COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 41

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 242

[Release No. 34–90244; File No. S7–09–19]

RIN 3235–AM55

Customer Margin Rules Relating to Security Futures

AGENCY: Commodity Futures Trading Commission and Securities and Exchange Commission.

ACTION: Joint final rule.

SUMMARY: The Commodity Futures Trading Commission (''CFTC'') and the Securities and Exchange Commission (''SEC'') (collectively, the ''Commissions'') are adopting rule amendments to lower the margin requirement for an unhedged security futures position from 20% to 15% and adopting certain conforming revisions to the security futures margin offset table.

DATES: This rule is effective December 24, 2020.

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SUPPLEMENTARY INFORMATION:

I. Background

A security future is a futures contract on a single security or on a narrow-based securities index.[1] The Commodity Futures Modernization Act of 2000 (''CFMA'') lifted the ban on trading security futures and established a framework for the joint regulation of these products by the Commissions.[2] Among other things, the CFMA amended Section 7 of the Securities Exchange Act of 1934 (''Exchange Act'') to establish a margin program for security futures. Section 7(c)(2)(A) of the Exchange Act provides that it shall be unlawful for any broker, dealer, or member of a national securities exchange[3] to, directly or indirectly, extend or maintain credit to or for, or collect margin from any customer on, any security future unless such activities comply with the regulations prescribed by: (1) The Board of Governors of the Federal Reserve System (''Federal Reserve Board''); or (2) the Commissions jointly pursuant to authority delegated by the Federal Reserve Board.

Section 7(c)(2)(B) of the Exchange Act provides that the customer margin requirements for security futures products adopted by the Federal Reserve Board or jointly by the Commissions, ''including the establishment of levels of margin (initial and maintenance),'' must satisfy four requirements. First, they must preserve the financial integrity of markets trading security futures products.[4] Second, they must prevent systemic risk.[5] Third: (1) They must be consistent with the margin requirements for comparable options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act;[6] and (2) the initial and maintenance margin levels must not be lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded options.[7] Fourth, excluding margin levels, they must be, and remain consistent with, the margin requirements established by the Federal Reserve Board under 12 CFR part 220 (''Regulation T'').[8]

On March 6, 2001, the Federal Reserve Board delegated its authority under Section 7(c)(2)(A) of the Exchange Act to the Commissions.[9] Pursuant to that delegation, the Commissions adopted rules in 2002 establishing a margin program for security futures.[10]

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[1] *See* Section 1a(44) of the Commodity Exchange Act (''CEA'') and Section 3(a)(55) of the Exchange Act (both defining the term ''security future''). A ''security future'' is distinguished from a ''security futures product,'' which is defined to include a security future as well as any put, call, straddle, option, or privilege on a security future. *See* Section 1a(45) of the CEA and Section 3(a)(56) of the Exchange Act (both defining the term ''security futures product''). Under Section 2(a)(1)(D)(iii)(II) of the CEA and Section 6(h)(6) of the Exchange Act, the Commissions may, by order, jointly determine to permit the listing of options on security futures. The Commissions have not exercised this authority. The amendments being adopted in this release relate to margin requirements for security futures and not for options on security futures. Most of the discussion in this release relates to security futures. The term ''security futures products'' will be used when discussing security futures and options on security futures.

[2] *See* Appendix E of Public Law 106–554, 114 Stat. 2763 (2000). Futures on security indexes that are not narrow-based are subject to the exclusive jurisdiction of the CFTC.

[3] A futures commission merchant (''FCM'') (as defined in Section 1(a)(28) of the CEA) may be a member of a national securities exchange, a clearing member of a clearinghouse, or a customer of a clearing member of a clearinghouse.

[4] *See* Section 7(c)(2)(B)(i) of the Exchange Act.

[5] *See* Section 7(c)(2)(B)(ii) of the Exchange Act.

[6] *See* Section 7(c)(2)(B)(iii)(I) of the Exchange Act. In this release, this provision of the statute is sometimes referred to as the ''consistent with restriction.''

[7] *See* Section 7(c)(2)(B)(iii)(II) of the Exchange Act. In this release, this provision of the statute is sometimes referred to as the ''not lower than restriction.''

[8] *See* Section 7(c)(2)(B)(iv) of the Exchange Act.

