCF Repo service allows FICC Government Securities Division (“GSD”) dealer members to trade GCF repos throughout the day with inter-dealer broker netting members (“brokers”) on a blind basis without requiring intraday, trade-for-trade settlement on a delivery-versus-payment (DVP) basis. Standardized, generic CUSIP numbers have been established exclusively for GCF Repo processing and are used to specify the acceptable type of underlying Fedwire book-entry eligible collateral, which includes Treasuries, Agencies, and certain mortgage-backed securities.

The GCF Repo service was developed as part of a collaborative effort among FICC’s predecessor, the Government Securities Clearing Corporation (“GSCC”), its two clearing banks, The Bank of New York (“BNY”) and The Chase Manhattan Bank, now JP Morgan Chase Bank, National Association (“Chase”), and industry representatives.⁴ GSCC introduced the GCF Repo service on an intraclearing bank basis in 1998.⁵ Under the intrabank service, dealer members

³ The Commission has modified the text of the summaries prepared by FICC.

⁴ BNY and Chase remain the two clearing banks approved by FICC to provide GCF Repo settlement services. In the future, other banks that FICC in its sole discretion determines meet its operational requirements may be approved to provide GCF Repo settlement services.

⁵ Securities Exchange Act Release No. 40623 (October 30, 1998), 63 FR 59831 (November 5, 1998) (SR-GSCC-98-02).

could only engage in GCF Repo transactions with other dealers that cleared at the same clearing bank.

In 1999, GSCC expanded the GCF Repo service to permit dealer members to engage in GCF Repo trading on an interclearing bank basis, which allowed dealers using different clearing banks to enter into GCF Repo transactions on a blind brokered basis.⁶ Because dealer members that participated in the GCF Repo service did not, and still do not, all clear at the same clearing bank, expanding the service to be interclearing bank necessitated the establishment of a mechanism to permit after-hours movements of securities between the two clearing banks because GSCC would probably have unbalanced net GCF securities positions and unbalanced net cash positions within each clearing bank at the end of each day. (In other words, it was probable that at the end of GCF Repo processing each business day, the dealers at one clearing bank would be net funds borrowers while the dealers at the other clearing bank would be net funds lenders). To address this issue, GSCC and its clearing banks established a legal mechanism by which securities would “move” across the clearing banks without the use of the securities Fedwire.⁷ At the end of the day after the GCF Repo net results were produced, securities were pledged using a tri-party-like mechanism, and the interbank cash component was moved through the cash Fedwire. In the morning, the pledges were unwound with the funds being returned to the net funds lenders and the securities being returned to the net funds borrowers.

⁶ Securities Exchange Act Release No. 41303 (April 16, 1999), 64 FR 20346 (April 26, 1999) (SR-GSCC-99-01).

However, as use of the service increased, certain payment systems risk issues from the interbank funds settlements arose. In 2003, FICC shifted the service back to intrabank status to enable it to study the risk issues presented and to devise a satisfactory solution to those issues in order that it could bring the service back to interbank status.⁸

2. Proposal

FICC is now seeking to return the GCF Repo service to interbank status. This proposed rule change would address the risk issues raised by the interbank funds movement by placing a security interest on a dealer's "net free equity" ("NFE") at its clearing bank to collateralize its GCF Repo cash obligation to FICC on an intraday basis and by making changes with respect to the morning "unwind" period.⁹ No changes are being proposed with respect to the procedures used for after-hours movement of securities, which procedures were used when the interbank service was first introduced.

Specifically, the interbank funds payment would not move during the GCF Repo morning unwind process. In lieu of making funds payments, each interbank dealer ("Interbank Pledging Member") at the GCF net funds borrower bank would grant to FICC a security interest in its

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⁷ Movements of cash did not present the same need because the cash Fedwire is open later than the securities Fedwire.

⁸ Securities Exchange Act Release No. 48006 (June 10, 2003), 68 FR 35745 (June 16, 2003) (SR-FICC-2003-04).

⁹ NFE is a methodology that clearing banks use to determine whether an account holder, such as a dealer, has sufficient collateral to enter a specific transaction. NFE allows the clearing bank to place a limit on its customer's activity by calculating a value on the customer's balances at the bank. Bank customers have the ability to monitor their NFE balance throughout the day.

NFE-Related Collateral in an amount equal to its pro rata share of the total interbank funds debit (“Prorated Interbank Cash Amount”).¹⁰ FICC’s lien on this collateral would be pari passu to any lien created by the dealer in favor of the relevant GCF clearing bank.

FICC would in turn grant to the GCF net funds lender bank, which was due to receive funds, a security interest in the NFE-Related Collateral to support the debit in the FICC account. The debit in the FICC account (“Interbank Cash Amount Debit”) would occur because the dealers that are due to receive funds in the morning must receive those funds in return for their release of GCF collateral. The clearing banks would agree to manage the collateral value of the NFE-Related Collateral as they do today.

