

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-71910; File No. SR-OCC-2014-07)

April 9, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change to Eliminate Preferred Stock and Corporate Bonds as Acceptable Forms of Margin Assets and Make Additional, Conforming, Rule Changes

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> notice is hereby given that on March 28, 2014, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

OCC proposes to amend its Rules to eliminate preferred stock and corporate bonds as acceptable forms of margin assets. OCC is also proposing additional amendments to eliminate a provision that automatically renders a common stock as ineligible for deposit if it is subject to special margin requirements under the rules of the listing market, and to also eliminate certain provisions from the Rules that will no longer be applicable upon the elimination of preferred stock as an acceptable form of margin asset.

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

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

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

The principal purpose of this proposed rule change is to amend OCC's Rule 604(b)(4) (the "Rule") to eliminate preferred stock and corporate bonds as acceptable forms of margin assets. Other changes also are proposed to the Rule in order to update its terms and provisions to reflect current practices with respect to the deposit of assets (i.e., common stock, including fund shares and index linked-securities, which are collectively referred to as "common stock") that will continued to be covered by the Rule on the approval of this proposed rule change.

*Background*

OCC historically has sought to permit clearing members to deposit as margin a diverse mix of assets, subject to the application of prudent safeguards designed to ensure such assets present limited credit, market and liquidation risk, as applicable. OCC Rule 604 sets forth the forms of assets eligible to be deposited as margin and conditions that must be satisfied in order for margin credit to be given to such deposits. Eligible forms

of margin assets presently are: cash, Government securities,<sup>3</sup> GSE Debt Securities, money market fund shares, letters of credit, common stock (including fund shares), corporate bonds and preferred stock. Since 1988, OCC has been authorized to accept preferred stock and corporate bonds as margin.<sup>4</sup> OCC recently reviewed its current practices with respect to these two asset types and, for the reasons discussed below, determined they should no longer be accepted as a form of margin.

#### *Review of Preferred Stock and Corporate Bonds*

Preferred stock and corporate bonds (on a combined basis) consistently have accounted for less than one percent of the margin assets on deposit at OCC. Corporate bonds have not been deposited as margin, nor have clearing members attempted to deposit corporate bonds as margin, since March 2012. As of March 6, 2014, preferred stock comprised .13% of OCC's total margin deposits and less than five percent of any individual clearing member's margin deposits.

OCC presently uses a manual process to review the valuation methodology for preferred stocks and corporate bonds. Such review process occurs monthly and contemplates: 1) adequacy of haircuts, 2) volume, and 3) price transparency. While OCC believes this review process is adequate, OCC has concluded it is less robust than the process applied to deposits of common stocks. In comparison, OCC uses STANS, its daily automated Monte Carlo simulation-based margining methodology, to value and risk

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<sup>3</sup> OCC defines the term "Government securities" to mean securities issued or guaranteed by the United States or Canadian Government, or by any other foreign government acceptable to the Corporation, except Separate Trading of Registered Interest and Principal Securities issued on Treasury Inflation Protected Securities (commonly called TIP-STRIPS). *See* OCC By-Laws Article I, Section 1(G)(5).

<sup>4</sup> *See* Securities Exchange Act Release No. 29576 (August 16, 1991), 56 FR 41873 (August 23, 1991), (SR-OCC-88-03).

manage common stocks deposited as margin collateral.<sup>5</sup> STANS calculates haircuts that are regularly tested, taking into account stressed market conditions.

OCC researched the work necessary to integrate preferred stock and corporate bonds into STANS and otherwise automate monitoring and controls as they relate to risk managing these asset types. Given their general lack of utilization as margin collateral, OCC determined that it would be inefficient and ineffective from a cost perspective to expend the significant time, resources and expense needed to complete the required systems development to automate monitoring and assessment processes for these asset types. OCC also concluded that the continued use of its current manual processes may not be fully consistent with Principle 5 of the CPSS-IOSCO Principles for Financial Market Utilities.<sup>6</sup> OCC is therefore proposing to stop accepting preferred stock and corporate bonds as forms of margin assets and to remove provisions from the Rule pertaining to the deposit of these asset types. OCC notes that after giving effect to this proposed rule change, a varied mix of asset types would still be available to clearing members for deposit as margin.<sup>7</sup>

#### *Additional Revisions*

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<sup>5</sup> OCC also uses STANS to value Government securities with the exception of TIPS and Canadian Government securities, which are valued using the haircuts set forth in OCC Rule 604.

<sup>6</sup> Principle 5 provides that margin collateral accepted by a financial market infrastructure (“FMI”) should have low credit, liquidity and market risk and should establish prudent valuation practices and develop haircuts that are regularly tested, taking into account stressed market conditions.

<sup>7</sup> OCC discussed this proposal with the Financial Risk Advisory Committee, a working group consisting of representatives of clearing members and exchanges that was formed by OCC to review and comment on risk management proposals under consideration. No concerns were raised by the group during the course of such discussions.

