

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51331; File No. SR-OCC-2002-16)

March 8, 2005

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Unsegregation of Long Option Positions

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on July 9, 2002, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") and on December 12, 2002, and January 11, 2005, amended, the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

OCC Rule 611 permits a clearing member to issue instructions to OCC to release from segregation a long option position carried in a customers' account or firm non-lien account provided that the clearing member is simultaneously carrying in such account for such customer a short position in option contracts and the margin requirement of the customer has been reduced as a result of carrying the long option position. The proposed rule change would amend Rule 611 to permit a clearing member to issue such spread instructions where one leg of the spread is a long option position and the other is a position in a security futures contract.

II. Self-Regulatory Organization'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

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

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 such statements.<sup>2</sup>

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

The proposed rule change is submitted by OCC in connection with trading in security futures. The Commission approved the basic rules for the clearance of security futures by OCC in File Nos. SR-OCC-2001-05 and SR-OCC-2001-07.<sup>3</sup> The proposed rule change is submitted in light of joint rules (“joint margin rules”) that were adopted by the Commission and by the Commodity Futures Trading Commission (“CFTC”) on August 1, 2002,<sup>4</sup> pursuant to Section 7(c)(2) of the Act and related provisions of the Commodity Exchange Act governing the setting of margin requirements for security futures.

Rule 15c3-3 under the Act requires broker-dealers to maintain customer fully-paid and excess margin securities in a control location free of any lien.<sup>5</sup> Rules 8c-1 and 15c2-1 under the Act, which govern hypothecation of customer securities, also place limitations on broker-dealers rights to encumber customer securities.<sup>6</sup> In order to permit compliance by clearing members with Rule 15c3-3 and with the hypothecation rules, OCC’s Rule 611(a) presently provides that long option positions in a customers’ account established under Article VI, Section 3(e) of OCC’s By-Laws are deemed to be segregated and therefore not subject to OCC’s lien except to

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<sup>2</sup> The Commission has modified parts of these statements.

<sup>3</sup> Securities Exchange Act Release Nos. 44434 (June 15, 2001), 66 FR 33283 and 44727 (August 20, 2001), 66 FR 45351.

<sup>4</sup> Securities Exchange Act Release No. 46292, 67 FR 53146 [File No. S7-16-01].

<sup>5</sup> 17 CFR 240.15c3-3.

<sup>6</sup> 17 CFR 240.8c-1 and 15c2-1.

the extent that the clearing member gives contrary instructions to OCC in accordance with the rule.<sup>7</sup> Under paragraph (c) of Rule 611, a clearing member is entitled to give an instruction to unsegregate such a long position if the long position constitutes the long leg of a spread position, the short leg that constitutes the short leg of the spread position is held by the same customer, and the customer's margin requirement has been reduced to reflect the net risk of the spread position. These provisions reflect the Commission's long-standing interpretation that under those circumstances the long leg of a customer spread need not be treated as fully-paid or excess margin securities for purposes of Rule 15c3-3 and pledging it to OCC will not violate Rule 15c3-3 or the hypothecation rules.<sup>8</sup>

Section 7(c)(2)(B) of the Act requires that the margin requirements for security futures products be consistent with the margin requirements for comparable options contracts traded on any exchange registered pursuant to section 6(a) of the Act. OCC anticipates that clearing members will be permitted under the joint margin rules and exchange and security futures market rules adopted thereunder to reduce a customer's margin requirement when the customer has offsetting positions in security futures and options on the same underlying interest. Accordingly, a clearing member should be permitted under OCC's Rule 611 to unsegregate long option positions in the customers' account and firm non-lien account when the customer holds an offsetting long or short security futures position and the clearing member has reduced the

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<sup>7</sup> The provisions of Rule 611 also apply to long option positions of certain "non-customers" carried in a "firm non-lien account" under Article VI, Section 3(a) of OCC's By-Laws. At present, no clearing member carries such an account.

<sup>8</sup> The Commission staff has stated that "provision by OCC of clearing-level spread margin treatment of customer positions was consistent with Exchange Act Rules 15c3-3, 15c2-1 and 8c-1" so long as the conditions cited above are complied with. Securities Exchange Act Release No. 31626 (Dec. 21, 1992), 57 FR 62588 [File No. OCC-92-14], n.10, citing letter to Burton R. Rissman, Schiff Hardin & Waite, from Lee A. Pickard, Director, Division of Market Regulation (April 18, 1975).

customer's margin requirement in recognition of the spread. It should not matter whether the other leg of the spread is a security future or an option.<sup>9</sup>

The proposed change in OCC Rule 611(c) merely extends the same basic rule applicable to permitted spread positions in options contracts to any permitted spread position where one leg of the spread is a long option position and the other is a position in a security futures contract. The proposed rule is drafted in such a way that its operation is dependent on the joint margin rules and the rules of the exchanges and security futures markets adopted thereunder. Only if a particular spread position involving a long option qualifies for reduced margin treatment under those rules could the option be treated as unsegregated for purposes of Rule 611. With approval of this proposed rule change, consistency between the joint margin rules and Rule 611(c) would be therefore assured.<sup>10</sup>

OCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act and the rules and regulations thereunder because it promotes the prompt and accurate clearance and settlement of securities transactions, fosters cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, and removes impediments to and perfects the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.

(B) Self-Regulatory Organization's Statement on Burden on Competition

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<sup>9</sup> Under OCC Rule 611(a), all positions in security futures are deemed to be unsegregated because a futures contract, which represents a potential liability as well as a potential asset, is never deemed to be fully-paid or to represent excess margin securities. Accordingly, this rule filing addresses only the case where long put or call options are spread against long or short futures contracts.

<sup>10</sup> OCC has requested no action relief from the Commission's Division of Market Regulation that a clearing member who gives an instruction to unsegregate long option positions pursuant to this amended rule will not be deemed to be in violation of Rule 15c3-3 or the hypothecation rules.

OCC does not believe that the proposed rule change would impose any burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments 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 thirty five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date 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 the 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-2002-16 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and

Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-OCC-2002-16. 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 inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at [www.optionsclearing.com](http://www.optionsclearing.com). 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-2002-16 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).