

time if such action is consistent with the protection of investors and the public interest. The Exchange seeks to have the proposed rule change become operative immediately so that its specialists may begin trading in accordance with the proposed rule change. The Commission, consistent with the protection of investors and the public interest, has determined to make the proposed rule change effective as of the date of this notice.<sup>16</sup> The Commission notes that the execution guarantees provided by the Exchange are made on a voluntary basis by the Exchange, and that a specialist's duty of best execution will in no way be affected by this proposed rule change.

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-CHX-2004-36 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-CHX-2004-36. 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 offices of the CHX. 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-CHX-2004-36 and should be submitted on or before November 22, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Jill M. Peterson,

*Assistant Secretary.*

[FR Doc. E4-2946 Filed 10-29-04; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50594; File No. SR-FICC-2004-16]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to Establishment of a Cross-Margining Agreement With the Clearing Corporation

October 26, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 12, 2004, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change 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 parties.

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

The Government Securities Division of FICC ("GSD") is seeking to establish

a cross-margining arrangement with The Clearing Corporation ("TCC").

#### 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 these statements.<sup>2</sup>

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

###### 1. Background

The Government Securities Division of FICC is proposing to enter into a new cross-margining agreement with TCC. FICC had a cross-margining arrangement in place with the Board of Trade Clearing Corporation ("BOTCC"), TCC's predecessor, through which certain Chicago Board of Trade ("CBOT") products were cross-margined with certain FICC products.<sup>3</sup> The BOTCC arrangement was terminated on January 2, 2004, the date on which BOTCC ceased being the clearing organization for the CBOT products that were the subject of the arrangement.<sup>4</sup> On January 2, 2004, the Chicago Mercantile Exchange ("CME") became the clearing organization for the CBOT products, which are now included in the cross-margining arrangement that FICC recently has with the CME.<sup>5</sup>

TCC recently became the clearing organization for EurexUS and has approached FICC regarding cross-margining certain U.S. Treasury and Agency futures and options on futures products traded on the EurexUS futures exchange and cleared by TCC with certain FICC products.<sup>6</sup>

FICC is proposing to enter into a new cross-margining agreement with TCC

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

<sup>3</sup> Securities Exchange Act Release No. 45335 (January 25, 2002), 67 FR 4768 [File No. SR-GSCC-2001-03].

<sup>4</sup> Securities Exchange Act Release No. 49142 (January 28, 2004), 69 FR 5623 [File No. SR-FICC-2004-02].

<sup>5</sup> Securities Exchange Act Release No. 49003 (December 29, 2003), 69 FR 712 [File No. SR-FICC-2003-10].

<sup>6</sup> The products traded on the EurexUS futures exchange and cleared by TCC are substantially similar to the CBOT products originally cleared by BOTCC.

<sup>16</sup> For purposes of only accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. <sup>15</sup> U.S.C. 78c(f).

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

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

("Proposed FICC-TCC Agreement") to cover the EurexUS traded products cleared by TCC. Under the Proposed FICC-TCC Agreement, the FICC products that will be eligible for cross-margining will be Treasury securities that fall into the GSD's offset classes A through G and GCF Repo Treasury securities with equivalent remaining maturities, non-mortgage-backed Agency securities that fall into the GSD's offset classes e and f, and GCF Repo non-mortgage-backed Agency securities with equivalent remaining maturities. The TCC products that will be eligible for cross-margining will be the EurexUS products, which are Two-Year Treasury Note Futures contracts and options thereon, Five-Year Treasury Note Futures contracts and options thereon, Ten-Year Treasury Note Futures contracts and options thereon, Thirty-Year Treasury Bond Futures contracts and options thereon, Five-Year Agency Note Futures contracts and options thereon, and Ten-Year Agency Note Futures contracts and options thereon, cleared or to be cleared by TCC.<sup>7</sup>

## 2. FICC's Cross-Margining Program in General

In general, cross-margining allows members to optimize their capital usage by permitting their clearing organizations to view their positions across clearing organizations as a combined portfolio and to reduce margin requirements accordingly.<sup>8</sup> Margining based on the net combined risk of correlated positions is based on the cross margining arrangement under which FICC and each Participating CO agree to accept the correlated positions in lieu of supporting collateral.<sup>9</sup> All

eligible positions maintained by a cross-margining participant in its account at FICC and in its (or its affiliate's) proprietary account at a Participating CO are eligible for cross-margining.<sup>10</sup>

Under the arrangement, FICC and each Participating CO holds and manages its own positions and collateral and independently determines the amount of margin that it will make available for cross-margining, which is referred to as the "residual margin amount." FICC computes the amount by which the cross-margining participant's margin requirement can be reduced at each clearing organization (*i.e.*, the "cross-margining reduction") by comparing the participant's positions and the related margin requirements at FICC against those at each Participating CO.<sup>11</sup> FICC offsets each cross-margining participant's residual margin amount at FICC against the offsetting residual margin amounts of the participant (or its affiliate) at each Participating CO.

