



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-73355; File No. SR-CBOE-2014-073]

### **Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Margin Treatment of Over-the-Counter Options Contracts Cleared by The Options Clearing Corporation**

October 15, 2014

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 1, 2014, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, and II, below, which Items have been prepared by the Exchange. 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 Exchange proposes to amend its rules regarding the margin treatment of over-the-counter (“OTC”) options cleared by The Options Clearing Corporation (“OCC”). The text of the proposed rule change is provided below. (additions are italicized; deletions are [bracketed])

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

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

**Chicago Board Options Exchange, Incorporated**

**Rules**

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**Rule 1.1.** When used in these Rules, unless the context otherwise requires:

(a) – (l) No change.

**Option Contract**

(m) Except as otherwise provided, [T]the term “option contract” means a put or call issued, or subject to issuance, by the Clearing Corporation pursuant to the Rules of the Clearing Corporation.

(n) – (ooo) No change.

**OCC Cleared OTC Option Contract**

(ppp) The term “OCC cleared OTC option contract” means an over-the-counter option contract that is issued and guaranteed by the Clearing Corporation. Except as otherwise provided, an OCC cleared OTC option contract is not an “options contract” as defined in the Rules.

***... Interpretations and Policies:***

**.01 – .05** No change.

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**Rule 12.3. Margin Requirements**

(a) Definitions. For purposes of this Rule, the following terms shall have the meanings specified below.

(1) – (8) No change.

(9) The term “listed” for purposes of this Chapter 12 means a security traded on a registered national securities exchange or automated facility of a registered national securities

association or issued and guaranteed by the Clearing Corporation and shall include OCC cleared OTC options contracts.

(10) – (13) No change.

(14) The term “OTC option” as used with reference to a call or a put option contract in this Chapter 12 means an over-the-counter option contract that is issued and guaranteed by the carrying broker-dealer and not traded on a national securities exchange or issued and guaranteed by the Clearing Corporation [and is issued and guaranteed by the carrying broker-dealer].

(b) – (n) No change.

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#### **Rule 12.4 – Portfolio Margin**

Rule 12.4. As an alternative to the transaction / position specific margin requirements set forth in Rule 12.3 of this Chapter 12, a TPH organization may require margin for all margin equity securities (as defined in Section 220.2 of Regulation T), listed options, unlisted derivatives, security futures products, and index warrants in accordance with the portfolio margin requirements contained in this Rule 12.4.

In addition, a TPH organization, provided it is a Futures Commission Merchant ("FCM") and is either a clearing member of a futures clearing organization or has an affiliate that is a clearing member of a futures clearing organization, is permitted under this Rule 12.4 to combine a customer's related instruments (as defined below), listed index options, unlisted derivatives, options on exchange traded funds, index warrants, and underlying instruments and compute a margin requirement for such combined products on a portfolio margin basis.

Application of the portfolio margin provisions of this Rule 12.4 to IRA accounts is prohibited.

(a) Definitions.

(1) The term “listed option” for purposes of this Rule shall mean any equity (or equity index-based) option traded on a registered national securities exchange or automated facility of a registered national securities association or issued and guaranteed by the Clearing Corporation and shall include OCC cleared OTC options contracts.

(2) – (3) No change.

(4) The term “unlisted derivative” for purposes of this Rule means any equity-based (or equity index-based) unlisted option, forward contract or swap that can be valued by a theoretical pricing model approved by the Securities and Exchange Commission and does not include OCC cleared OTC options contracts.

(5) – (11) No change.

(b) – (j) No change.

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The text of the proposed rule change is also available on the Exchange’s website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, 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, the Exchange 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 in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to amend its margin requirements rules to treat OTC options contracts that are issued and guaranteed by the OCC (“OCC cleared OTC option contracts”) consistent with FINRA Rule 4210 (Margin Requirements).<sup>3</sup> Specifically, the Exchange proposes a definition of OCC cleared OTC option contract in Rule 1.1(ppp) and, for margin purposes, proposes to amend the definitions of the terms “listed” in Rule 12.3(a)(9) and “listed option” in Rule 12.4(a)(1) to include OCC cleared OTC option contracts. The Exchange also proposes, for margin purposes, to amend the definitions of the terms “OTC” in Rule 12.3(a)(14) and “unlisted derivative” in Rule 12.4(a)(4) to exclude OCC cleared OTC option contracts. The Exchange’s proposal is materially based on, and substantially similar to, changes made by FINRA to its margin requirements rules under FINRA Rule 4210.<sup>4</sup> The Exchange believes that a consistent margin treatment regime with respect to OCC cleared OTC option contracts will make margin requirements rules easier for market participants to understand and that the proposal is in the best interest of investors.