[9] *See* Letter from Jennifer J. Johnson, Secretary of the Board, Federal Reserve Board, to James E. Newsome, Acting Chairman, CFTC, and Laura S. Unger, Acting Chairman, SEC (Mar. 6, 2001) (''FRB Letter''); *see also Customer Margin Rules Relating to Security Futures,* Exchange Act Release No. 44853 (Sep. 26, 2001), 66 FR 50720 (Oct. 4, 2001) (''2001 Proposing Release'') (reprinting the FRB Letter in Appendix B).

[10] *See Customer Margin Rules Relating to Security Futures,* Exchange Act Release No. 46292 (Aug. 1, 2002), 67 FR 53146 (Aug. 14, 2002) (''2002 Adopting Release''). *See also* 17 CFR 41.41 through 41.49 (CFTC regulations, hereinafter referred to as ''CFTC Rule 41.42'', ''CFTC Rule 41.43'' *et seq.*) and 17 CFR 242.400 through 242.406 (SEC regulations,

These rules require security futures intermediaries to collect margin from their customers.[11] A security futures intermediary is a creditor, as defined under Regulation T, with respect to its financial relations with any person involving security futures, and includes registered entities such as brokers-dealers and FCMs.[12]

The Commissions' rules include requirements governing: Account administration; type, form, and use of collateral; calculation of equity; withdrawals from accounts; and the treatment of undermargined accounts. The Commissions stated that ''the inclusion of these provisions in the final rules satisfies the statutory requirement that the margin rules for security futures be consistent with Regulation T.'' [13]

The Commissions' rules contemplate that all security futures intermediaries will pay to or receive from their customers a daily variation settlement (*i.e.,* the daily net gain or loss on a security future) as a result of all open security futures positions being marked to current market value by the clearing organization where the security futures are cleared.[14] In addition, the Commissions' rules establish minimum initial and maintenance margin levels for unhedged security futures equal to 20% of their ''current market value.'' [15]

The Commissions' rules permit a ''self-regulatory authority'' (''SRA''),[16] as that term is defined in the rules, to set initial and maintenance margin levels lower than 20% of the current market value for certain strategy-based offsetting positions involving security futures and one or more related securities or futures.[17] The SRA rules must meet the four criteria set forth in Section 7(c)(2)(B) of the Exchange Act and must be effective in accordance with Section 19(b)(2) of the Exchange Act and, as applicable, Section 5c(c) of the CEA.[18] In connection with these provisions governing SRA rules, the Commissions published a table identifying offsets for security futures that were consistent with the offsets permitted for comparable exchange-traded options (''Strategy-Based Offset Table'').[19] SRAs have adopted margin rules that permit strategy-based offsets between security futures and related positions based on the Strategy-Based Offset Table.[20]

The Commissions' rules also enumerate specific exclusions from the margin requirements for security futures, and those exclusions will continue under the final rule amendments.[21] For example, margin requirements that derivatives clearing organizations (''DCOs'') or clearing agencies impose on their clearing members are not subject to the 20% margin level requirement.[22]

There also is an exclusion providing that the required 20% initial and maintenance margin levels do not apply to financial relations between a customer and a security futures intermediary to the extent that they comply with a portfolio margining system under rules that meet the four criteria set forth in Section 7(c)(2)(B) of the Exchange Act and that are effective in accordance with Section 19(b)(2) of the Exchange Act and, as applicable, Section 5c(c) of the CEA.[23] Subsequent to the adoption of the Commissions' rules, and consistent with this exclusion, two securities SROs implemented portfolio margining rules that permit a broker-dealer to combine certain of a customer's securities and security futures positions in a securities account in order to compute the customer's margin requirements (''Portfolio Margin Rules'').[24] As discussed in more detail below, the Portfolio Margin Rules established a 15% margin level for unhedged exchange-traded options on an equity security or narrow-based equity index (sometimes referred to herein as ''exchange-traded equity options'').[25] The 15% margin level also applies to unhedged security futures held in a securities account that is subject to Portfolio Margin Rules. There is no comparable portfolio margining system for security futures held in a futures account.[26] These same unhedged security futures positions, if held in a futures account, are subject to the required 20% initial and maintenance margin levels set forth in the Commissions' rules.

