

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63217; File No. SR-OCC-2010-14)

November 1, 2010

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Revise its Rules to Expand the Forms of Collateral Eligible for Incorporation in the System for Theoretical Analysis and Numerical Simulations Risk Management Methodology

I. Introduction

On August 25, 2010, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-OCC-2010-14 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The proposed rule change was published in the Federal Register on September 13, 2010. No comment letters were received on the proposal. This order approves the proposal.

II. Description

This rule change revises OCC’s Rules to expand the forms of collateral eligible for incorporation in OCC’s System for Theoretical Analysis and Numerical Simulations (“STANS”) risk management methodology.

The rule change alters Interpretation and Policy .06 to Rule 601 in connection with expanding the forms of collateral eligible for incorporation in the STANS risk management methodology. Prior to the rule change, OCC incorporated common stock and ETFs<sup>3</sup> in the STANS margin calculation process.<sup>4</sup> When OCC began including common stock and ETFs in

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

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

<sup>3</sup> ETFs fall within the definition of “fund shares” as that term is defined in Article I, Section 1 of OCC’s By-Laws.

<sup>4</sup> Securities Exchange Act Release No. 34-58158 (July 15, 2008), 73 F.R. 42626

the STANS margin calculation process, it noted its belief that the procedure would more accurately measure risk in Clearing Members' accounts and thereby permit OCC to more precisely set margin requirements to reflect that risk. For those same reasons, OCC will now incorporate certain fixed-income, "government securities" into the STANS margin calculation process.

The specific amendments to OCC's Rules that facilitate incorporation of government securities into the STANS margin calculation process can be found at

[http://www.optionsclearing.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_10\\_14.pdf](http://www.optionsclearing.com/components/docs/legal/rules_and_bylaws/sr_occ_10_14.pdf)

OCC will now incorporate in phases certain "government securities" into the STANS margin calculation beginning with U.S. Government securities.<sup>5</sup> Treasury Inflation Protected Securities and callable U.S Treasury Securities will be excluded from the initial phase, as will be Canadian government securities and GSE debt securities.<sup>6</sup>

Currently, government securities deposited as collateral to satisfy margin requirements are priced on a nightly basis and are assigned a value equal to their current market value less an applicable haircut based on the term to maturity. While this method of valuing collateral has generally served OCC well in the past, OCC believes analyzing cleared positions and margin assets as a single portfolio using STANS provides a more accurate valuation of the Clearing Members' securities deposited as collateral in relation to other account positions. As when OCC began including common stocks and ETFs in the STANS calculation, OCC believes phasing in

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(July 22, 2008)(SR-OCC-2007-20).

<sup>5</sup> This would include but would not be limited to Government securities and GSE debt securities.

<sup>6</sup> The government securities being initially excluded will be evaluated by OCC for possible inclusion in STANS as appropriate models are developed.

government securities will align risk-management techniques utilized to manage market risk of cleared positions, for example for Treasury futures contracts, with those techniques used to value margin deposits.

The inclusion of government securities into STANS will be implemented using an approach similar to that used when common stocks and ETFs were added into STANS. The value of the securities deposited in a Clearing Member's account will be determined along with the risk on the margin assets on a portfolio basis with reference to the volatility and correlation of each deposited security to the other positions in the account. Given the conservative nature of the current haircuts applied to deposits of government securities, OCC anticipates a modest increase in their collateral valuation upon the implementation of this change.

As a part of this rule change, OCC will apply a portfolio specific adjustment factor when determining whether there is sufficient margin excess in an account. This will enable OCC to release margin collateral to a Clearing Member on an intraday basis. The adjustment factor is account and security specific and is determined by approximating the change in margin requirement caused by depositing or withdrawing a particular security from the Clearing Member's account based on the risk characteristics of that security and its consequent assessed value. OCC believes this process will provide a more accurate projection of the margin impact of collateral withdrawals and substitutions on a Clearing Member's account. This process is already used to analyze the impact of substitutions and withdrawals of equity collateral within

the STANS Monte Carlo simulations.<sup>7</sup>

OCC's Rule 601, "Margin Requirements," already provides that margin assets in the form of securities may be incorporated into the Monte Carlo calculations as an alternative to valuing such assets under Rule 604, "Form of Margin Assets." In connection with incorporating common stocks and ETFs into the STANS calculation, OCC adopted Interpretation and Policy .06 under Rule 601 to clarify that margin assets in the form of common stocks and ETFs would be included in the Monte Carlo simulations described in Rule 601 for purposes of determining the minimum expected liquidating value of an account with other margin assets being valued as provided for under Rule 604.<sup>8</sup> OCC is now broadening the interpretation to provide that OCC may designate those margin assets which if deposited into a Clearing Member's account will be valued as provided in Rule 601 rather than Rule 604. This change is intended to facilitate OCC's adoption of certain government securities into the STANS margin calculation process.

### III. Discussion

Section 17A(b)(3)(F),<sup>9</sup> requires, among other things, that the rules of a clearing agency are designed to safeguard securities and funds in the clearing agency's possession or control or for which it is responsible. This requires OCC to have the ability to meet its settlement

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<sup>7</sup> OCC believes the approach currently used to assess the impact of collateral substitutions and withdrawals represents an improvement over that outlined in File No. SR-OCC-2007-20. Interpretation and Policy .01 under Rule 608 generally provides that OCC may specify procedures from time-to-time to assess the impact of collateral withdrawals and substitutions.

<sup>8</sup> Rule 604(f) provides that, in lieu of the valuations provided for in Rule 604, OCC may elect to value any or all margin assets in the form of securities pursuant to Rule 601.

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(F).

obligations following a member's default. It is therefore necessary that OCC have an effective methodology for calculating margin requirements that are sufficient to enable OCC to complete settlement in the event a member becomes insolvent or otherwise fails to meet its obligations to OCC. The Commission believes that the changes OCC is making to include government securities within the STANS risk management methodology should better enable OCC to fulfill its safeguarding obligations under the Act and therefore is consistent with the Act.

#### 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 Act<sup>10</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (File No. SR-OCC-2010-14) be, and hereby is, approved.<sup>12</sup>

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>10</sup> 15 U.S.C. 78q-1.

<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>13</sup> 17 CFR 200.30-3(a)(12).