

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-64712; File No. SR-OCC-2011-03)

June 21, 2011

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Allow for an Expansion of OCC's Internal Cross-Margining Program to Include the Ability of a Pair of Affiliated Clearing Members to Establish an Internal Non-Proprietary Cross-Margining Account

I. Introduction

On March 17, 2011, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2011-03 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>1</sup> The proposed rule change was published for comment in the Federal Register on April 7, 2011.<sup>2</sup> The Commission received three comment letters on the proposal, including OCC’s letter responding to one of the commenters.<sup>3</sup> This order approves the proposal.

II. Description of the Proposal

The purpose of this rule change is to expand OCC’s internal cross-margining program to permit a pair of affiliated clearing members to establish a cross-margining account (“Internal Non-Proprietary Cross-Margining Account”) in which securities and security futures that are cleared by OCC in its capacity as a securities clearing agency may be cross-margined with commodity futures and options on such futures that are cleared by OCC in its capacity as a

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

<sup>2</sup> Securities Exchange Act Release No. 34-63811 (February 1, 2011), 76 FR 6648 (February 7, 2011).

<sup>3</sup> Letter from Gene Thomas (Retired), (April 24, 2011); letter from Andrew S. Margolin, Associate General Counsel, Bank of America Corporation, to Elizabeth M. Murphy, Secretary, Commission (April 21, 2010); and letter from Stephen M. Szamarck, V.P. Associate General Counsel, OCC, to Elizabeth M. Murphy, Secretary, Commission (May 23, 2011).

derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (“CFTC”) under the Commodity Exchange Act (“CEA”).

In 2004, the CFTC and the Commission<sup>4</sup> approved OCC’s proposal to create an “internal cross-margining” program under which an OCC clearing member could elect to cross-margin a non-proprietary futures account of a “market professional”<sup>5</sup> with a non-proprietary securities account containing positions of the same market professional. At OCC, the securities and futures positions of all market professionals with cross-margined accounts at the clearing member are combined in a single Internal Non-Proprietary Cross-Margining Account of the clearing member at OCC. The existing program, which has operated successfully since 2004, requires that the same clearing member clear the securities and futures positions. In contrast, the existing cross-margining programs between OCC and other DCOs, such as the clearing division of the Chicago Mercantile Exchange (“CME”) and ICE Clear U.S., permit cross-margining where the member of the futures clearing organization is a different entity from its affiliate that is an OCC clearing member. The purpose of this proposed rule change is to expand the existing internal cross-margining program in an analogous way so that it would permit an Internal Non-Proprietary Cross-Margining Account to be maintained at OCC jointly by a pair of affiliated clearing members that clear transactions in securities options and in futures products through two

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<sup>4</sup> Securities Exchange Act Release No. 34-50509 (October 8, 2004), 69 FR 61289 (October 15, 2004).

<sup>5</sup> As set forth in OCC’s By-Laws, a market professional could be a market-maker, specialist or person acting in a similar capacity on a securities exchange, or a member of a futures exchange trading for its own account. A non-proprietary market professional is any market professional that is required to be treated as a “customer” under the CEA, and therefore excludes any market professional that is affiliated with the carrying clearing member in a way that would cause its account to be treated as a “proprietary account” under Section 1.3(y) of the CFTC’s regulations. OCC By-Laws, Article I, Definitions.

different entities. In order to participate, both OCC clearing members would have to be affiliates of one another and would have to be registered as both a futures commission merchant under the CEA and as a broker-dealer under the Act.

OCC's current internal cross-margining program does not provide for internal cross-margining accounts to be carried jointly by a pair of affiliated clearing members because OCC did not believe in 2004 that there was any clearing member demand for such a service. Recently, however, OCC has learned that there is demand for such a service. Under OCC's current proposal, two affiliated clearing members will jointly maintain an Internal Non-Proprietary Cross-Margining Account. The clearing member that normally clears transactions in securities options would submit transactions in eligible securities options to the account for clearance, and the clearing member that normally clears transactions in futures products would submit transactions in eligible futures products to the account for clearance.

OCC is amending its current By-Laws and Rules governing internal cross-margining to create rules similar to the rules of the long-standing cross-margining program between OCC and CME, for example, for affiliated clearing members. In the case of the cross-margining programs between OCC and other DCOs, there are two accounts at the clearing level—one at each of the participating clearing organizations. In the internal cross-margining program, there is no need for two separate accounts, which would in any event be margined together and for which the affiliated clearing members would in any event be jointly and severally liable as they are for the two accounts in the case of the OCC-CME program.

