

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72206; File No. SR-OCC-2014-07)

May 21, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Eliminate Preferred Stock and Corporate Bonds as Acceptable Forms of Margin Assets

I. Introduction

On March 28, 2014, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2014-07 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on April 15, 2014.³ The Commission received no comment letters. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

A. Elimination of Preferred Stock & Corporate Bonds as Acceptable Margin Assets

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 71910 (April 9, 2014), 79 FR 21319 (April 15, 2014).

Pursuant to the proposed rule change, as approved, OCC is amending Rule 604(b)(4)⁴ to eliminate preferred stock and corporate bonds as acceptable forms of margin assets.

OCC has accepted preferred stock and corporate bonds as margin since 1988.⁵ However, in more recent times, 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. No corporate bonds have been deposited since March 2012.

OCC presently uses a manual process to review the valuation methodology for preferred stocks and corporate bonds.⁶ While OCC believes this review process is adequate, it has concluded that the manual process is less robust than the daily automated Monte Carlo simulation-based methodology applied to deposits of common stocks.⁷ OCC states that it has researched the work necessary to integrate preferred stock and corporate bonds into STANS and otherwise automate monitoring and controls as they

⁴ 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, GSE debt securities, money market fund shares, letters of credit, common stock (including fund shares and index linked securities), corporate bonds, and preferred stock.

⁵ See Securities Exchange Act Release No. 29576 (August 16, 1991), 56 FR 41873 (August 23, 1991), (SR-OCC-88-03).

⁶ Such review process occurs monthly and contemplates: 1) adequacy of haircuts, 2) volume, and 3) price transparency.

⁷ OCC uses STANS to value and risk-manage common stocks deposited as margin collateral. STANS calculates haircuts that are regularly tested, taking into account stressed market conditions.

relate to risk managing these asset types. However, given the de minimis use of these securities as margin collateral, OCC determined that it would be inefficient and ineffective from a cost perspective to expend the significant time, resources and expenses needed to complete the required systems development to automate monitoring and assessment processes for these asset types. Therefore, OCC will discontinue accepting preferred stock and corporate bonds as forms of margin assets and remove provisions from the Rule 604(b)(4) pertaining to the deposit of these asset types.

B. Additional Changes

OCC is making additional amendments to Rule 604(b)(4) to eliminate certain provisions that will no longer be applicable upon the elimination of preferred stock as an acceptable form of margin asset.⁸ OCC is making conforming changes to remove provisions of Rule 604(b)(4) that: (i) limit the amount of margin credit of any single issue to 10% of the market value of margin deposited by a 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 601.⁹ OCC is also adding a provision explicitly stating that common stock margin deposits are valued in accordance with Rule 601.

⁸ Amended Rule 604(b)(4) will still set forth common stocks as a form of assets eligible for deposit as margin.

⁹ OCC has integrated common stocks into the process by which OCC calculates margin requirements using STANS. *See* Securities Exchange Act Release No.

OCC is also making additional amendments to Rule 604(b)(4) 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. 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.

III. Discussion

Section 19(b)(2)(C) of the Act¹⁰ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act¹¹ requires that the rules of a clearing agency that is registered with the Commission be designed to, among other things, promote the prompt and accurate clearance and settlement of securities transactions.

The Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act¹² because eliminating preferred stock and corporate bonds as

58158 (July 15, 2008), 73 FR 42646 (July 22, 2008), (SR-OCC-2007-20).

¹⁰ 15 U.S.C. 78s(b)(2)(C).

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

¹² Id.

acceptable margin assets should facilitate the prompt and accurate clearance and settlement of securities transactions by ensuring that the process for valuing all margin assets will be automated using STANS, which should provide for a more expeditious and accurate valuation process than a manual haircut-based approach. Furthermore, eliminating preferred stock and corporate bonds as acceptable margin assets should further facilitate the prompt and accurate clearance and settlement of securities transactions because completely automating the margin valuation process should also give OCC the ability to make a more accurate determination of the sufficiency of all margin assets on deposit at any given point in time.

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 Act¹³ and the rules and regulations thereunder.

¹³ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (File No. SR-OCC-2014-07) be and hereby is APPROVED.¹⁵

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁶

Kevin M. O'Neill
Deputy Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 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).

¹⁶ 17 CFR 200.30-3(a)(12).