

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47599; File No. SR-OCC-2002-04]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Money Market Funds as Margin Collateral

March 31, 2003.

I. Introduction

On January 29, 2002, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-OCC-2002-04 pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ Notice of the proposal was published in the *Federal Register* on January 16, 2003.² No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

The change to OCC's rule 604 expands the permissible forms of margin collateral to include shares in money market funds. The rule change also reorganizes the rule and makes certain nonsubstantive format changes.

Rule 604 specifies the forms of collateral that may be deposited as margin. Permitted forms of margin collateral include cash, government securities, letters of credit, and certain equity and debt securities.³ OCC regularly reviews these forms of collateral for suitability with the intent of addressing clearing members' desire to use a diverse combination of readily available and cost-effective forms of collateral while ensuring that collateral is limited to instruments that are relatively stable in value and are easily converted to cash. OCC believes that shares in certain money market funds meet these criteria and that it is appropriate for OCC to expand its categories of acceptable collateral to include such instruments.

OCC believes that the professional asset management, liquidity, and stable principal value typically associated with money market funds make shares

in such funds an attractive collateral alternative for all OCC clearing accounts. As a result of recent amendments to the regulations of the Commodity Futures Trading Commission ("CFTC"), clearing members that are registered as futures commission merchants are now permitted to invest customer funds of their futures customers in money market fund shares.⁴ Accordingly, clearing members want to be able to pledge shares in such funds as margin for their "non-proprietary" cross-margining accounts. OCC believes that such deposits are appropriate collateral not only for cross-margining accounts but for all accounts.

Requirements for Eligibility of Funds

OCC will define acceptable money market funds as those meeting the criteria of SEC rule 2a-7,⁵ "Money Market Funds," under the Investment Company Act of 1940 ("ICA"),⁶ subject to certain additional criteria. The ICA sets the standards by which mutual funds and other investment vehicles operate, and rule 2a-7 thereunder requires a qualifying money market fund to meet certain portfolio maturity, quality, and diversification criteria. Instruments that may qualify as permitted investments for money market funds typically include U.S. Treasury securities, repurchase agreements, Federal agency securities, commercial paper, certificates of deposit, time deposits, corporate notes, asset-backed securities, and municipal securities. To minimize credit risk, OCC will accept only money market funds that limit their investments to "first tier securities" as defined in rule 2a-7 under the ICA.⁷ Although certain types of instruments that qualify as first tier securities would not qualify to be pledged directly as margin collateral

under rule 604,⁸ OCC believes that the rating requirements and maturity prerequisites combined with inherent diversification of the funds provides sufficient protection to warrant acceptance of shares of money market funds containing such instruments.

To ensure a diverse group of fund investors so that the actions of any one shareholder (e.g., redeeming a large interest in a fund) do not materially disrupt the ability of the fund to redeem shares in an orderly manner, rule 604(b)(3) will prohibit a clearing member from depositing as margin collateral any money market fund where a registered holder of the money market fund has an interest of 10% or more in the money market fund.

In order for a fund's shares to be acceptable as margin collateral, the fund (and/or its sponsor, transfer agent, or other agent as appropriate) will be required to represent to OCC that it meets the foregoing requirements and to agree that it will continue to do so. In addition, OCC will require the fund to make certain other agreements intended to further ensure OCC's ability to convert fund shares promptly to cash if necessary.

Redemption

While the ICA generally prohibits mutual funds from suspending the right of redemption, the ICA does allow funds to postpone the payment of redemption proceeds for up to seven days after the tender of fund shares to the fund or its agent. The ICA also allows for the suspension or postponement of redemption in certain emergency situations. In addition, while the intent of a money market fund is to redeem shares in cash, most issuers retain the right to redeem their shares in kind where the redeeming shareholder would receive portfolio securities rather than cash. Any such action would introduce liquidation risk as well as additional costs associated with the sale of such securities.

Rule 604(b)(3)(i)(H) will require any fund accepted as margin collateral to waive its rights under the ICA to delay redemption or to redeem in kind. The fund will instead have to agree to redeem fund shares in cash no later than the business day following a redemption request by OCC with limited exceptions for unscheduled closings of Federal Reserve Banks or the New York Stock Exchange. These waivers of redemption restrictions along with the next day

⁴ In December 2000, the CFTC amended its Regulation 1.25 to expand the range of instruments in which FCMs and clearing organizations may invest customer segregated funds to include highly liquid instruments such as money market mutual funds. Rules Relating to Intermediaries of Commodity Interest Transactions, 65 FR 77993 (December 13, 2000).

⁵ 17 CFR 270.2a-7.

⁶ 15 U.S.C. 80a *et seq.*

⁷ In general, a first tier security is a security with a remaining maturity of 397 calendar days or less that: (i) Has received a short-term rating from at least two nationally recognized statistical rating organizations in the highest short-term rating category for debt obligations; (ii) is unrated but is deemed to be of comparable quality to securities identified in (i) as determined by the fund's board of directors; (iii) is issued by a registered investment company that is itself a money market fund; or (iv) is a government security. 17 CFR 270.2a-7(a)(12).

