

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68147; File No. SR-OCC-2012-17)

November 2, 2012

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing, as Modified by Amendment No. 1 Thereto, Relating to the Margining of Segregated Futures Customer Accounts on a Gross Basis

I. Introduction

On September 14, 2012, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) an advance notice concerning a proposed rule change SR-OCC-2012-17 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The proposed rule change was published in the Federal Register on September 26, 2012.<sup>3</sup> The advance notice was published in the Federal Register on October 1, 2012.<sup>4</sup> On October 11, 2012, OCC filed Amendment No. 1 to the proposed rule change and the advance notice.<sup>5</sup> The

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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> “Notice of Filing of Proposed Rule Change Relating to the Margining of Segregated Futures Customer Accounts on a Gross Basis,” Release No. 34-67896 (September 20, 2012), 77 FR 59231 (September 26, 2012).

<sup>4</sup> “Advance Notice Relating to the Margining of Segregated Futures Customer Accounts on a Gross Basis,” Release No. 34-67921 (September 25, 2012), 77 FR 59998 (October 1, 2012).

<sup>5</sup> In Amendment No. 1, OCC proposed wording changes and responded to a CFTC interpretation concerning what constitutes initial margin. Specifically, it amended the text of Rule 601 by inserting the word “initial” before the word “margin,” to more closely parallel CFTC Rule 39.13(g)(8)(i)<sup>5</sup> which references “initial margin.” It also amended Item 3 of Form 19b-4 to, first, include CFTC’s definition of “initial margin” and second, to clarify which components of OCC’s margin calculations meets the definition of “initial margin” as the term is defined under CFTC Rules.

Commission received no comment letters on either publication. This publication serves as a notice of no objection to the advance notice.

## II. Description of the Proposed Rule Change

This advance notice concerns a proposed rule change. The purpose of this proposed rule change is to provide for the calculation of initial margin for OCC segregated futures customer accounts on a gross basis, as required by CFTC Rule 39.13(g)(8)(i).<sup>6</sup>

### **The CFTC’s Customer Gross Margin Rule**

On October 18, 2011, the CFTC issued final regulations implementing many of the new statutory core principles for CFTC-registered derivatives clearing organizations (“DCOs”) enacted under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). As a registered DCO (as well as a registered securities clearing agency), OCC has previously implemented rule changes designed to bring OCC into compliance with CFTC rules applicable to DCOs that went into effect on January 9, 2012<sup>7</sup> and May 7, 2012.<sup>8</sup> OCC believes it is necessary to amend its Rules in order to ensure compliance with the gross margin rule, which requires a DCO to “collect initial margin on a gross basis for each clearing member’s customer account(s) equal to the sum of the initial margin amounts that would be required by the derivatives clearing organization for each individual customer within that account if each individual customer were a clearing

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Amendment No. 1 is technical in nature, and therefore the Commission is not publishing Amendment No. 1 for public comment.

<sup>6</sup> 17 CFR 39.13(g)(8)(i).

<sup>7</sup> See SR-OCC-2011-18.

<sup>8</sup> See SR-OCC-2012-06.

member”<sup>9</sup> as required by CFTC Rule 39.13(g)(8)(i). The gross margin rule goes into effect on November 8, 2012; however, OCC proposed to begin complying with the gross margin rule on November 5, 2012 as described herein.

### **OCC’s System for Calculating Margin**

OCC currently calculates margin requirements for each clearing member’s segregated futures customer account held at OCC on a net basis by applying OCC’s System for Theoretical Analysis and Numerical Simulations (“STANS”). STANS calculates initial margin with respect to each account of a clearing member, including each clearing member’s futures customer account(s), on a net basis. STANS includes both a net asset value (“NAV”) component and a risk component, with the risk component being the equivalent of “initial margin” as that term is defined under CFTC Rules. The NAV component marks all positions to market and nets long and short positions to determine the NAV of each clearing member’s portfolio of customer positions. The NAV component represents the cost to liquidate the portfolio at current prices by selling the net long positions and buying in the net short positions. The risk component is estimated by means of an expected shortfall risk measure obtained from “Monte Carlo” simulations designed to measure the additional asset value required in any portfolio to eliminate an unacceptable level of risk that the portfolio would liquidate to a deficit.

OCC presently lacks sufficient information about individual customer positions to calculate initial margin at the level of each individual customer. However, OCC has been coordinating with other DCOs to establish an industry-wide mechanism for complying with the customer gross margin rule. Pursuant to this new system, each DCO’s clearing

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<sup>9</sup> Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334, 69439 (November 8, 2011).

members will submit data files to the DCO identifying positions by numerical customer identifiers.<sup>10</sup> OCC will use this information to calculate initial margins, using STANS, for each customer identifier of a clearing member and to aggregate those initial margin calculations to determine the total futures customer margin requirement for the clearing member's segregated futures customer account(s) held at OCC.<sup>11</sup> OCC will then compare the aggregate positions reported by each clearing member with its own records and make any needed adjustments to the initial margin calculation to ensure all positions on OCC's books are properly margined.

