

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

**Kevin M. O'Neill,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-70709; File No. SR-OCC-2013-803]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing To Reflect Enhancements in OCC's System for Theoretical Analysis and Numerical Simulations as Applied to Longer-Tenor Options

October 17, 2013.

On June 4, 2013, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-OCC-2013-803 ("Advance Notice") pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act" or "Title VIII")<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 ("Exchange Act").<sup>2</sup> The Advance Notice was published for comment in the **Federal Register** on July 9, 2013.<sup>3</sup> The Commission did not receive any comments on the Advance Notice publication. This publication serves as a notice of no objection to the Advance Notice.

#### I. Description of the Advance Notice

On December 14, 2012, the Commission issued an order approving a proposed rule change and a notice of no objection to an advance notice, collectively ("December 14, 2012 Action"), through which OCC proposed

to establish a legal and operational framework for OCC to clear certain OTC index options on the S&P 500 Index ("OTC S&P 500 Index Options").<sup>4</sup> OCC is prohibited from clearing OTC S&P 500 Index Options until the Commission approves and OCC implements certain enhancements to OCC's System for Theoretical Analysis and Numerical Simulations ("STANS") as applied to all options,<sup>5</sup> including over-the-counter ("OTC") options that OCC is otherwise permitted to clear, with at least three years of residual tenor ("Risk Management Proposal").<sup>6</sup> This Advance Notice is the Risk Management Proposal. By this Advance Notice, OCC is enhancing STANS by: (i) Including daily OTC indicative quotations; (ii) introducing variations in implied volatility; and (iii) introducing a valuation adjustment.

STANS is a margin system that OCC uses to calculate clearing-level margin.<sup>7</sup> Through this Risk Management Proposal, OCC is enhancing STANS in the following ways:

(i) *Daily OTC Indicative Quotations.* According to OCC, STANS uses a daily dataset of market prices to value each portfolio.<sup>8</sup> OCC is enhancing this daily dataset of market prices by including daily OTC indicative quotations.<sup>9</sup> OCC will obtain daily OTC indicative quotations from a third-party service provider who obtains it through a daily poll of OTC derivatives dealers.<sup>10</sup>

(ii) *Variations in Implied Volatility.* According to OCC, STANS currently uses a two-day risk horizon which assumes that implied volatilities of option contracts do not change during

that period.<sup>11</sup> OCC will introduce variations in implied volatility in the modeling of all longer-tenor options under STANS.<sup>12</sup> OCC plans to achieve this by "incorporating, into the set of risk factors whose behavior is included in the econometric models underlying STANS, time series of proportional changes in implied volatilities for a range of tenors and in-the-money and out-of-the-money amounts representative of the dataset provided by OCC's third-party service provider."<sup>13</sup>

(iii) *Valuation Adjustment.* OCC intends to enhance the portfolio net asset value that STANS uses, by introducing a valuation adjustment.<sup>14</sup> According to OCC, the valuation adjustment will be "based upon the aggregate sensitivity of any longer-tenor options in a portfolio to the overall level of implied volatilities at three years and five years and to the relationship between implied volatility and exercise prices at both the three- and five-year tenors in order to allow for the anticipated market impact of unwinding a portfolio of longer-tenor options, as well as for any differences in the quality of data in OCC's third party service provider's dataset, given that month-end data may be subjected to more extensive validation by the service provider than daily data."<sup>15</sup>

#### II. Discussion and Commission Findings

Although Title VIII does not specify a standard of review for an advance notice, the Commission believes that the stated purpose of Title VIII is instructive.<sup>16</sup> The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically-important financial market utilities ("FMUs") and strengthening the liquidity of systemically important FMUs.<sup>17</sup>

Section 805(a)(2) of the Clearing Supervision Act<sup>18</sup> authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the supervisory agency or the appropriate

<sup>4</sup> Release No. 68434 (December 14, 2012), 77 FR 75243 (December 19, 2012) (SR-OCC-2012-14, AN-OCC-2012-01).

<sup>5</sup> OCC represents that its Risk Management Proposal is part of OCC's ongoing efforts to test and improve its risk management operations with respect to all longer-tenor options that OCC currently clears. See December 14, 2012 Action, *supra* note 4, 77 FR at 75243. OCC states it intends to use its STANS margin system to calculate margin requirements on the same basis as for exchange-listed options cleared by OCC. See Notice, *supra* note 3, 78 FR at 41161.

<sup>6</sup> Release No. 68434 (December 14, 2012), 77 FR 75243 (December 19, 2012) (SR-OCC-2012-14, AN-OCC-2012-01).

<sup>7</sup> According to OCC, STANS calculates margin by determining the minimum expected liquidating value of each account using a large number of projected price scenarios created by large-scale Monte Carlo simulations. See Notice, *supra* note 3, 78 FR at 41161.

<sup>8</sup> See Notice, *supra* note 3, 78 FR at 41161.

<sup>9</sup> *Id.*

<sup>10</sup> OCC selected a third-party service provider rather than having the OTC derivatives dealers provide the information directly to OCC to avoid unnecessarily duplicating reporting that is already being done in the OTC markets. See Notice, *supra* note 3, 78 FR at 41161-62.

<sup>11</sup> See Notice, *supra* note 3, 78 FR at 41162.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> See 12 U.S.C. 5461(b).