The debit in the FICC account at the GCF net funds lender bank would be satisfied during the end of day GCF settlement process. Specifically, that day’s new activity would yield a new interbank funds amount to move at end of day; however, this new interbank funds amount would be netted with the amount that was due in the morning to reduce the interbank funds movement. The NFE security interest would be released when the interbank funds movement is made at end of day.

As described above, FICC would have a security interest in the dealers’ NFE-Related Collateral on an intraday basis. In the unlikely event of an intraday GCF participant default, FICC would need to have the NFE-Related Collateral liquidated in order to have use of the proceeds. FICC would enter into an agreement with each of the clearing banks whereby each

¹⁰ “NFE-Related Collateral” is the total amount of collateral that a dealer has at its clearing bank.

bank would agree to liquidate the NFE-Related Collateral both for itself as well as on behalf of FICC. FICC and each bank would agree to share pro rata in the liquidation proceeds.

Due to the nature of the various assets that may be part of a particular dealer's NFE-Related Collateral, liquidation of the NFE-Related Collateral might take longer than one day, GSD's typical collateral liquidation time frame, to be completed. Therefore, FICC would establish standby liquidity facilities or other financing arrangements with each of the clearing banks to be invoked as needed in the event of the default of an interbank pledging member.

FICC is also proposing to impose a collateral premium ("GCF Premium Charge") on the GCF Repo portion of the Clearing Fund deposits of all GCF participants to further protect FICC in the event of an intraday default of a GCF participant. FICC would require GCF Repo participants to submit a quarterly "snapshot" of their holdings by asset type to enable FICC Risk Management staff to determine the appropriate Clearing Fund premium. Any GCF Repo participant that does not submit this required information by the deadlines established by FICC would be subject to a fine and an increased Clearing Fund premium.

Because the NFE-Related Collateral is held at the clearing banks and because the clearing banks monitor the activity of their dealer customers, FICC would have the right, using its sole discretion, to cease to act for a member that is a GCF Repo participant in the event that a clearing bank ceases to extend credit to such member.

The proposal results in the need for the following specific GSD rule changes.

1. The new terms referred to above (GCF Premium Charge, Interbank Cash Amount Debit, Interbank Pledging Member, NFE-Related Collateral, and Prorated Interbank Cash Amount) would be added to Rule 1 (Definitions). A new term, "NFE-Related

Account,” which is referred to in the definition of “NFE-Related Collateral,” would also be added.

2. Section 3 (Collateral Allocation) of Rule 20 (Special Provisions for GCF Repo Transactions), which governs the GCF Repo collateral allocation process, would be amended to reflect the new process that would occur on the morning of the unwind (to be referred to as the morning of “Day 2” in the Rules).
3. Section 3 of Rule 20 would be further amended to provide for the following:
 - (a) the granting of the security interest in the NFE-Related Collateral to FICC by the dealers;
 - (b) the granting of authority for FICC to provide instructions to the clearing banks regarding the NFE-Related Collateral by the dealers;
 - (c) the granting of the security interest in the NFE-Related Collateral to the clearing banks by FICC; and
 - (d) FICC’s right to enter into agreements with the clearing banks regarding the collateral management of the NFE-Related Collateral, the liquidation of the NFE-Related Collateral, and the standby liquidity facilities or other financing arrangements.
4. Rule 4 (Clearing Fund, Watch List, and Loss Allocation) would be amended to provide for the Clearing Fund premium that would be imposed on GCF Repo participants. Rule 3 (Ongoing Membership Requirements) would be amended to include the quarterly NFE reporting requirement which, if not followed timely by the members, would result in fines and Clearing Fund premium consequences.

5. Rules 21 (Restrictions on Access to Services) and 22 (Insolvency of a Member) would be amended to provide that FICC may in its sole discretion cease to act for a member in the event that the member's clearing bank has ceased to extend credit to the member.

6. The schedule of GCF time frames would be amended to reflect technical changes.

3. The Amendment

The amendment to the proposed rule change addresses the situation where FICC becomes concerned about the volume of interbank GCF Repo activity. For example, such a concern might arise if market events were to cause dealers to turn to the GCF Repo service for increased funding at levels above normal processing. In order to protect itself and its members, FICC believes it is important to have the discretion to institute risk mitigation and appropriate disincentive measures in order to bring GCF Repo levels down to a comfortable level from a risk management perspective.

