

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

FICC is seeking to amend its cross-margining agreements with the Chicago Mercantile Exchange ("CME"), BrokerTec Clearing Company ("BCC"), and the Board of Trade Clearing Corporation ("BOTCC") and to eliminate its cross-margining agreement with the New York Clearing Corporation ("NYCC").

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.²

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

1. New Cross-Margining Agreement With CME

Through its Government Securities Division ("GSD"), FICC has a cross-margining arrangement with CME.³ FICC is proposing to terminate its existing cross-margining agreement with CME and to enter into a new cross-margining agreement with the CME ("New FICC-CME Agreement") to reflect the fact that, as of January 2, 2004, the CME will begin clearing certain Treasury and Agency futures contracts and options on futures contracts that are traded on the Chicago Board of Trade ("CBOT") and are currently cleared by BOTCC. Under the New FICC-CME 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 and 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 CME products that will be eligible for cross-margining will be of two types: (i) the products currently eligible under the existing arrangement between FICC and CME which are Eurodollar futures contracts with ranges in maturity from 3 months to 10 years and options on such future contracts cleared by CME and (ii) the CBOT 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 to be cleared by CME.

No significant changes are being proposed to the existing FICC-CME cross-margining arrangement other than the addition of the CBOT products and certain FICC products as discussed in more detail below. The key aspects of the cross-margining arrangement, most notably, the calculation of the cross-margining reduction and the loss sharing provisions in the event of a participant default are not being amended.

2. Key Proposed Changes to the Existing Cross-Margining Agreement Between FICC and CME

The addition of the CBOT products has necessitated new definitions for "CBOT Eligible Products," "CME Eligible Products," and "FICC Eligible Products," as well as Offset Class tables for these products in Appendix B of the agreement.

Appendix B of the FICC-CME Agreement is also being amended to include FICC's GCF Repo Treasury and non-mortgage-backed Agency products in the cross-margining arrangement.⁴ By the effective date of the New FICC-CME Agreement, FICC will be margining its GCF Repo Treasury and non-mortgage-backed Agency products based upon the specific underlying collateral, as opposed to the current system of margining these products based upon the longest maturity of eligible underlying collateral.⁵ Therefore, these

⁴ This amendment is also being proposed with respect to the GCF Repo Treasury products and the BCC cross-margining arrangement as discussed below.

⁵ Because of a previous inability to obtain timely data on the actual instruments posted in support of GCF Repo positions, the GSD has 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.

GCF Repo products can now be included in the cross-margining arrangement because they will no longer be margined at a generic rate but rather at a specific rate based on the actual underlying Treasury and Agency collateral.

As is the case with the current agreement between FICC and CME, the parties provide in the New FICC-CME Agreement that they will agree from time to time in a separate writing on the disallowance factors that will be used in the cross-margining arrangement. The disallowance factors that will be used upon implementation of the new arrangement are the ones set forth as examples in Appendix B to the New FICC-CME Agreement. The disallowance factors between FICC eligible products and CME eligible products (*i.e.*, Eurodollar products) have not changed. A new disallowance factor table has been added for cross-margining of FICC eligible Treasury and Agency products with CBOT Treasury and Agency eligible products.⁶

Appendix C of the current agreement which sets forth the methodology for converting CME eligible products into Treasury cash equivalents for purposes of ultimately calculating the cross-margining reduction has been made into Appendix C1 and a new Appendix C2 has been added which contains the methodology for converting the CBOT eligible products into Treasury cash equivalents. This is identical to the methodology contained in the BOTCC and BCC cross-margining agreements.

The existing agreement between FICC and CME provides for a "Maximization Payment" which is a cross-guaranty provision that sets forth a mechanism for a clearing organization with a remaining surplus after all guaranty payments in relation to cross-margining have been made ("Aggregate Net Surplus") to distribute funds to one or more cross-margining partners with remaining losses. The New FICC-CME Agreement will make it clear that: (i) The Maximization Payment is also a guaranty payment (albeit outside of cross-margining, arising out of the "Maximization Payment Guaranty") and (ii) the defaulting member would have a reimbursement obligation with respect to such payment ("Maximization

The GSD has been in the process of developing improvements to the current margining methodology. By the effective date of the proposed rule change, the GSD will be able to identify the specific CUSIP posted in calculating a member's Clearing Fund requirement related to its Treasury and Agency GCF Repo activity.

⁶ FICC has computed and tested disallowance factors that will be applicable to each potential pair of positions being offset.

² The Commission has modified the text of the summaries prepared by FICC.

³ Securities Exchange Act Release No. 44301 (May 11, 2001), 66 FR 28207 (May 22, 2001) [File No. SR-GSCC-00-13].