If the margin that FICC has available for a participant is greater than the combined margin submitted by the Participating COs, FICC will allocate a portion of its margin equal to the combined margin at the Participating COs. If the combined margin submitted by the Participating COs is greater than the margin that FICC has available for that participant, FICC will first allocate its margin to the Participating CO with the most highly correlated position. If the positions are equally correlated, FICC will allocate pro rata based upon the residual margin amount available at each Participating CO. FICC and each Participating CO may then reduce the amount of collateral that they collect to reflect the offsets between the cross-margining participant's positions at FICC and its (or its affiliate's) positions at the Participating CO.<sup>12</sup>

margin agreement between itself and FICC. No preference is given by FICC to one Participating CO over another.

<sup>10</sup> Upon implementation of the new arrangement between FICC and TCC, the arrangement will not apply to positions in a customer account at TCC that would be subject to the segregation requirements of the Commodity Exchange Act. This is also the case under the cross-margining arrangement that FICC has in place with the CME.

<sup>11</sup> FICC and the Participating COs currently use different margin rates to establish margin requirements for their respective products. Margin reductions in the cross-margining arrangement are always computed based on the lower of the applicable margin rates. This methodology results in a potentially lesser benefit to the participant but ensures a more conservative result (*i.e.*, more collateral held at the clearing organization) for the Participating CO and FICC.

<sup>12</sup> FICC and each Participating CO unilaterally have the right not to reduce a participant's margin requirement by the cross-margining reduction or to reduce it by less than the cross-margining reduction. However, the clearing organizations may

FICC and each Participating CO will guarantee the cross-margining participant's (or its affiliate's) performance to each other up to a specified maximum amount that relates back to the cross-margining reduction and the results of liquidating the member's positions and ultimately its collateral. The guaranty represents a contractual commitment that each clearing organization has to the other.

A default by a cross-margining participant will trigger the loss sharing provisions of the cross-margining agreement. The loss-sharing provisions determine the guaranty payments, if any, that will flow between the clearing organizations if the default of the participant results in a loss. It should be noted that a declaration of default of a cross-margining participant by one of the clearing organizations in and of itself will provide grounds for the other clearing organization to declare the participant (or its affiliate) in default as well. If the guaranty is triggered, the cross-margining participant becomes obligated to reimburse the guarantor clearing organization for the amount of the guaranty payment (called the "Reimbursement Obligation").

The cross-margining agreement also provides for the sharing of remaining resources beyond the cross-margining arrangement through a "cross-guaranty" provision. This provision reflects the view that excess collateral of a defaulting member should remain with the clearing organizations, if needed, to cover their losses. Specifically, if after guaranty payments, if any, one of the clearing organizations has a remaining surplus, and the other has a remaining loss, the agreement provides a mechanism for the distribution of that surplus to the clearing organization that still has a remaining loss.

## 3. Key Proposed Changes to the Former Agreement Between FICC and TCC

(a) The minimum margin factor under the former FICC-BOTCC cross-margining agreement was 50 percent. FICC and TCC have agreed to a minimum margin factor of 25 percent. This is the same minimum margin factor used in the current cross-margining arrangement with the CME.<sup>13</sup>

(b) The Proposed FICC-TCC Agreement provides for inter-offset class cross-margining whereas the former

not reduce a participant's margin requirement by more than the cross-margining reduction.

<sup>13</sup> The minimum margin factor is the contractually agreed upon cap on the amount of the margin reduction that the clearing organizations will allow. Should FICC decide to change the minimum margin factor, it will submit a proposed rule filing under Section 19(b) of the Act.

<sup>7</sup> TCC is not currently clearing the Agency futures products. However, because it expects to clear Agency futures products in the future, FICC has included these products in the proposed rule change and the draft agreement. These Agency products are also covered by the current cross-margining agreement between FICC and the CME.

