SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58156; File No. SR-FICC-2007-05)

July 15, 2008

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change as Amended to Restructure the Rules of the Government Securities Division and the Mortgage-Backed Securities Division Relating to Fines and to Harmonize Them with Similar Rules of its Affiliates and to Restructure the Watch List

I. Introduction

On April 30, 2007, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") and on May 18, 2007, December 10, 2007, and January 31, 2008, amended proposed rule change SR-FICC-2007-05 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").[1] On April 22, 2008, the Commission published notice of the proposed rule change to solicit comments from interested parties.[2] The Commission received no comment letters in response to the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change, as amended.

II. Description

FICC is seeking to (i) restructure the Government Securities Division ("GSD") and the Mortgage-Backed Securities Division ("MBSD") rules related to fines, clearing fund consequences imposed on members for rule violations, and certain aspects of the watch list and (ii) harmonize its rules with similar rules of FICC's clearing agency affiliates, The Depository Trust Company ("DTC") and the National Securities Clearing Corporation ("NSCC"). DTC and

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1 15 U.S.C. 78s(b)(1).

2 Securities Exchange Act Release No. 57666 (April 15, 2008), 73 FR 21675.

NSCC have filed similar proposed rule changes.[3] FICC's proposed revisions to its fine schedule are set forth in Exhibit 5 to its proposed rule change.

1. Fines

(a) Fines Scheduled for Failure to Submit Financial and Other Information

Members of the GSD and MBSD are assessed fines for failure to submit required financial, regulatory, and other information within the time frames set forth in FICC's rules. Often a member that is fined is a common member of FICC and DTC, FICC and NSCC, or FICC, DTC, and NSCC, (collectively, the "Clearing Agencies") which would cause the member to incur multiple penalties for the same offense.[4] FICC is proposing that when a common member of the Clearing Agencies is late in providing the same information to more than one Clearing Agency, the fine amount will be divided equally among the Clearing Agencies.[5]

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3 Securities Exchange Act Release No. 57665 (April 15, 2008) [SR-DTC-2007-05]. Securities Exchange Act Release No. 57667 (April 15, 2008) [SR-NSCC-2007-07].

4 The Clearing Agencies do not view the proposed rule changes as fee reductions because they never intended to charge a common member two or three times for a single violation that trips another clearing agency's rules on the same matter.

DTC does not currently maintain a fine in this regard. However, DTC has filed a proposal to adopt a fine schedule similar to the one used by FICC. Supra note 3.

5 For example, if a firm that is a member of FICC and NSCC, did not submit its annual audited financial statements within the required time frame, and this was the firm's first failure to meet the deadline, the $200 fine will be split equally between FICC and NSCC.

Where the member is a participant of DTC and also a member of one or more of the other Clearing Agencies, the fine would be collected by DTC and allocated equally among the other Clearing Agencies, as appropriate. If the member is not a DTC participant, but is a common member of NSCC and FICC, NSCC will collect the fine and allocate the appropriate portion to FICC.

In addition, FICC proposes changes to the notes to this section of the fine schedule to make clear that (i) the method by which the reporting requirements will be published and (ii) the determination of the fine amount after the fourth or more occasion of an offense within a twelve-month rolling period will be made by FICC management with the concurrence of the Board or the Credit and Market Risk Management Committee.[6]

(b) General Continuance Standards

Both GSD and MBSD currently impose a fine of $1,000 on a member that fails to notify FICC within two business days of the member's learning of its non-compliance with the general continuance standards for membership or of its becoming subject to a statutory disqualification. Both GSD and MBSD currently impose a $5,000 fine if a member fails to notify FICC of a "material change" to its business. A material change currently includes events such as a merger or acquisition involving the member, a change in corporate form, a name change, a material change in ownership, control, or management, and participation as a defendant in litigation which could reasonably be anticipated to have a direct negative impact on the member's financial condition or ability to conduct its business.

With respect to both GSD and MBSD, FICC is proposing to amend its rules to reflect that when a common member of the Clearing Agencies is late in providing the same information to

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6 Under the rules of GSD and MBSD, the terms "Board" or "Board of Directors" mean the Board of Directors of FICC or a committee thereof acting under delegated authority ("Board"). In this situation, the Board would have to concur with the fine.

more than one Clearing Agency, the fine amount will be divided equally among the Clearing Agencies.[7]

(c) Fine Schedule for Late Clearing/Participants Fund Deficiency Payments

GSD and MBSD Netting and Clearing members are also subject to fines for late payments of clearing fund and participants fund deficiency calls. In order to harmonize its fine schedule with NSCC, FICC is proposing to adopt the fine amounts utilized by NSCC for this purpose and to adopt other provisions set forth in the notes to NSCC's fine schedule. As proposed, the first occasion lateness will generate a warning letter to the firm for all deficiency amounts.[8] If the number of occasions of late Clearing Fund deficiency call payments within a three-month rolling period exceeds four, FICC will obtain the Board's concurrence for the fine amount. Furthermore, a late payment of more than one hour will result in a fine equal to the amount applicable to the next highest occasion for the specific deficiency amount.[9] If a member

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7 DTC does not currently maintain a fine in this regard. However, DTC has filed a proposal to adopt a fine schedule similar to the one NSCC is proposing to adopt. Supra note 3.