Specifically, the amendment introduces the term "GCF Repo Event," which would be declared by FICC if either of the following occurs: (i) the GCF interbank funds amount exceeds five times the average interbank funds amount over the previous ninety days for three consecutive days¹¹ or (ii) the GCF interbank funds amount exceeded fifty percent of the amount of GCF Repo collateral pledged for three consecutive days.¹² FICC would review the Repo

¹¹ For example, assume that the average interbank funds amount over the previous ninety days is \$11 billion. FICC would declare a GCF Repo Event if the interbank funds amount exceeded \$55 billion over three consecutive days.

¹² For example, assume that on Monday the total amount of GCF Repo collateral pledged was \$86.8 billion and that \$11 billion was the interbank funds amount. The interbank

Event triggering levels on a semi-annual basis to determine whether they remain adequate.¹³

FICC would also have the right to declare a GCF Repo Event in any other circumstances where it was concerned about GCF Repo volumes and believed it was necessary to declare a Repo Event in order to protect itself and its members.¹⁴

The declaration of a GCF Repo Event would trigger the imposition of risk mitigation and disincentive measures. These measures would be imposed each day during the Event, and they would be imposed on each day's GCF net funds borrowers whose aggregate GCF net short position exceeded a certain threshold.¹⁵

Specifically, FICC would establish a "GCF Repo Event Parameter," which would be a certain percentage of each dealer's average GCF Repo net short settlement amount during a one-month look-back period. FICC would establish 140 percent as the maximum percentage for the GCF Repo Event Parameter and would have the discretion to reduce this percentage during a GCF Repo Event if it believed that the maximum percentage was not adequately addressing the

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funds amount would be 12.7 percent of the daily pledged amount. A GCF Repo Event would be declared if the overall pledged amount stayed at \$86.6 billion and the interbank amount exceeded \$43.3 billion for three consecutive days.

¹³ Any changes to these figures would require FICC to submit a proposed rule change to the Commission.

¹⁴ For example, FICC may determine to declare a GCF Repo Event if one of the specified events noted above occurs for less than three consecutive days.

¹⁵ FICC would inform its members about the declaration of a GCF Repo Event by issuing an Important Notice. The Important Notice, which, would, among other things, inform members of the implementation date of the measures. FICC would also inform the Commission about the declaration of the Event. The GCF Repo Event would last until FICC notifies its members that the Event has ended.

particular event. Any GCF Repo net short settlement amount that exceeded the GCF Repo Event Parameter would be subject to a “GCF Repo Event Clearing Fund Premium” and a “GCF Repo Event Carry Charge.”¹⁶

FICC would set 12% as the minimum percentage on which the GCF Repo Event Clearing Fund Premium would be based and 50 basis points as the minimum on which the GCF Repo Event Carry Charge would be based, and would have the discretion to increase these amounts during a GCF Repo Event if FICC believed that the minimums were not adequately addressing the particular GCF Repo Event.

FICC would retain the right to waive imposition of the GCF Repo Event Clearing Fund Premium and the GCF Repo Event Carry Charge if FICC determined, based on monitoring against the GCF Repo Event Parameters, that these measures were not necessary to protect FICC and its members.

4. Statutory Basis

¹⁶ For example, assume that FICC has declared a GCF Repo Event, and on the day of implementation of the protective measures, Dealer A’s average net short settlement amount is \$1 billion. This means that Dealer A’s GCF Repo Event Parameter is \$1.4 billion. On the day of implementation of the protective measures, Dealer A’s net settlement amount is \$1.9 billion, so the measures will be applied to \$500 million (i.e., \$1.9 billion minus \$1.4 billion). If the percentage for the GCF Repo Event Collateral Premium is 12 percent and the GCF Repo Event Carry Charge is 50 basis points, Dealer A will pay a GCF Repo Event Clearing Fund Premium of \$60 million and a GCF Repo Event Carry Charge of \$6,944.44 on the day of implementation. On each succeeding day that the GCF Repo Event remains in effect, FICC will reevaluate, Dealer A’s net settlement position.

FICC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act¹⁷ and the rules and regulations thereunder applicable to FICC because it should allow GCF Repo participants to expand their use of the GCF Repo service to include GCF Repos done with dealers that clear at a different clearing bank in a manner that will support the prompt and accurate clearance and settlement of securities transactions.

(B) Self-Regulatory Organization's Statement on Burden on Competition

FICC does not believe that the proposed rule change would 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

Written comments have not been solicited with respect to the proposed rule change, and none have been received. FICC will notify the Commission of any written comments it receives.

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.

¹⁷ 15 U.S.C. 78q-1.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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. Please include File Number SR-FICC-2007-08 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FICC-2007-08. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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 <http://www.ficc.com/gov/gov.docs.jsp?NS-query>. 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-2007-08 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Florence E. Harmon
Deputy Secretary

¹⁸ 17 CFR 200.30-3(a)(12).