### **Proposed By-Law and Rule Changes**

The proposed changes to OCC's Rules provide for the calculation of initial margin for segregated futures customer accounts on a gross basis and mandate submission of the clearing member data files necessary to allow OCC to calculate initial margin at the level of each futures customer. In the event that the data included in these data files is incomplete (for example, if OCC shows positions held in a clearing member's segregated futures accounts, but those positions are not reflected in the data file), OCC will create a

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<sup>10</sup> The position data provided to OCC by clearing members will not include (a) information with respect to the allocation of margin assets to particular customers, nor (b) information with respect to settlement obligations arising from the exercise, assignment or maturity of cleared contracts. For this reason, OCC will treat all margin assets and settlement obligations for each account to which the gross margin rule applies as being in sub-accounts of the Clearing Member. OCC will calculate margin, using STANS, separately for each sub-account and will aggregate the calculated margin requirements at the level of the clearing member's segregated futures customer account to which the sub-accounts relate.

<sup>11</sup> OCC currently carries the following account types that are segregated pursuant to Section 4d of the Commodity Exchange Act: Segregated Futures Accounts, Segregated Futures Professional Accounts, non-Proprietary X-M accounts, and internal non-proprietary cross-margining accounts. All such accounts would be margined on a gross basis under the proposed amendments to OCC Rule 601.

separate sub-account to be used for initial margin calculation purposes only. Positions recorded on OCC's books and records, but not reflected in the data file, will be attributed to this sub-account and an initial margin amount will be calculated for the sub-account. This initial margin amount will be added to a clearing member's initial margin requirement. OCC has determined to adopt this approach to dealing with discrepancies between its own records and clearing member data files in order to ensure that OCC does not collect an inadequate amount of initial margin from clearing members.

### III. Description of the Advance Notice

OCC filed its proposed rule change as an advance notice pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act") because OCC believed it could be deemed to materially affect the nature or level of risks presented by OCC. OCC's proposed rule changes would require the collection of futures customer margin on a gross basis in order to comply with CFTC Rule 39.13(g)(8)(i). This is expected to lead to an increase in the amount of margin OCC collects from its clearing members with respect to their segregated futures customer accounts held at OCC, as well as a corresponding decrease in OCC's default risk with respect to those accounts. This decreased risk may be material. While the amount of initial margin collected by OCC with respect to segregated futures customer accounts of clearing members will increase, the fundamental processes used by OCC to calculate such initial margin requirements will continue to rely on STANS, which OCC is not proposing to change as a result of the gross margin rule. OCC therefore does not expect that the nature of its risks with respect to segregated futures customer accounts will change, merely that the level of such risk will change.

The industry-wide effort to implement gross initial margining for segregated futures customer accounts could pose operational risks to OCC due to the complexities involved in the exchange of customer-level position data between clearing members and OCC and in ensuring that OCC is prepared to process the information received and incorporate it into its own margin calculations. Implementing the customer gross margin rule changes on November 8, 2012 (a Thursday) could also exacerbate the operational challenges involved in implementing customer gross margining. In order to mitigate these challenges, OCC and other DCOs have determined that it is advisable to implement these changes in advance of the CFTC's mandatory November 8, 2012 compliance date, on November 5, 2012 (a Monday). This is being done in coordination with other DCOs and in order to avoid a mid-week implementation date. As the Rule change described herein is mandated by regulations to which OCC is subject as a registered DCO, OCC has no discretion in whether to implement these Rule changes. Nevertheless, OCC believes that these Rule changes will not diminish OCC's ability to ensure the safeguarding of securities and funds in OCC's custody or control or for which OCC is responsible.

#### IV. Analysis of Advance Notice

##### **Standard of Review**

A registered clearing agency that has been designated as a systemically important financial market utility ("FMU") by the Financial Stability Oversight Council ("FSOC") must provide advance notice of all changes to its rules, procedures or operations that could, as defined in the rules of the supervisory agency, materially affect the nature or level of risk

presented by the clearing agency.<sup>12</sup> Absent an extension or request for additional information, as discussed in greater detail below, the Commission is required to notify the clearing agency of any objection regarding the proposed change within the 60 day time frame established by Title VIII of the Dodd-Frank Act (“Title VIII”).<sup>13</sup> A designated clearing agency may not implement a change to which its supervisory agency has objected;<sup>14</sup> however, the clearing agency is explicitly permitted to implement a change if it has not received an objection from its supervisory agency within the same 60 day time period.<sup>15</sup>

Although Title VIII does not specify a standard that the Commission must apply to determine whether to object to an advance notice, the Commission believes that the purpose of Title VIII, as stated under Section 802(b),<sup>16</sup> is relevant to the review of advance notices.