In connection with reviewing the Rule for the purposes described above, and in order to conform the Rule to current operational practices after giving effect to the proposed rule change, OCC also reassessed the remaining provisions of this Rule as applied to OCC's practices for accepting common stock, the form of margin asset that the Rule would continue to address after Commission approval of this rule filing. As a result of such review, OCC is proposing several additional changes to the Rule. OCC proposes to eliminate a provision that automatically renders a common stock as ineligible for deposit if it is subject to special margin rules under the rules of the listing market. OCC believes that it is not an efficient use of resources to monitor listing markets to determine if a common stock becomes subject to special margin rules. OCC also believes it is currently able to effectively risk manage common stocks that may become subject to special margin rules through existing STANS functionality. Additionally, OCC notes that it may act under Rule 604, Interpretation and Policy .14, to restrict deposits of issues that are subject to special margin rules by a listing market.

Moreover, as a result of the proposed elimination of preferred stock as a form of margin asset, OCC proposes conforming changes to remove provisions of the Rule that: (i) limit the amount of margin credit of any single issue to 10% of the market value of margin deposited by Clearing Member because additional charges for concentrated positions are determined under STANS pursuant to Rule 601, and (ii) limit margin credit given to deposits to 70% of daily closing bid prices because haircuts applied to common stock deposits are determined under STANS pursuant to Rule 601.<sup>8</sup> Also, a provision

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<sup>8</sup> OCC has integrated common stocks into the process by which OCC calculates margin requirements using STANS. *See* Securities Exchange Act Release No. 58158 (July 15, 2008), 73 FR 42646 (July 22, 2008), (SR-OCC-2007-20).

would be added to make explicit that common stock deposits are valued in accordance with Rule 601.<sup>9</sup>

### *Implementation*

OCC has advised its clearing members of its intent to eliminate the acceptance of preferred stock and corporate bonds, subject to regulatory approval. Because corporate bonds have not been deposited as margin since March 2012 and are not currently deposited for such purposes, OCC requested clearing members to voluntarily not deposit such asset type pending regulatory approval of this rule filing. OCC further has discussed this planned change with those clearing members maintaining preferred stock as a form of margin deposit and has worked with them to ensure each has developed an appropriate plan to wind down its use of such deposits in light of this proposal. No concerns were raised by clearing members with respect to the elimination of preferred stock and OCC does not anticipate any delay in the implementation of this proposed rule change upon regulatory approval. A final Information Memorandum will be issued once this proposed rule change is eligible to be implemented and OCC will modify its system to prohibit clearing members from depositing preferred stock and corporate bonds as margin collateral thereafter.

### (2) Statutory Basis

OCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>10</sup> because it promotes the prompt and accurate clearance and settlement of securities transactions for which it is responsible. OCC believes that the

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<sup>9</sup> *Id.*

<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(F).

proposed elimination of preferred stocks and corporate bonds as acceptable forms of margin is consistent with the Act because these assets are subject to a manual valuation process, not OCC's automated STANS system. STANS provides more expeditious and accurate margin calculations than a manual process. As such, investors and the public will be more confident that OCC will be able to meet its daily settlement obligations because the possibility that clearing member margin deposits would be insufficient should OCC need to use them to complete a settlement will be reduced since margin in the form of preferred stock and corporate bonds valued through a manual process will no longer be permitted. Additionally, OCC will be better able to determine the sufficiency of its margin deposits at any given time since manually valued margin forms of assets, consisting of preferred stock and corporate bonds, will be eliminated. The proposed rule change is not inconsistent with any rules of OCC, including any other rules proposed to be amended.

(B) Clearing Agency's Statement on Burden on Competition

OCC does not believe that the proposed rule change would impact, or impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.<sup>11</sup> Changes to the rules of a clearing agency may have an impact on the participants in a clearing agency, their customers, and the markets that the clearing agency serves. This proposed rule change affects certain clearing members and their customers inasmuch as it eliminates two forms of assets eligible for deposit as margin. However, as stated above, corporate bonds have not been deposited as margin since

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<sup>11</sup> 15 U.S.C. 78q-1(b)(3)(I).

March 2012 and preferred stock comprises .13% of OCC's total margin deposits and less than five percent of the margin deposits of any individual clearing member.

OCC believes it would be inefficient and ineffective from a cost perspective to expend significant time, resources and expense needed to complete the required systems work to automate monitoring and assessment processes for these asset types in light of their limited usage over time. Moreover, OCC will continue to accept multiple forms of assets from clearing members to meet margin requirements and, based on the quantitative measures concerning clearing member usage of preferred stocks and corporate bonds set forth above, OCC does not believe that the proposed rule change will materially impact users of its services.

For the foregoing reasons, OCC believes that the proposed rule change is in the public interest, would be consistent with the requirements of the Act applicable to clearing agencies, and does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate 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 or disapprove 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-OCC-2014-07 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2014-07. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1090 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website:

[http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_14\\_07.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_07.pdf)

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-OCC-2014-07 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

Kevin M. O'Neill  
Deputy Secretary

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