

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57272; File No. SR-NYSE-2007-101]

### Self-Regulatory Organizations; New York Stock Exchange, LLC; Order Granting Approval of Proposed Rule Change Relating to Amendments to NYSE Rule 104.21 (“Specialist Organizations—Additional Capital Requirements”)

February 5, 2008.

#### I. Introduction

On November 2, 2007, the New York Stock Exchange LLC (“NYSE” or the “Exchange”) filed with the Securities and Exchange Commission (“SEC” or the “Commission”), pursuant to section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> a proposal to amend its Rule 104.21 regarding additional capital requirements for specialist organizations. The proposed rule change was published for comment in the *Federal Register* on December 28, 2007.<sup>4</sup> The Commission received no comments regarding the proposal. This order approves the proposed rule changes.

#### II. Description of the Proposal

The proposed rule change would reduce the total base capital requirement that must be maintained as net liquid assets for all specialists from \$1 billion to \$250 million. NYSE believes this amount will adequately protect specialist organizations during periods of market stress. Further, each of the specialist organizations have sources of funding that can provide necessary liquidity during a period of market stress. It is no longer necessary for specialist organizations to maintain the currently required levels of liquid capital, as specialist positions and the likelihood of losses have been reduced dramatically due to changes in the structure of the market.

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

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

<sup>2</sup> 15 U.S.C. 78(a) *et seq.*

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> See Securities Exchange Act Release No. 57000 (Dec. 20, 2007), 72 FR 73947.

#### III. Discussion

After careful review and based on the Exchange’s representations, the Commission finds that the proposed rule changes are consistent with the Act and the rules and regulations applicable to a national securities exchange.<sup>5</sup> In particular, the Commission finds that the proposed rule changes are consistent with section 6(b)(5)<sup>6</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes it is consistent with the Act for the Exchange to amend NYSE Rule 104.21 as proposed, because the level of participation by specialist firms in trading on the Exchange has declined with the proliferation of electronic trading and the significant change in the Exchange’s trading system introduced by the Hybrid Market.<sup>7</sup> The NYSE has noted that the increased efficiency with which others can access the Exchange’s market has increased liquidity and decreased the market’s reliance on the specialist to provide the contra side in a continuous auction. While the NYSE considers specialist participation to still be an important feature of its Hybrid Market, it has documented a lower participation by specialist organizations. This decreased participation means that specialists are assuming less risk.

The Commission notes that FINRA, on behalf of NYSE, will continue to assess the specialists’ net liquid asset requirements in relation to the Hybrid Market and monitor their net liquid assets on a daily basis. NYSE and FINRA require notification for all

<sup>5</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> See Release No. 34-53539 (March 22, 2006); 71 FR 16353 (March 31, 2006) File No. SR-NYSE-2004-05) (approving amendments to NYSE Rules (approving the proposed rule change to establish the NYSE Hybrid Market). The rule change created a “Hybrid Market” by, among other things, increasing the availability of automatic executions in its existing automatic execution facility, NYSE Direct+, and providing a means for participation in the expanded automated market by its floor members. The change altered the way NYSE’s market operates by allowing more orders to be executed directly in Direct+, which in essence moves NYSE from a floor-based auction market with limited automation order interaction to a more automated market with limited floor-based auction market availability.

withdrawals of capital, and approval for any withdrawal being made on less than six months advance notice to the Exchange.

#### IV. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-NYSE-2007-101), as amended, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>9</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57270; File No. SR-OCC-2007-20]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to the System for Theoretical Analysis and Numerical Simulations

February 5, 2008.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> notice is hereby given that on December 14, 2007, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) 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

The proposed rule change would permit the incorporation of certain forms of securities deposited as margin collateral into OCC’s System for Theoretical Analysis and Numerical Simulations (“STANS”) risk management methodology.

#### 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

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).