On April 25, 2014, the OCC launched central clearing services for bilaterally negotiated OTC equity index options contracts on the S&P 500 Index. Under OCC By-laws, the OCC may, under limited circumstances, clear OTC options on the S&P 500 Index. Such contracts must be of a

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<sup>3</sup> See FINRA Rule 4210(f)(2)(A)(xxiv); see also FINRA Rules 2360(a)(9), (19), (32), (33) and 4210(g)(2)(A).

<sup>4</sup> See Securities Exchange Act Release No. 70619 (October 7, 2013), 78 FR 62722 (October 22, 2013) (Order Granting Approval of Proposed Rule Change Relating to Amendments to FINRA Rules 2360 and 4210 in Connection with OCC Cleared Over-the-Counter Options) (SR-FINRA-2013-027) (“Order”).

term between four months and five years and have minimum notional values of either 500,000 or 100,000 times the value of the S&P 500 Index. In clearing these options, the OCC becomes both the issuer and guarantor of the OTC contract.

In response to rules adopted by the OCC permitting the OCC to issue and guarantee these particular OTC option contracts and responsive rules adopted by FINRA regarding OCC cleared OTC option contracts, the Exchange proposes to adopt a definition of OCC cleared OTC option contract and make certain changes to its margin rules. The Exchange proposes to define the term OCC cleared OTC option contract to carve-out OCC cleared OTC option contracts from the definition of “option contract” reflecting the fact that the Rules are intended to control transactions in options contracts traded at the Exchange. Specifically, the Exchange proposes changes to Rule 1.1(m) defining “option contract” and the adoption of Rule 1.1(ppp) to define the term “OCC cleared OTC option contract” in the Rules.

Under Rule 1.1(m), an “option contract” is defined as “a put or a call issued, or subject to issuance, by the [Options] Clearing Corporation pursuant to the rules of the [Options] Clearing Corporation.” OCC cleared OTC option contracts are option contracts that are subject to issuance by the OCC. Accordingly, the Exchange proposes to amend Rule 1.1(m) to exclude OCC cleared OTC option contracts. Proposed Rule 1.1(ppp) would define OCC cleared OTC option contracts as over-the-counter option contracts that are issued and guaranteed by the Clearing Corporation. The proposed definition would also provide that except as otherwise indicated in the Rules, OCC cleared OTC option contracts are not “options contracts” under the Rules. Thus, consistent with the proposed changes to Rule 1.1(m), proposed Rule 1.1(ppp) would make clear that OCC cleared OTC option contracts are not Exchange-traded products and that the Rules, unless otherwise indicated, are not intended to extend to OCC cleared OTC options contracts.

The Exchange also proposes changes to its margin treatment rules with respect to OCC cleared OTC options contracts. In general, the margin requirements for options listed on an exchange (and cleared and guaranteed by the OCC) are lower than the margin requirement for OTC options (not cleared or guaranteed by the OCC). This is because the clearing and guaranteeing functions performed by the OCC greatly reduce the counterparty risk present on exchange-traded option contracts. Thus, for margin requirements and securities setoff purposes, the Exchange requires less initial and maintenance margin for listed options positions than for OTC options positions.<sup>5</sup> The reasons underlying the more favorable margin treatment for listed (and OCC cleared and guaranteed) options, however, apply with equal force to OCC cleared OTC options contracts. The clearing and guaranteeing functions performed by the OCC reduce the counterparty credit risk associated with these contracts to levels more commonly associated with listed options contracts. In light of the clearing and guaranteeing functions performed by the OCC, the Exchange proposes to treat OCC cleared OTC options as it treats other cleared and guaranteed options by defining OCC cleared OTC option contracts as “listed” option contracts for margin purposes only. Notably, the Exchange proposes to treat OCC cleared OTC options as listed options only after such contracts have been accepted for clearing and guaranteed by the OCC.

