

## 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").<sup>1</sup> Notice of the proposal was published in the *Federal Register* on January 16, 2003.<sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup> 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,<sup>5</sup> "Money Market Funds," under the Investment Company Act of 1940 ("ICA"),<sup>6</sup> 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.<sup>7</sup> Although certain types of instruments that qualify as first tier securities would not qualify to be pledged directly as margin collateral

under rule 604,<sup>8</sup> 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

<sup>4</sup> 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).

<sup>5</sup> 17 CFR 270.2a-7.

<sup>6</sup> 15 U.S.C. 80a et seq.

<sup>7</sup> 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).

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

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

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

<sup>3</sup> 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).