

Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of the Act.<sup>18</sup>

#### 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-2005-14 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-CBOE-2005-14. 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. 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

<sup>18</sup> For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposed rule change under Section 19(b)(3)(C) of the Act, the Commission considers that period to commence on March 2, 2005, the date the Exchange filed Amendment No. 1 to the proposed rule change. See 15 U.S.C. 78s(b)(3)(C).

submissions should refer to File Number SR-CBOE-2005-14 and should be submitted on or before April 6, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51355; File No. SR-FICC-2004-08]

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

March 10, 2005.

#### I. Introduction

On March 29, 2004, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") and on February 28, 2005,<sup>1</sup> and March 3, 2005, amended<sup>2</sup> proposed rule change SR-FICC-2004-08 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>3</sup> Notice of the proposal was published in the **Federal Register** on November 23, 2004.<sup>4</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### II. Description

FICC is seeking to provide interpretive guidance to members pertaining to the member surveillance rules of the Government Securities Division ("GSD") and the Mortgage-Backed Securities Division ("MBSD") of FICC.

##### 1. Background

Prior to the Commission's approval of SR-FICC-2003-03,<sup>5</sup> the GSD had the ability to place a member in a surveillance status class depending on

<sup>19</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> The February 28, 2005, amendment was withdrawn by FICC on March 3, 2005.

<sup>2</sup> In the March 3, 2005, amendment, FICC elaborated on how it applies and monitors the matrix. The amendment did not modify the substance of the proposed rule change and therefore did not require republication of notice.

<sup>3</sup> 15 U.S.C. 78s(b)(1).

<sup>4</sup> Securities Exchange Act Release No. 50671 (November 16, 2004), 69 FR 68200.

<sup>5</sup> Securities Exchange Act Release No. 49158 (January 30, 2004), 69 FR 5624 (February 5, 2004).

whether the member satisfied one or more of the enumerated financial and operational criteria. Upon approval of SR-FICC-2003-03, FICC implemented new criteria for placing members on surveillance. Specifically, all domestic broker-dealers and banks that are GSD netting members and/or MBSD clearing members are now assigned a rating that is generated by entering financial data of the member into a risk assessment matrix ("Matrix"). The Matrix is used by FICC and its affiliated clearing agency, National Securities Clearing Corporation. Specifically, in order to run the Matrix, credit risk staff uses the financial data of each applicable FICC member and the financial data of each applicable member of NSCC. In this way, each applicable member of GSD, MBSD, and NSCC is rated against other applicable members of FICC and NSCC. Members who receive a low rating are placed on an internal "watch list" and are monitored more closely. All members that are not domestic banks or broker-dealers are not included in the Matrix process but are monitored by FICC's credit risk staff using financial criteria deemed relevant by FICC.

FICC will continually evaluate the methodology and its effectiveness and make such changes as it deems prudent and practicable within such time frame as is determined to be appropriate by FICC. FICC will update the Commission staff on its evaluations of the Matrix pursuant to a schedule developed by FICC, NSCC, and Commission staff.

##### 2. Clarification of Rules Provisions

In describing the process by which credit risk staff will implement the Matrix process and review members, FICC included in SR-FICC-2003-03 explanatory footnotes 2 and 3. FICC at this time wishes to clarify its procedures with regard to application of the Matrix.

Credit risk staff approaches its analysis of members pursuant to the new procedures in the following manner. First, as mentioned above, domestic broker-dealers and domestic banks are run through the Matrix and assigned a rating. Low-rated members are placed on the watch list. At this point, credit risk staff may downgrade a particular member's score based on various qualitative factors. For example, one qualitative factor might be that the member in question received a qualified audit opinion on its annual audit. In order to protect FICC and its other members, it is important that credit risk staff maintain the discretion to downgrade a member's rating on the Matrix and thus subject the member to closer monitoring. All rated members, including those on the watch list, are

monitored monthly or quarterly, depending upon the member's financial filing frequency, against basic minimum financial requirements and other parameters.

