

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55037; File No. SR-FICC-2006-10)

January 3, 2007

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Amend the Rules of its Mortgage-Backed Securities Division Regarding Membership Requirements for Unregistered Investment Pools

I. Introduction

On June 9, 2006, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2006-10 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on November 24, 2006.² No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

FICC is proposing to amend the rules of its Mortgage-Backed Securities Division (“MBSD”) regarding the membership requirements of “Unregistered Investment Pools.”³ Currently, unregistered investment pools have essentially the same membership standards as other MBSD non-broker clearing members.⁴ The size of the unregistered investment pool

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 54769 (November 16, 2006), 71 FR 67946.

³ As noted below, the term “Unregistered Investment Pool” is a newly-defined term in the MBSD’s Rules.

⁴ Currently, a clearing applicant or participant that is an unregistered investment pool and whose financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) must satisfy a minimum financial requirement of \$10 million in net asset value. In this filing, FICC is making a technical change to replace the term “net asset value” with the term “net assets” to more accurately state the financial requirement.

industry has grown, and Unregistered Investment Pools and their advisers have become significant participants in the industry. FICC reexamined its treatment of participants that are Unregistered Investment Pools and has determined it is necessary to enhance the clearing membership standards applicable to these entities.

FICC is proposing to adopt a definition for Unregistered Investment Pool, which will identify the entities that would become subject to the enhanced membership requirements for such entities. Under the new membership requirements, an Unregistered Investment Pool is an entity that holds a pool of securities and/or other assets that meets the following criteria: (i) it is not registered as an investment company under the Investment Company Act of 1940, (ii) it does not register its securities offerings under the Securities Act of 1933, and (iii) it has an investment advisor that is registered with the Commission under the Investment Advisers Act of 1940, or if the investment advisor is not registered, the Unregistered Investment Pool has a lock-up period of two (2) years or greater.

Entities that meet the definition of Unregistered Investment Pool will be eligible to apply to become MBSB clearing participants only if they meet the new membership criteria set forth below.⁵ The MBSB's current participants that fall within the definition of Unregistered Investment Pool will have one year from the date of approval of this rule filing in which to conform to the new minimum financial and qualitative rating requirements.

The new membership requirements for Unregistered Investment Pools are as follows:

- (1) SEC Registration: The investment advisor of the Unregistered Investment Pool must: (i) be registered with the Commission under the Investment Advisers Act

⁵ It is important to note that entities that meet the MBSB's definition of Unregistered Investment Pool will be treated as such by the MBSB regardless of whether the entity considers itself to be an Unregistered Investment Pool.

of 1940 or (ii) if it is not registered with the Commission, the Unregistered Investment Pool that the investment adviser advises must have an initial lock-up period of two (2) years or greater.

- (2) Minimum Net Assets: The Unregistered Investment Pool will be required to have and to maintain net assets of \$250 million or greater.⁶ If the Unregistered Investment Pool does not meet the \$250 million net asset requirement but the Unregistered Investment Pool has net assets of at least \$50 million⁷ or greater, the Unregistered Investment Pool will be eligible for MBSD clearing membership if its investment advisor has assets under management of at least \$1.5 billion and advises an existing MBSD clearing participant.
- (3) Qualitative Rating: The MBSD will require an Unregistered Investment Pool to obtain a minimum required rating of “above average” as a result of an FICC internal qualitative assessment. FICC believes it is important to consider

⁶ The \$250 million net assets requirement is the requirement that will be applicable to Unregistered Investment Pools whose financial statements are prepared in accordance with U.S. GAAP. Those Unregistered Investment Pools whose financial statements are prepared using other types of GAAP will be subject to the higher minimum requirements as determined by Article III, Rule 1, Section 2 of the MBSD’s Rules.

⁷ The \$50 million net assets requirement is the requirement that will be applicable to Unregistered Investment Pools whose financial statements are prepared in accordance with U.S. GAAP. Those Unregistered Investment Pools whose financial statements are prepared using other types of GAAP will be subject to the higher minimum requirements as determined by Article III, Rule 1, Section 2 of the MBSD’s Rules.

qualitative factors in order to assess both Unregistered Investment Pool applicants and members.⁸

III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in its custody or control.⁹ The Commission finds that FICC's proposed rule change is consistent with this requirement because by enhancing membership requirements for Unregistered Investment Pools, FICC should be better able to mitigate financial risk to itself and to its members and therefore should be better able to assure the safeguarding of securities and funds that 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 proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act¹⁰ and the rules and regulations thereunder.

⁸ Staff in the MBSD's Risk Division will determine a qualitative rating for each Unregistered Investment Pool applicant and will review qualitative ratings of Unregistered Investment Pool members on an annual basis. The assessment will include consideration of factors deemed relevant by the Risk Division, including management, capital, strategy and risk profile, and internal controls. (Because responsibility for these factors with respect to a particular Unregistered Investment Pool may be with the Unregistered Investment Pool, with the investment advisor, with some other entity (i.e., a third party service provider), or with some combination of these, Risk staff will perform the assessment for each factor with the entity or entities it deems appropriate.) The assessment will assess the strengths and weaknesses of these factors and will assign a qualitative rating to the Unregistered Investment Pool. In order to qualify for membership, Unregistered Investment Pools must meet a qualitative rating of at least "above average" as determined by the Risk Division's staff.

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2006-10) be and hereby is approved.¹¹

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹²

Florence E. Harmon
Deputy Secretary

¹¹ In approving the proposed rule change, the Commission considered efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹² 17 CFR 200.30-3(a)(12).