⁸ For example, OCC does not currently accept commercial paper, certificates of deposit, time deposits, corporate notes, asset-backed securities, or municipal securities.

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 47146 (January 9, 2003), 68 FR 2385.

³ Pursuant to a rule filing approved by the Commission last year, OCC clearing members are allowed to deposit as margin debt securities issued by Congressionally chartered corporations that OCC's membership/margin committee has approved. Securities Exchange Act Release No. 45745 (April 12, 2002), 67 FR 19467 (April 19, 2002) (File No. SR-OCC-2001-04).

payment requirement have been established to maintain adequate liquidity of margin collateral and are also intended to be consistent with the redemption conditions contained in CFTC rule 1.25.⁹

Valuation

OCC will require funds to perform a net asset value computation at least once per day with the dissemination of such computation to be made available to OCC no later than 9 a.m. central time the following day. Given the diversified nature of eligible fund investments as well as the investment duration limitations, a daily computation of net asset value appears reasonable. Nevertheless, OCC will apply a 2% haircut on the current market value of fund shares. The 2% haircut was selected for consistency with the treatment of similar assets under the net capital rule.¹⁰

OCC's Security Interest

As in the case of other securities held as collateral, OCC will require that clearing members give OCC a first priority perfected security interest in deposited fund shares. Because shares in money market funds are typically not issued in certificated form, ownership is established by registration of the securities on the books of the fund or its transfer agent. OCC can ordinarily obtain a perfected security interest in fund shares registered in the name of a clearing member by execution of the fund's standard three-party agreement among OCC, the clearing member, and the fund or its transfer agent.

In addition, to preclude a situation whereby a clearing member secures its obligations to OCC with collateral managed and within the control of that clearing member or a related party, an association restriction is included in rule 604(b)(3)(iii). This restriction is consistent with OCC rules regarding the deposit of government securities, debt or equity issues, or letters of credit as margin collateral.¹¹ This standard may be waived if the issuing institution can demonstrate that an acceptable arrangement has been made for the control of underlying portfolio investments and for the processing of

⁹ CFTC Regulation 1.25(c)(5), 65 FR 77993, 78010, 78011 (Dec. 13, 2000); *see also*, 65 FR 82270 (Dec. 28, 2000). CFTC Interpretive Letter No. 01-31 (April 2, 2001) (Funds will be deemed in compliance with Regulation 1.25(c)(5) even though they provide for delayed redemption in specified emergency situations).

¹⁰ 17 CFR 240.15c3-1(c)(2)(vi)(D)(1).

¹¹ OCC rule 604, Interpretation and Policies .07 and .10.

OCC redemption requests by a third party.

OCC is also moving the provisions which require compliance with the Commission's rule 15c3-3 when applicable, formerly set forth in rule 604(d)(2), have been moved so that these provisions apply not only to equity and debt securities but to all securities deposited as margin under rule 604(b). A sentence has been added to these provisions to require compliance with the CFTC's customer protection regime when securities are deposited with respect to futures accounts.

OCC believes that the proposed rule change is consistent with the requirements of section 17A of the Securities Exchange Act of 1934, as amended, because it enhances the efficiency of the clearing system while still allowing OCC to safeguard securities and funds by permitting clearing members to collateralize their obligations to OCC with an additional form of highly liquid, stable value assets.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder and particularly with the requirements of section 17A(b)(3)(F).¹² Section 17A(b)(3)(F) requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible. The Commission believes that OCC's rule change meets this requirement because while OCC clearing members will be able to deposit money market funds as margin collateral, OCC has established procedures with respect to the deposits of money market funds as margin collateral that should ensure that OCC will be able to safeguard the securities and funds that are within its custody or control or for which it is responsible.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-2002-04) be and hereby is approved.

¹² 15 U.S.C. 78q-1(b)(3)(F).

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 03-8387 Filed 4-4-03; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47605; File No. SR-Phlx-2003-17]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. To Adopt a License Fee for Transactions in Standard & Poor's Depository Receipts[®]

April 1, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 17, 2003, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange amended the proposal on March 28, 2003.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend its Summary of Equity Charges to adopt a license fee of \$0.00025 per share per trade side for sides greater than 500 shares, with no maximum fee per trade side charged to Non-PACE Customers⁴ and Electronic Communications Networks ("ECNs"),⁵ and a license fee

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On March 28, 2003, the Exchange filed a Form 19b-4, which completely replaced and superceded the original filing in its entirety ("Amendment No. 1"). For purposes of calculating the 60-day abrogation period, the Commission considers the period to have commenced on March 28, 2003, the date the Exchange filed Amendment No. 1. 15 U.S.C. 78(s)(b)(3)(C).

⁴ PACE is the acronym for the Exchange's Automated Communication and Execution System, which is the Exchange's order routing, delivery, execution and reporting system for its equity trading floor. *See* Exchange Rules 229 and 229A.

⁵ ECNs shall mean any electronic system that widely disseminates to third parties orders entered therein by an Exchange market maker or over-the-