2019 Proposing Release

In July 2019, the Commissions proposed amending the security futures margin rules to lower the required initial and maintenance margin levels for an unhedged security futures position from 20% to 15% of its current

hereinafter referred to as ''SEC Rule 400'', ''SEC Rule 401'' *et seq.*). CFTC regulations referred to herein are found at 17 CFR chapter I, and SEC regulations referred to herein are found at 17 CFR chapter II.

[11] *See* CFTC Rule 41.45 and SEC Rule 403. *See also* CFTC Rule 41.43(a)(29) and SEC Rule 401(a)(1)(29) (both defining the term ''security futures intermediary'' to include a broker-dealer and an FCM). The term ''security futures intermediary'' includes FCMs that are clearing members or customers of clearing members. As of September 18, 2020, the Options Clearing Corporation (''OCC'') was the only clearinghouse for U.S. exchange-traded security futures.

[12] Because a security future is both a security and a future, customers who wish to buy or sell security futures must conduct the transaction through a person registered both with the CFTC as either an FCM or an introducing broker (''IB'') and with the SEC as a broker-dealer.

[13] *See* 2002 Adopting Release, 67 FR at 53155. As indicated above, Section 7(c)(2)(B)(iv) of the Exchange Act requires that margin requirements for security futures (other than levels of margin), including the type, form, and use of collateral, must be consistent with the requirements of Regulation T.

[14] *See* CFTC Rules 41.43(a)(32), 41.46(c)(1)(vi) and (c)(2)(iii), and 41.47(b)(1), and SEC Rules 401(a)(32), 404(c)(1)(vi) and (c)(2)(iii), and 405(b)(1).

[15] *See* CFTC Rule 41.45(b)(1) and SEC Rule 403(b)(1). *See also* CFTC Rule 41.43(a)(4) and SEC Rule 401(a)(4) (defining the term ''current market value'').

[16] The Commissions' rules define the term ''self-regulatory authority'' to mean a national securities exchange registered under Section 6 of the Exchange Act, a national securities association registered under Section 15A of the Exchange Act, a contract market registered under Section 5 of the CEA or Section 5f of the CEA, or a derivatives transaction execution facility registered under Section 5a of the CEA. *See* CFTC Rule 41.43(a)(30) and SEC Rule 401(a)(30). The term ''SRA'' as used in this release refers to self-regulatory organizations (''SROs'') registered under the Exchange Act and self-regulatory authorities registered under the CEA. The term ''securities SRO'' as used in this release refers only to SROs registered under the Exchange Act.

[17] *See* CFTC Rule 41.45(b)(2) and SEC Rule 403(b)(2). *See also* 2002 Adopting Release, 67 FR at 53158–61. The initial margin level is the required amount of margin that must be posted when the trade is executed. The maintenance margin level is the required amount of margin that must be maintained while the contract is open.

[18] Section 19(b)(2) of the Exchange Act governs SRA rulemaking with respect to SEC registrants, and Section 5c(c) of the CEA governs SRA rulemaking with respect to CFTC registrants.

[19] *See* 2002 Adopting Release, 67 FR at 53158–61.

[20] *See, e.g.,* FINRA Rule 4210(f)(10) and Cboe Rule 10.3(k).

[21] *See* CFTC Rule 41.42(c)(2)(i) through (v) and SEC Rule 400(c)(2)(i) through (v).

[22] *See* CFTC Rule 41.42(c)(2)(iii) and SEC Rule 400(c)(2)(iii). The OCC is registered with the SEC as a clearing agency pursuant to Section 17A of the Exchange Act and registered with the CFTC as a DCO pursuant to Section 5b of the CEA.

[23] CFTC Rule 41.42(c)(2)(i) and SEC Rule 400(c)(2)(i).

[24] *See* FINRA Rule 4210(g) and Cboe Rule 10.4. The broker-dealer would need to be registered with the CFTC (as an FCM) to include security futures in the securities account. *See also* 2019 Proposing Release, 84 FR 36437, n.36. FINRA Rule 4210 (Margin Requirements) was adopted as part of a new consolidated rulebook effective permanently on December 2, 2010, after the pilot program was approved and made available on August 1, 2008. Cboe rules on portfolio margining became effective permanently on July 8, 2008, after they were approved under a pilot program on April 2, 2007.