<sup>17</sup> *Id.*

<sup>18</sup> 12 U.S.C. 5464(a)(2).

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>17</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i). OCC is a designated financial market utility and is required to file advance notices with the Commission. See 12 U.S.C. 5465(e). OCC also filed the proposal in this Advance Notice as a proposed rule change under Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder, which was published for comment in the **Federal Register** on June 14, 2013. 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4. See Release No. 69723 (June 10, 2013), 78 FR 36002 (June 14, 2013) (SR-OCC-2013-08). OCC withdrew the proposed rule change on August 27, 2013. Prior to the date of withdrawal, the Commission did not receive any comments on the proposed rule change. On October 10, 2013, OCC re-filed the proposal in this Advance Notice as a proposed rule change under Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder.

<sup>3</sup> Release No. 69925 (July 3, 2013), 78 FR 41161 (July 9, 2013) (SR-OCC-2013-803) ("Notice").

financial regulator. Section 805(b) of the Clearing Supervision Act<sup>19</sup> states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- Promote robust risk management;
- Promote safety and soundness;
- Reduce systemic risks; and
- Support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act<sup>20</sup> (“Clearing Agency Standards”).<sup>21</sup> The Clearing Agency Standards became effective on January 2, 2013 and require registered clearing agencies that perform central counterparty (“CCP”) services to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.<sup>22</sup> As such, it is appropriate for the Commission to review advance notices against these risk management standards that the Commission promulgated under Section 805(a) of the Clearing Supervision Act<sup>23</sup> and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.<sup>24</sup>

OCC’s Risk Management Proposal, as described above, is designed to enhance OCC’s margin calculation requirements for longer-tenor options. Consistent with Section 805(b) of the Clearing Supervision Act,<sup>25</sup> the Division believes that OCC’s Risk Management Proposal should help promote robust risk management and mitigate systemic risk by introducing variations in implied volatility in the modeling of all Longer-Tenor Options, and introducing a valuation adjustment in STANS to address OCC’s increased exposure to Longer-Tenor Options that may possess characteristics that are more illiquid than other options that are cleared by OCC. The Risk Management proposal may also improve liquidity in the

market for Longer-Tenor Options, which may improve price discovery in this market.

Commission Rule 17Ad-22(b)(2),<sup>26</sup> adopted as part of the Clearing Agency Standards,<sup>27</sup> requires that a registered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to “use margin requirements to limit its credit exposures to participants under normal market conditions;” and “use risk-based models and parameters to set margin requirements.” Furthermore, Commission Rule 17Ad-22(b)(3),<sup>28</sup> also adopted as part of the Clearing Agency Standards,<sup>29</sup> requires, in relevant part, a central counterparty to establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions. The proposed enhancements to STANS, as described in the Risk Management Proposal, should help OCC to more accurately set margin requirements for Longer-Tenor Options, which OCC will use to limit its credit exposures to participants under both normal and stressed market conditions and should help OCC maintain sufficient financial resources to withstand a default by the participant family to which it has the largest exposure in extreme but plausible market conditions.

### III. Conclusion

*It is therefore noticed*, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,<sup>30</sup> that the Commission DOES NOT OBJECT to advance notice proposal (SR-OCC-2013-803) and that OCC is AUTHORIZED to implement the proposal as of the date of this notice or the date of an order by the Commission approving a proposed rule change that reflects rule changes that are consistent with this advance notice proposal (SR-OCC-2013-803), whichever is later.

By the Commission.

**Kevin M. O’Neill,**  
*Deputy Secretary.*

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<sup>19</sup> 12 U.S.C. 5464(b).

<sup>20</sup> 12 U.S.C. 5464(a)(2).

<sup>21</sup> Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11).

<sup>22</sup> The Clearing Agency Standards are

substantially similar to the risk management

standards established by the Board of Governors of

the Federal Reserve System (“*Federal Reserve*”) governing the operations of designated DFMUs that

are not clearing entities and financial institutions engaged in designated activities for which the

Commission or the Commodity Futures Trading

Commission is the Supervisory Agency. See

Financial Market Utilities, 77 FR 45907 (August 2,

2012).

<sup>23</sup> 12 U.S.C. 5464(a).

<sup>24</sup> 12 U.S.C. 5464(b).

<sup>25</sup> See 12 U.S.C. 5464(b).

<sup>26</sup> 17 CFR 240.17Ad-22(b)(2).

<sup>27</sup> Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (November 2, 2012).

<sup>28</sup> 17 CFR 240.17Ad-22(b)(3).

<sup>29</sup> Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (November 2, 2012).

<sup>30</sup> 12 U.S.C. 5465(e)(1)(I).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-70702; File No. SR-FINRA-2013-044]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Allow FINRA Members To Use the FINRA/NYSE Trade Reporting Facility To Transfer Transaction Fees Charged by One Member to Another Member

October 17, 2013.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) <sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 9, 2013, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. 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

FINRA is proposing to amend FINRA Rule 7230B (Trade Report Input) to permit FINRA members to use the FINRA/NYSE Trade Reporting Facility (the “FINRA/NYSE TRF”) to transfer transaction fees charged by one member to another member on trades reported to the FINRA/NYSE TRF.

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

#### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the 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

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4(f)(6).