<sup>8</sup> Cross-margining is available to any FICC GSD netting member (with the exception of inter-dealer broker netting members) that is or that has an affiliate that is a member of a participating clearing organization ("Participating CO"). The FICC member (and its affiliate, if applicable) sign an agreement under which it (or they) agree to be bound by the cross-margining agreement between FICC and the Participating CO and which allows FICC or the Participating CO to apply the member's (or its affiliate's) margin collateral to satisfy any obligation of FICC to the Participating CO (or vice versa) that results from a default of the member (or its affiliate). Ownership of 50 percent or more of the common stock of an entity indicates control of the entity for purposes of the definition of "affiliate."

<sup>9</sup> FICC employs the "hub-and-spoke" method of cross-margining, which means that FICC cross-margins on a multilateral basis (*i.e.*, with more than one Participating CO) with FICC as the "hub." Each Participating CO enters into a separate cross-

BOTCC arrangement was limited to intra-offset class cross-margining. The new agreement is consistent with the approach in the existing arrangement between FICC and the CME.

(c) Appendix B of the FICC–TCC Agreement will include more FICC products than did the former BOTCC arrangement. The former BOTCC agreement covered FICC offset classes C, E, F, G and f, and offset classes E, F, and f were defined more narrowly for purposes of the arrangement than they were defined in the GSD's rules. The Proposed FICC–TCC Agreement includes the GSD's offset classes A through G and GCF Repo Treasury securities with equivalent remaining maturities, non-mortgage-backed Agency securities that fall into the GSD's offset classes e and f, and GCF Repo non-mortgage-backed Agency securities with equivalent remaining maturities. These offset classes are as broad as they are defined in the GSD's rules.

(d) Appendix B of the FICC–TCC Agreement will also include FICC's GCF Repo Treasury and non-mortgage-backed Agency products. FICC is now able to margin its GCF Repo Treasury and non-mortgage-backed Agency products based upon the specific underlying collateral as opposed to the former system of margining these products based upon the longest maturity of eligible underlying collateral.<sup>14</sup> Therefore, these GCF Repo products can now be included in the cross-margining arrangement because they are being margined at a specific rate based on the actual underlying Treasury and Agency collateral. These products are also included in the current cross-margining agreement between FICC and the CME.

(e) The Proposed FICC–TCC Agreement provides that the parties will agree from time to time in a separate writing on the disallowance factors that will be used in the arrangement. Prior to the implementation date of the proposed FICC–TCC cross-margining program, the disallowance factors will be tested and agreed to by FICC and TCC in writing.

(f) The current agreement between FICC and CME provides that in order to determine the gain or loss from the liquidation (resulting from a default) of

the positions that were cross-margined, only the proceeds from the side of the market that was offset pursuant to the agreement at the last margin cycle are considered. This approach will be extended to the Proposed FICC–TCC Agreement products to provide consistency in the liquidation methods.

(g) The former FICC–BOTCC agreement provided for a “Maximization Payment” whereby a clearing organization with a remaining surplus after all guaranty payments in relation to cross-margining were made (“Aggregate Net Surplus”) to distribute funds to one or more cross-margining partners with remaining losses. The Proposed FICC–TCC Agreement makes clear that: (i) the Maximization Payment is also a guaranty payment (albeit outside of cross-margining) and (ii) the defaulting member would have a reimbursement obligation with respect to such payment (“Maximization Reimbursement Obligation”). Should a clearing organization become obligated to pay the Maximization Payment, it may rely on the defaulting member's collateral to do so.<sup>15</sup>

(h) A provision has been added to take into account that a regulator or other entity having supervisory authority over FICC or TCC may direct the clearing organization not to liquidate a defaulting member or to partially liquidate such member. In order to prevent the affected clearing organization from being penalized under the agreement for failing to liquidate or partially liquidating the member in this type of situation, the Proposed FICC–TCC Agreement provides that the affected clearing organization would be deemed to have a cross-margin gain equal to the base amount of the guaranty (*i.e.*, cross-margining reduction) or a pro rated amount of the base amount of the guaranty in a partial liquidation scenario.

(i) The proposed FICC–TCC Agreement makes clear that the clearing organizations have security interests in the “Aggregate Net Surplus,” a large component of which would be the collateral and proceeds of positions of a

defaulting member, as security for any reimbursement obligation, including any maximization reimbursement obligation, that arises on the part of a defaulting member.

(j) The proposed FICC–TCC cross-margining participant agreement has language in Appendices D and E in order to further protect the clearing organizations by making clear that the clearing organizations have a security interest in the Aggregate Net Surplus and that a participant will have a reimbursement obligation in the event that a clearing organization becomes obligated to make a maximization payment. Members that wish to participate in the proposed FICC–TCC cross-margining arrangement will be required to execute the participant agreement to make them subject to the provisions of the Proposed FICC–TCC Agreement.