The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability, by (among other things) authorizing the Federal Reserve Board to promote uniform risk management standards for systemically important FMUs,

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<sup>12</sup> 12 U.S.C. 5465(e). See also, Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, Rel. No. 34-63557 (December 15, 2010), 75 FR 82490 (December 30, 2010) (Proposing Release); Rel. No. 34-67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) (Adopting Release).

<sup>13</sup> 12 U.S.C. 5465(e)(1)(E).

<sup>14</sup> 12 U.S.C. 5465(e)(1)(F).

<sup>15</sup> 12 U.S.C. 5465(e)(1)(G).

<sup>16</sup> 12 U.S.C. 5461(b).

and providing an enhanced role for the Federal Reserve Board in the supervising of risk management standards for systemically important FMUs.<sup>17</sup> Therefore, the Commission believes that when reviewing advance notices for FMUs, the consistency of an advance notice with Title VIII may be judged principally by reference to the consistency of the advance notice with applicable rules of the Federal Reserve Board governing payment, clearing, and settlement activity of the designated FMU.<sup>18</sup>

Section 805(a) requires the Federal Reserve Board and authorizes the Commission to prescribe standards for the payment, clearing, and settlement activities of FMUs designated as systemically important, in consultation with the supervisory agencies. Section 805(b) of the Clearing Supervision Act<sup>19</sup> requires that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- Promote robust risk management and safety and soundness;
- Reduce systemic risks; and
- Support the stability of the broader financial system.

The relevant rules of the Federal Reserve Board prescribing risk management standards for designated FMUs by their terms do not apply to designated FMUs that are clearing agencies registered with the Commission.<sup>20</sup> Therefore, the Commission believes that the objectives and principles by which the Federal Reserve Board is required and the Commission is authorized to promulgate such rules, as expressed in Section 805(b) of Title

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<sup>17</sup> 12 U.S.C. 5461(b).

<sup>18</sup> See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012).

<sup>19</sup> 12 U.S.C. 5464(b).

<sup>20</sup> 12 CFR 234.1(b).



VIII,<sup>21</sup> are the appropriate standards at this time by which to evaluate advance notices.<sup>22</sup>

Accordingly, the analysis set forth below is organized by reference to the stated objectives and principles in Section 805(b).

### **Discussion of Advance Notice**

OCC's proposed rule changes are expected to increase the amount of margin collected with respect to clearing members' segregated futures accounts held at OCC. This higher level of margin is expected to lead to a corresponding decrease in OCC's default risk with respect to those accounts. And while the level of risk is expected to change, OCC does not expect that the nature of its risks to change because the fundamental processes used to calculate initial margin will continue to rely on the same system for margin calculations. In addition, OCC represents that the rule change does not diminish OCC's ability to ensure the safeguarding of the securities and funds in OCC's custody or control.

Moreover, OCC is making these changes in order to facilitate compliance with a CFTC requirement. Its ability to comply with relevant regulatory requirements and to not be faced with inconsistent regulatory requirements (as would be the case if the Commission objected to the proposal) promotes legal certainty and predictability as to what OCC will

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<sup>21</sup> 12 U.S.C. 5464(b).

<sup>22</sup> The risk management standards that have been adopted by the Commission in Rule 17Ad-22 are substantially similar to those of the Federal Reserve Board applicable to designated FMUs other than those designated clearing organizations registered with the CFTC or clearing agencies registered with the Commission. See Clearing Agency Standards, Exchange Act Release No. 34-68080 (Oct.22, 2012). To the extent such Commission standards are in effect at the time advance notices are reviewed in the future, the standards would be relevant to the analysis. Moreover, the analysis of clearing agency rule filings under the Exchange Act would incorporate such standards directly.

require from its clearing members. This legal certainty and predictability promotes the objectives and principles described above.

For these reasons, the Commission finds that OCC's proposed rule change promotes robust risk management and safety and soundness, reduces systemic risks and supports the stability of the broader financial system, and therefore does not object to the advance notice.

V. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,<sup>23</sup> that, the Commission DOES NOT OBJECT to proposed rule change (File No. SR-OCC-2012-17) and that OCC be and hereby is AUTHORIZED to implement proposed rule change (File No. SR-OCC-2012-17) as of the date of this notice or the date of the “Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to the Margining of Segregated Futures Customer Accounts on a Gross Basis” (File No. SR-OCC-2012-17), whichever is later.

By the Commission.

Kevin M. O’Neill  
Deputy Secretary

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<sup>23</sup> 12 U.S.C. 5465(e)(1)(I).