Where the member is a participant of DTC and also a member of one or more of the other Clearing Agencies, the fine will be collected by DTC and allocated equally among the other Clearing Agencies, as appropriate. If the member is not a DTC participant, but is a common member of NSCC and FICC, NSCC will collect the fine and allocate the appropriate portion to FICC.

8 GSD and MBSD currently impose a fine for a first occasion lateness for its highest deficiency amount.

9 For example, if a firm's deficiency amount is under $1,000,000, it is the firm's second occurrence of late satisfaction of a deficiency call in the rolling three-month period, and the firm is late by more than one hour, the firm will be fined $200 (i.e., the fine for a third occasion) instead of $100 (i.e., the fine for a second occasion) pursuant to the proposed fine schedule.

is late for more than one hour and it is the member's fourth occasion in the rolling period, FICC will obtain the Board's concurrence for the fine amount.

(d) Fine Schedule for Late Settlement Payments

The GSD and MBSD currently fine members for late payment of settlement obligations. FICC is proposing the following to harmonize its fine schedule with those of NSCC. The GSD and MBSD will adopt the deficiency and fine amounts of the NSCC fine schedules. As a result, the first occasion will result in a fine rather than a warning letter as under FICC's current fine schedule. Also, FICC will use a rolling three-month period to determine the number of occasions rather than the current 30-days rolling period. In addition, the fine schedules of GSD and MBSD will be amended to provide that (i) if the number of occasions within the rolling three-month period exceeds four, management will obtain the Board's concurrence of the fine amount and (ii) a payment late by more than one hour will result in a fine equal to the amount applicable for the next highest occasion for the specific deficiency amount. If a member is late for more than one hour and it is the member's fourth occasion in the rolling period, management will obtain the Board's concurrence of the fine amount.

2. Placement on the Watch List and Prohibition Against Return of Excess Clearing Fund as Consequences for Rules Violations

The rules of both GSD and MBSD contain provisions requiring a member to be placed on the watch list and, in certain instances, prohibiting the return of excess clearing fund collateral as consequences for certain rules violations or certain member actions. For example, the FICC rules require that a member be placed on the watch list and prohibited from receiving the return of excess clearing fund collateral for failure to timely submit a required financial report or other information to FICC. FICC is proposing the deletion of all these provisions because the placement a member on the watch list and the prohibiting of the return of a member's excess of clearing fund collateral should result from management's monitoring of the member and should not automatically occur because of rules violations.[10]

3. Consequences for Being on the Watch List

Currently, the GSD rules contain a very specific amount by which the clearing fund requirement of a netting member that is placed on the watch list may be increased.[11] The MBSD

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10 FICC currently has and would retain the right to deny the return of excess clearing fund collateral in instances where it is concerned about a particular member's financial or operational capability.

11 The GSD rules currently state that GSD "may require a Netting Member that has been placed on the Watch List, to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Section 2 of Rule 4 (which additional deposit shall constitute a portion of the Netting Member's Required Fund Deposit) of up to 200 percent of its highest single Business Day's Required Fund Deposit during the most recent 20 Business Days, or such higher amount as the Board may deem necessary . . . ."

and NSCC rules contain provisions that are more general in this regard.[12] FICC believes the GSD rules are unnecessarily specific in this regard and should be amended to more closely reflect the MBSD and NSCC rules.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, the Commission believes the proposal is consistent with the requirements of Section 17A(b)(3)(F),[13] which, among other things, requires that the rules of a clearing agency are designed to remove impediments to and perfect the mechanisms of a national system for the prompt and accurate clearance and settlement of securities transactions and with the requirements of Section 17A(b)(3)(H)[14] which, among other things, requires that the rules of a clearing agency provide a fair procedure with respect to the disciplining of participants and the denial of participation to any person seeking to be a participant. The Commission finds that the proposed rule change, which restructures and harmonizes FICC's fines with those of DTC and NSCC, is consistent with those statutory obligations.

IV. Conclusion

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12 For example, MBSD rules state that MBSD "may require a Participant that has been placed on the Watch List to make and maintain a deposit to the Participants Fund over and above the amount determined . . . ."

13 15 U.S.C. 78q-1(b)(3)(F).

14 15 U.S.C. 78q-1(b)(3)(H).

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. In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition and capital formation.[15]

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2007-05), as amended, be and hereby is approved.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.[16]

Florence E. Harmon
Acting Secretary

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15 15 U.S.C. 78c(f).

16 17 CFR 200.30-3(a)(12).