[25] The amendments adopted in this release were motivated, in part, by changes made to margin requirements for certain exchange-traded options pursuant to securities SRO pilot programs offering risk-based portfolio margining rules. Those pilot programs were later made permanent after review and approval by the SEC. *See* 2019 Proposing Release, 84 FR 36437, n.34–36.

[26] For purposes of this rulemaking a ''futures account'' is an account that is maintained in accordance with the requirements of Sections 4d(a) and 4d(b) of the CEA. *See also* 17 CFR 1.3 (CFTC Rule 1.3).

market value.[27] The Commissions sought to align margin requirements for security futures held in futures accounts and customer securities accounts that are not subject to the Portfolio Margin Rules with security futures and exchange-traded options held in customer securities accounts subject to the Portfolio Margin Rules (''Portfolio Margin Account'').[28] The Commissions also proposed certain conforming revisions to the Strategy-Based Offset Table.[29] Because the Commissions' proposal solely related to the reduction in ''levels of margin'' for security futures, the Commissions stated a preliminary belief that they did not implicate the requirement of Section 7(c)(2)(B)(iv) of the Exchange Act that the Commissions' rules be consistent with Regulation T.[30]

The Commissions received a number of comment letters in response to the proposal.[31] As discussed below, after considering the comments, the Commissions are adopting, as proposed, the amendments to the security futures margin rules to lower the required initial and maintenance margin levels for an unhedged security futures position from 20% to 15%. The Commissions also are publishing a revised Strategy-Based Offset Table as proposed.

Subsequent to the issuance of the 2019 Proposing Release, OneChicago, the only exchange listing security futures in the U.S., discontinued all trading operations on September 21, 2020. At this time, there are no security futures contracts listed for trading on U.S. exchanges. The final rule amendments in this release, however, would apply to customer margin requirements for security futures if an exchange were to resume operations or another exchange were to launch security futures contracts.

II. Final Rule Amendments

A. Lowering the Minimum Margin Level From 20% to 15%

1. The Commissions' Proposal

As discussed above, the current minimum initial and maintenance margin levels for an unhedged long or short position in a security future are 20% of the current market value of the position,[32] unless an exclusion applies.[33] For context, as discussed when adopting the margin requirements for security futures in 2002, the 20% margin levels were designed to be consistent with the margin requirements then in effect for an unhedged *short* at-the-money exchange-traded option held in a customer account where the underlying instrument is either an equity security or a narrow-based index of equity securities.[34] In this case, the margin requirement was 100% of the exchange-traded option proceeds, plus 20% of the value of the underlying equity security or narrow-based equity index.[35] This margin requirement on options continues to apply if the exchange-traded option is held in a securities account that is *not* subject to the Portfolio Margin Rules.[36]

However, as a result of the more recent Portfolio Margin Rules, an unhedged short at-the-money exchange-traded equity option held in a Portfolio Margin Account is now subject to a lower margin level. More specifically, under the Portfolio Margin Rules, a broker-dealer can group options, security futures, long securities positions, and short securities positions in a customer's account involving the same underlying security and stress the current market price for each position at ten equidistant points along a range of positive and negative potential future market movements using a theoretical option pricing model that has been approved by the SEC.[37] In the case of an option on an equity security or narrow-based equity securities index, the ten equidistant stress points span a range from −15% to +15% (*i.e.,* −15%, −12%, −9%, −6%, −3%, +3%, +6%, +9%, +12%, +15%).[38] The gains and losses of each position in the portfolio are allowed to offset each other to yield a net gain or loss at each stress point.[39] The stress point that yields the largest potential net loss for the portfolio is used to determine the aggregate margin requirement for all the positions in the portfolio.[40]

Under the Portfolio Margin Rules, the margin requirement for a short at-the-money exchange-traded equity option generally would be 15% if there were no other products in the account eligible to be grouped with the option position to form a portfolio (*i.e.,* an unhedged position). Consequently, the Commissions proposed to lower the required initial and maintenance margin levels for unhedged security futures

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[27] *See Customer Margin Rules Relating to Security Futures,* Exchange Act Release No. 86304 (July 3, 2019), 84 FR 36434 (July 26, 2019) (''2019 Proposing Release''). OneChicago, LLC (''OneChicago'') filed a rulemaking petition requesting that the minimum required margin for unhedged security futures be reduced from 20% to 15%. *See* Letter from Donald L. Horwitz, Managing Director and General Counsel, OneChicago, to David Stawick, Secretary, CFTC, and Nancy M. Morris, Secretary, SEC (Aug. 1, 2008) (''OneChicago Petition''), at 2.