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

proposed rule change and discussed any comments it received on the proposed 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 purpose of the proposed rule change is to more accurately measure the risk in clearing members' accounts and thereby permit OCC to set margin requirements that more precisely reflect that risk. In connection with this proposed change, it is also necessary to propose additional flexibility in determining the amount of replacement collateral required when securities deposited as margin are withdrawn. In addition, because OCC believes that certain existing concentration limits and requirements regarding minimum share prices are no longer appropriately applied to securities that are underlying securities or to fund shares that track an index that is an underlying index for covered contracts, OCC is proposing to eliminate such requirements with respect to such securities.

*Overview of Proposed Changes.* OCC proposes to incorporate certain common stocks and ETFs (defined as "fund shares" in Article I of OCC's By-Laws) into the STANS margin calculation process.<sup>3</sup> STANS is a large-scale Monte Carlo-based risk management methodology used to measure risk associated with portfolios of cleared contracts. Currently, these forms of securities when deposited as collateral to satisfy margin requirements are priced on a nightly basis and are assigned a value equal to their end-of-day market price minus the haircut applicable to that form of collateral, an amount that varies according to asset type. While this method of valuing collateral has generally served OCC well in the past, it does not take into account the potential risk-reducing impact that the deposited collateral might have on a clearing member's portfolio. Under the proposed rule change, cleared options positions and underlying securities in the forms indicated above would be analyzed as a single portfolio using STANS, thus providing a more accurate valuation of securities deposited as

collateral in relation to the other positions in the account. The proposed rule change would align risk management techniques utilized to manage market risk of options portfolios with those used to value margin deposits. There are two primary benefits expected from the rule change. First, margin requirements would be based on the risk of the combined portfolio that includes both cleared contracts and deposited collateral thereby allowing the relevant intercorrelations of cleared contracts and deposited collateral to be taken into consideration rather than treating securities deposited as collateral as having fixed values. Second, the coverage provided by a particular asset class (e.g., shares of IBM common stock) would be based on the historical volatility of that particular asset rather than by taking a flat "haircut" rate across a much broader class of assets (e.g., 30% haircut for common stock). For the period from August 16, 2007, to September 10, 2007, OCC staff computed margin requirements for all existing accounts according to this proposed approach. The result showed an average daily reduction in risk margin requirements of approximately \$1.2 billion, or 5%, as compared to OCC's current approach. At the same time that average daily collateral requirements would be reduced, the STANS calculations would also measure and compensate for added risk arising where risks are positively correlated rather than offsetting.

OCC is also proposing an exception to collateral minimum price and concentration limits with respect to certain securities deposited as collateral. Currently, eligible collateral securities deposited with OCC must (1) have a market value greater than \$10 per share and (2) be traded on a national securities exchange, the Nasdaq Global Market, or the Nasdaq Capital Market. Additionally, the aggregate value of margin attributed to a single security cannot exceed 10% of a clearing member's total margin requirement. These criteria were designed to limit deposits to liquid, readily marketable securities and to avoid concentrations of deposits in a single security. OCC proposes an exception to these eligibility and concentration requirements for securities that are deliverable upon exercise of a contract cleared by OCC or, in the case of ETFs, that track an index underlying cleared contracts whether or not the particular ETF is an underlying security. OCC believes that this exception would permit and encourage the use of collateral that closely hedges related

options positions. The proposed exception would apply only to the approximately 2,800 exchange-listed equity securities that currently underlie listed options. Thus, OCC's existing minimum value and concentration restrictions would continue to apply to the approximate 7,200 exchange-listed equity securities that do not underlie listed options.

OCC also proposes a minor amendment to the current requirement that the aggregate value of margin attributed to a single security cannot exceed 10% of the total margin requirement in an account. The proposed change would base the calculation on the clearing member's actual margin deposits rather than the clearing member's total margin requirement in the account. Thus, the requirement as amended would limit the value given to deposits in any single security to no more than 10% of the market value of a member's aggregate margin deposits in the account. This test is very similar in purpose and effect to the current test, but OCC believes it will be much easier to administer than the current test when collateral is included in STANS.