Exchange Rules 12.3 (Margin Requirements) and 12.4 (Portfolio Margin) describe minimum transaction or position-specific and portfolio margin requirements that Trading Permit Holders (“TPHs”) must require and securities offsets that may be applied for margin requirements purposes. For margin purposes only, the Exchange proposes to modify the definition of the term “listed” in Rule 12.3(a)(9) to include OCC cleared OTC options. Similarly, the Exchange proposes changes to Rule 12.4(a)(1) to define the term “listed option” to include OCC cleared OTC option

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<sup>5</sup> See generally CBOE Rule 12.3 (Margin Requirements).

contracts for portfolio margin purposes only. These rule changes would allow the Exchange to treat OCC cleared OTC options in the same manner as Exchange-listed options for margin purposes, but make clear that the Rules are not intended to extend to or control transactions involving unlisted option contracts or OTC options contracts. The Exchange also proposes to change the definitions of the terms “OTC” in Rule 12.3(a)(14)<sup>6</sup> and “unlisted derivative” in Rule 12.4(a)(4) to exclude OCC cleared OTC option contracts for margin purposes. These proposed changes are substantially similar in all material respects to FINRA Rule 4210(f)(2)(A)(xxiv), which the Commission recently approved.<sup>7</sup>

Notably, the Exchange is not proposing changes to Chapter IX of the Rules, particularly Rules 9.7 (Opening of Accounts) or 9.15 (Delivery of Current Options Disclosure Documents) therein. Under Rule 9.7, TPHs are required to furnish the options disclosure documents described in Rule 9.15 to customers at or prior to approving a customer’s account for options trading. Because Rules 9.7 and 9.15 relate to disclosures that must be made before a customer’s account may be approved for trading in options at the Exchange, no rule changes are needed to accommodate OCC cleared OTC option contracts, which are not Exchange-traded products. In addition, the Exchange echoes FINRA’s comments that such delivery requirements are unnecessary because the counterparties to OCC cleared OTC options must be “eligible contract participants” as

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<sup>6</sup> The Exchange is also proposing to add the word “option” to its definition of “OTC” in Rule 12.3(a)(14) to make clear that OTC as used in Chapter 12 would refer to an options contract. Since the current definition already states that that “OTC” “as used with reference to a call or a put option contract means an over-the-counter option contract . . .”, the Exchange believes that the addition of the word “option” would simply clarify the language in the Rule without any substantive change to the Rule.

<sup>7</sup> See Order, supra note 4.

defined in the Act,<sup>8</sup> and thus, are more sophisticated investors who are likely to be aware of the risks associated with trading OTC options.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>9</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>10</sup> requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>11</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes that the proposed rule change will add consistency to the margin treatment rules and make them easier for investors to understand. For purposes of margin treatment, the Exchange believes that the clearing and guaranteeing functions performed

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<sup>8</sup> See 15 U.S.C. 78c(a)(65) which states that an “eligible contract participant has the same meaning as in section 1a of the Commodity Exchange Act.” The Commodity Exchange Act details the requirements for eligibility as an “eligible contract participant” which generally require a sufficient regulated status or a specified minimum amount of assets; see also 7 U.S.C. 1(a)(18).

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> Id.

by the OCC support a determination to treat OCC cleared OTC option contracts in the same manner as other option contracts that are cleared and guaranteed by the OCC. The Exchange believes that treating OCC cleared OTC option contracts as “listed” options for margin purposes is consistent with FINRA rules and the treatment of option contracts cleared and guaranteed by the OCC generally. The Exchange believes that treating OCC cleared OTC option contracts in this manner would protect investors’ interests and support a rational regulatory framework, which is in the best interest of investors.

B. Self-Regulatory Organization’s Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes that the proposed margin requirements rule changes are consistent with substantially similar rule changes made by FINRA. The Exchange believes that consistency across markets with respect to margin requirements will make it easier for investors to trade options and is in the interests of all investors. Moreover, the Exchange believes that the proposed rule changes are necessary in order to not disadvantage its TPHs who would otherwise be required to maintain additional margin in their accounts, placing TPHs at the Exchange at a competitive disadvantage in the market. Furthermore, because the proposed margin rules would be applied equally to all TPHs, no TPH would be placed at a competitive disadvantage at the Exchange.

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

The Exchange neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not:

A. significantly affect the protection of investors or the public interest;

B. impose any significant burden on competition; and

C. become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 19b-4(f)(6)<sup>13</sup> thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission will institute proceedings to determine whether the proposed rule change should be approved or 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-CBOE-2014-073 on the subject line.

##### Paper comments:

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

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<sup>12</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>13</sup> 17 CFR 240.19b-4(f)(6).

All submissions should refer to File Number SR-CBOE-2014-073. 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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549 on official business days between the hours of 10 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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-CBOE-2014-073 and should be submitted on or before **[INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

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

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<sup>14</sup> 17 CFR 200.30-3(a)(12).

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