Article VI, Section 25(b) of OCC's By-Laws currently requires clearing members to obtain a "Market Professional's Agreement for Internal Cross-Margining" from each market professional whose positions are included in an Internal Non-Proprietary Cross-Margining

Account. OCC will use a modified form of this agreement for the account held jointly by a pair of affiliated clearing members.<sup>6</sup> OCC does not intend to require current participants in the internal cross-margining program to obtain reexecuted agreements in updated form because the modifications are clarifications only and not substantive changes.

As in the case of the existing internal cross-margining program, the Internal Non-Proprietary Cross-Margining Account would be treated as a segregated futures account under Section 4d of the CEA and, in accordance with Appendix B to Part 190 of the CFTC's regulations, would be separately segregated from the regular segregated futures account that an OCC clearing member may maintain under Article VI, Section 3(f) of OCC's By-Laws. In order to expand the internal cross-margining program to include accounts carried by pairs of affiliated clearing members, OCC has requested that the CFTC either issue a new or amended order under Section 4d of the CEA.<sup>7</sup>

### III. Comment Letters

The Commission received one comment letter opposing the proposed rule change<sup>8</sup> and

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<sup>6</sup> The proposed form of the agreement, titled "Market Professional's Agreement for Internal Cross-Margining (Affiliated Clearing Members)" is attached as Exhibit 5A to the proposed rule change filing. The existing "Market Professional's Agreement for Internal Cross-Margining" applicable to the internal cross-margining program for single clearing members has been renamed "Market Professional's Agreement for Internal Cross-Margining (Single Clearing Member)" and is attached as Exhibit 5B to the proposed rule change filing. In addition to modifying the title to the form of the agreement applicable to single clearing members, a sentence has been added at the end of paragraph seven of that agreement to conform it to the corresponding provision in the form of the agreement for affiliated clearing members.

<sup>7</sup> OCC will not implement the internal cross-margining program for affiliated clearing members until after such time that the CFTC has issued an order or amended order under Section 4d of the CEA as discussed above.

<sup>8</sup> Letter from Gene Thomas, supra note 3.

one comment letter in favor of the proposed rule change.<sup>9</sup> OCC responded to the letter in opposition to the proposal.<sup>10</sup> The commenter opposing OCC's proposal stated that there was "no universal advantage to commingled monies or other valued properties" and that he "visualize[d] the possibility of from [sic] frequent disagreements between the Dual Registrants and OCC." In its response, OCC disagreed and stated that cross-margining programs "are consistent with clearing agency responsibilities under Section 17A of the Securities Exchange Act of 1934 and are highly beneficial to the clearing organizations, its clearing members and the public."<sup>11</sup> OCC also stated in its response that the internal cross-margining program is limited to OCC clearing members and that participation in the program is completely voluntary. OCC response also indicated that it was not aware of any disagreements between dual registrants and OCC over the many years that the various cross-margining agreements have been in operation.

The commenter in support of OCC's proposed rule change stated he supported the proposal because it "would harmonize the manner in which OCC conducts its internal cross-margining program with the manner in which existing cross-margining programs between OCC and other derivatives clearing organizations (e.g., the Chicago Mercantile Exchange) are conducted."<sup>12</sup>

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<sup>9</sup> Letter from Andrew Margolin, supra note 3.

<sup>10</sup> Letter from OCC, supra note 3.

<sup>11</sup> Id at 1.

<sup>12</sup> See BofA Letter at 2.

#### IV. Discussion

Section 17A(b)(3)(F) of the Act<sup>13</sup> requires, among other things, that the rules of a clearing agency be designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. Since it granted approval of the first cross-margining program in 1988,<sup>14</sup> the Commission has found that cross-margining programs are consistent with clearing agency responsibilities under Section 17A of the Act<sup>15</sup> and highly beneficial to the clearing organization, its clearing members, and the public. The Commission has found that cross-margining programs enhance clearing member and systemic liquidity both in times of normal market conditions and in times of stress. They result in lower initial margin deposits, which can reduce the risk that a clearing member will become insolvent in a distressed market and the risk of a ripple effect of multiple insolvencies caused by the demise of a major market participant.<sup>16</sup>

#### V. 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>17</sup> and the rules and regulations thereunder.

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<sup>13</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>14</sup> Securities Exchange Act Release No. 34-26153 (October 3, 1988), 53 FR 39567 (October 7, 1988).

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

<sup>16</sup> Securities Exchange Act Release No. 34-32708 (August 2, 1993), 58 FR 42586 (August 10, 1993).

<sup>17</sup> 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (File No. SR-OCC-2011-03) be, and hereby is, approved.<sup>19</sup>

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</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>20</sup> 17 CFR 200.30-3(a)(12).