In addition, OCC would need a different means for addressing substitutions of collateral where a security that has been valued in STANS was being replaced during the business day. STANS performs multiple portfolio revaluations during the business day using current prices of collateral and cleared contracts. While the revaluations include updated positions in cleared contracts reflecting intraday trading activity, they do not at present include updated collateral positions reflecting withdrawals and substitutions. In addition, it is operationally too intensive, given the complexity of the STANS methodology and the frequency of substitution requests, to recalculate the STANS requirement for each such collateral withdrawal/deposit. Although OCC intends ultimately to make further systems changes to address these issues in more efficient ways, OCC has developed an approach that provides the necessary protection to the clearing system by taking a conservative view of the estimated impact that a withdrawal/deposit would have on the member's requirement.

OCC proposes to treat margin collateral substitutions and withdrawals in the same manner that substitutions and withdrawals of specific and escrow deposits are treated. In the case of a margin withdrawal or deposit, OCC would incorporate an adjustment factor, based on the historical volatility of the

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

<sup>3</sup> For a description of STANS, refer to Securities Exchange Act Release No. 53322 (February 15, 2006) 71 FR 9403 (February 23, 2006) (File No. SR-OCC-2004-20).

security, equal to the estimated impact (within the 99% confidence interval) of the security on the projected liquidating value of the account. For example, if a clearing member deposited \$300 in IBM stock and IBM is given a risk adjustment factor of 10%, the deposited stock would be given a value of \$270 ( $\$300 \times [100\% - 10\%]$ ) in intraday excess collateral value to be used against releases to account for the potential negative risk impact of adding the stock to the portfolio. If the clearing member then released \$200 of Google stock and Google is given a risk adjustment factor of 12%, the clearing member would be required to maintain \$224 ( $\$200 \times [100\% + 12\%]$ ) in excess collateral to account for the negative impact of removing Google from the portfolio.

*Proposed Changes to OCC's Rules to Implement the Foregoing Concepts.* OCC's Rule 601, "Margin Requirements," currently states in paragraph (c) that margin assets may be incorporated into the Monte Carlo calculations as an alternative to valuing such assets under Rule 604, "Form of Margin Assets." OCC now proposes merely to add an Interpretation to Rule 601 to indicate that OCC is implementing this alternative to the extent that it will be incorporating common stocks and ETFs into the STANS calculation of expected net liquidating value. Rule 604(b)(4), which governs the deposit of equity and debt issues to satisfy margin requirements, would be amended to provide exceptions to the per share minimum price and concentration limits and to provide that concentration limits will be measured in relation to the aggregate margin on deposit rather than to the margin requirement in an account. Rule 604(b)(4) is also proposed to be amended to reflect the fact that Nasdaq is now registered as a national securities exchange. An Interpretation is proposed to be added to Rule 608, "Withdrawals of Margin," to give OCC the flexibility to adopt the interim method of dealing with collateral withdrawals and substitutions as described above. The proposed changes in Rules 609, "Intraday Margin," and 706(c), "Cross-Margining Settlement Procedures," would reflect minor conforming changes and nonsubstantive updates to streamline the rules and add flexibility.

OCC proposes to put all of the foregoing proposed rule changes into effect simultaneously upon appropriate notice to clearing members once systems changes needed for full implementation are in place. The published text of OCC's Rules would not be modified until that time although this rule change would be published as

pending approval or approved but not yet implemented, as the case may be.

The proposed changes to OCC's Rules are consistent with the purposes and requirements of section 17A of the Act because they are designed to promote accuracy in the clearance and settlement of transactions in options and other derivatives cleared by OCC and in the risk assessments related thereto, to promote efficiency and eliminate unnecessary costs to investors by reducing risk margin requirements, and in general to protect investors and the public interest. The proposed changes accomplish this purpose by more accurately evaluating collateral deposits and encouraging the use of collateral that closely hedges options positions. The proposed changes are not inconsistent with the existing By-laws and Rules of OCC, including any proposed to be amended.

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

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-2007-20 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2007-20. 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 Web site (<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, 100 F Street, NE., Washington, DC 20549, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's Web site at <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-2007-20 and should be submitted on or before March 4, 2008.

For the Commission by the Division of Trading and Markets, pursuant to delegated authority:<sup>4</sup>

**Florence E. Harmon**,  
Deputy Secretary.

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<sup>4</sup> 17 CFR 200.30-3(a)(12).