All broker-dealer members included on the watch list are monitored more closely. This means that they are also monitored for various parameter breaks which may include but are not limited to such things as a defined decline in excess net capital over a one month or three month period, a defined period loss, a defined aggregate indebtedness/net capital ratio, a defined net capital/aggregate debit items ratio, and a defined net capital/regulatory net capital ratio. All bank members included on the watch list are also monitored more closely for watch list parameter breaks which may include but are not limited to such things as a defined quarter loss, a defined decline in equity, a defined tier one leverage ratio, a defined tier one risk-based capital ratio, and a defined total risk-based capital ratio. FICC wishes to make clear that monitoring for the above more stringent parameter breaks is only applicable to those members placed on the watch list.

In addition, FICC would like to address footnote 5 of Amendment I to rule filing SR-FICC-2003-03. That footnote stated that credit risk staff would monitor those members not included in the Matrix process (this includes members that are not domestic banks and broker dealers) using the same criteria as those used for members included on the Matrix. FICC wishes to make clear that credit risk staff will not be using the same criteria to monitor these members but will use similar criteria. As stated in the narrative of SR-FICC-2003-03, these criteria may include but are not limited to such things as failure to meet minimum financial requirements, experiencing a significant decrease in equity or net asset value, or a significant loss. This class of members may be placed on the watch list based on credit risk staff's analysis of this information.

### 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>6</sup> The Commission finds that FICC's proposed rule change is consistent with this requirement because it improves FICC's member surveillance process which should 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-2004-08) be and hereby is approved.

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

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51354; File No. SR-FICC-2004-18]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of a Proposed Rule Change To Clarify Certain Sections of the Loss Allocation Rule of Its Government Securities Division

March 10, 2005.

#### I. Introduction

On October 1, 2004, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") and on October 27, 2004, amended proposed rule change File No. SR-FICC-2004-18 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 January 24, 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

The purpose of this proposed rule change is to clarify certain sections of the loss allocation rule of the Government Securities Division ("GSD") of FICC. If the GSD, upon liquidating a defaulting member's positions, incurs a loss due to the failure

of the defaulting member to fulfill its obligations to the GSD, the GSD looks to the margin collateral deposited by that defaulting member to satisfy the loss. If the defaulting member's margin collateral is insufficient to cover the loss and if there are no other funds available from any applicable cross-margining and/or cross-guaranty arrangements, the GSD would have a "Remaining Loss"<sup>3</sup> and would institute its loss allocation process to cover such Remaining Loss. In doing so, the GSD would determine the types of transactions from which the Remaining Loss has arisen (such as direct transactions and member brokered transactions) and would allocate the Remaining Loss as set forth in Sections 8(d)(i) through (v) of Rule 4 of the GSD Rules.

The allocations in Section 8(d)(ii) of Rule 4 to cover a Remaining Loss that is due to member brokered transactions distributes the loss between the affected broker, including repo brokers, and non-broker members that dealt with the defaulting member, are limited as an initial matter. Specifically, a broker netting member will not be subject to an allocation of loss, for any single loss-allocation event in an amount greater than \$5 million, and a non-broker netting member will not be subject to an allocation of loss for any single loss-allocation event in an amount greater than the lesser of \$5 million or five percent of the overall loss amount allocated to non-broker netting members. If the Remaining Loss from member brokered transactions is not covered due to these limitations on allocations, the uncovered loss will be reallocated as set forth in Section 8(e) of Rule 4. This section calls for a pro rata allocation to the netting membership in general based on each netting member's average daily required clearing fund deposit over the twelve-month period immediately prior to the insolvency. The rule change makes clear that the amounts allocated pursuant to Section 8(e) will be assessed to a netting member in addition to any loss amount allocated pursuant to Section 8(d)(ii). Therefore, a netting member may be subject to an aggregate allocation of loss that may exceed the applicable limitation set forth in Section 8(d)(ii).

Even with the allocation pursuant to Section 8(e) of Rule 4, a broker netting member would not be subject to an aggregate loss allocation for any single loss allocation event in an amount greater than \$5 million. In addition, what has been intended, but is not clear in the current rules, is that a non-broker netting member can terminate its GSD

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

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

<sup>2</sup> Securities Exchange Act Release No. 51037 (January 13, 2005), 70 FR 3410.

<sup>3</sup> GSD Rules, Rule 4, Section 8(d).

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).