#### (4) Amendment 1 to the FICC–CME Cross-margining Agreement

FICC is proposing to amend Appendix A of the cross-margining agreement with the CME to add a reference to the Proposed FICC–TCC Agreement. In Appendix A, the parties set forth the other cross-margining or similar arrangements that they have in place and indicate whether such agreements take priority over the present agreement. As stated above, no preference is given by FICC to one Participating CO over another.

FICC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to FICC and particularly with the requirements of Section 17A(b)(3)(F)<sup>16</sup> of the Act, which requires that the rules of a clearing agency be designed to provide for the safeguarding of securities and funds which are in its possession or control or for which it is responsible. By continuing its cross-margin program to include products cleared by TCC, FICC will provide its members with the benefits of cross-margining, including greater liquidity and more efficient use of collateral, in a manner that is consistent with FICC's overall risk management process.

#### (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.

<sup>14</sup> Because of a previous inability to obtain timely data on the actual instruments posted in support of GCF Repo positions, up until recently the GSD calculated affected members' clearing fund requirements based upon the assumption that collateral providers have assigned to each generic CUSIP the most volatile (*i.e.*, the longest maturity) collateral eligible. The GSD recently developed improvements to its margining methodology and is now able to identify the specific CUSIP posted.

<sup>15</sup> The new guaranty provisions with respect to the Maximization Payment Guaranty are identical to the ones in the current cross-margining agreement between FICC and CME. In order to protect the clearing organizations in the event that a court determines that any amount of a Maximization Reimbursement Obligation may not be recovered by the clearing organization that made a Maximization Payment pursuant to a Maximization Payment Guaranty, provision has been added to the Proposed FICC–TCC Agreement providing that the payee clearing organization will be expected to return that amount. This protective provision is also in the FICC–CME cross-margining agreement.

<sup>16</sup> 15 U.S.C. 78q–1(b)(3)(F).

*(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

Written comments relating to the proposed rule change have not yet been solicited or received. FICC will notify the Commission of any written comments received by FICC.

**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, 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-2004-16 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-2004-16. 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 FICC and on FICC's Web site at <http://www.ficc.com>. 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-2004-16 and should be submitted on or before November 16, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. E4-2962 Filed 10-29-04; 8:45 am]

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**SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-50586; File No. SR-NYSE-2004-13]**

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. To Adopt Rule 405A ("Non-Managed Fee-Based Account Programs—Disclosure and Monitoring")**

October 25, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 25, 2004, the New York Stock Exchange, Inc. ("NYSE" or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or the "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On October 22, 2004, the NYSE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> 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**

Proposed new NYSE Rule 405A ("Non-Managed Fee-Based Account Programs—Disclosure and Monitoring") would prescribe certain requirements for members and member organizations that offer programs that charge customers a fixed fee or percentage of account value in lieu of commissions. The requirements include disclosure, appropriateness determination, monitoring of transactional activity, and a follow-up system to contact customers. The text of the proposed new rule appears below. Proposed new language is in *italics*.

\* \* \* \* \*

*Rule 405A ("Non-Managed Fee-Based Account Programs—Disclosure and Monitoring")*

*(1) General Disclosures Required*

*Each member or member organization shall provide each customer, prior to the opening of an account in a Non-Managed Fee-Based Account Program, and annually thereafter, a disclosure document describing the types of Non-Managed Fee-Based Account Programs available to such customer. The document shall disclose, for each such Program type, sufficient information for the customer to make a reasonably informed determination as to whether the Program is appropriate for them, including, at minimum: a description of the services provided, eligible assets, fees charged including projected customer costs, any conditions or restrictions imposed, and a summary of the Program's advantages and disadvantages.*

*(2) Opening of Accounts*

*Members and member organizations are required to make a determination, prior to opening an account in a Non-Managed Fee-Based Account Program, that such Program is appropriate for each customer taking into account the services provided, anticipated costs, and customer objectives.*

*(3) Monitoring of Accounts*

*Each member or member organization must establish and maintain systems and procedures adequate to monitor, on an ongoing basis, transactional activity by customers in Non-Managed Fee-Based Account Programs. Such systems and procedures must include specific transactional parameters or criteria for identifying levels of customer account*

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

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Mary Yeager to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated October 22, 2004.