[28] *See* 2019 Proposing Release, 84 FR at 36437.

[29] *See* 2019 Proposing Release, 84 FR at 36441–43.

[30] *See* 2019 Proposing Release, 84 FR at 36440. As discussed above, Section 7(c)(2)(B)(iv) of the Exchange Act requires that margin requirements for security futures *(other than levels of margin),* including the type, form, and use of collateral, must be consistent with the requirements of Regulation T (emphasis added).

[31] The comment letters are available at *https://www.sec.gov/comments/s7-09-19/s70919.htm* and *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3013.* The Commissions address these comments in section II below (discussing the final rule amendments), and in section IV (including the CFTC's consideration of the costs and benefits of the amendments and the SEC's economic analysis (including costs and benefits) of the amendments).

[32] *See* CFTC Rule 41.45(b) and SEC Rule 403(b).

[33] *See* CFTC Rule 41.42(c)(2)(i) through (v) and SEC Rule 400(c)(2)(i) through (v).

[34] *See* 2002 Adopting Release, 67 FR at 53157 (''The Commissions believe that a security future is comparable to a short, at-the-money option . . .''); 2001 Proposing Release, 66 FR at 50725–26 (''The Commissions propose that the initial and maintenance margin levels required of customers for each security future carried in a long or short position be 20 percent of the current market value of such security future because 20 percent is the uniform margin level required for short, at-the-money equity options traded on U.S. options exchanges.'') (footnote omitted). In 2002, the margin requirement for a *long* exchange-traded equity option with an expiration exceeding nine months was 75% of the contract's in-the-money amount plus 100% of the amount, if any, by which the current market value of the option exceeded its in-the-money amount, provided the option is guaranteed by the carrying broker-dealer and has an American-style exercise provision. Otherwise, long exchange-traded options were not margin eligible and the customer needed to pay 100% of the purchase price. These requirements remain in place for long options contracts. *See* FINRA Rule 4210 and Cboe Rule 10.3.

[35] This release generally discusses security futures on underlying equity securities and narrow-based equity security indexes because, while permitted, no exchange has listed security futures directly on one or more debt securities. *See* CFTC Rule 41.21(a)(2)(iii), 17 CFR 41.21(a)(2)(iii), and SEC Rule 6h–2, 17 CFR 240.6h-2 (both providing that a security futures may be based upon a security that is a note, bond, debenture, or evidence of indebtedness or a narrow-based security index composed of such securities).

[36] *See* FINRA Rule 4210 and Cboe Rule 10.3.

[37] *See* FINRA Rule 4210(g) and Cboe Rule 10.4.

[38] This range of price movements (+/−) 15% is consistent with the prescribed 15% haircut for most proprietary equity securities positions under the SEC's net capital rule for broker-dealers. *See* 17 CFR 240.15c3–1(c)(2)(vi)(J).

[39] For example, at the −6% stress point, XYZ Company stock long positions would experience a 6% loss, short positions would experience a 6% gain, and XYZ Company options would experience gains or losses depending on the features of the options. These gains and losses are added up resulting in a net gain or loss at that point.

[40] Because options are part of the portfolio, the greatest portfolio loss (or gain) would not necessarily occur at the largest potential market move stress points ((+/−) 15%). This is because a portfolio that holds derivative positions that are far out-of-the-money would potentially realize large gains at the greatest market move points as these positions come into the money. Thus, the greatest net loss for a portfolio conceivably could be at any market move stress point. In addition, the Portfolio Margin Rules impose a minimum charge based on the number of derivative positions in the account and that applies if the minimum charge is greater than the largest stress point charge.

from 20% to 15%.[41] In doing so, the Commissions preliminarily viewed unhedged exchange-traded equity options as comparable to security futures that may be held alongside the exchange-traded equity options in a Portfolio Margin Account.[42] The Commissions stated that Congress did not instruct the Commissions to set the margin requirement for security futures at the exact level as the margin requirements for exchange-traded equity options. Rather, pursuant to Section 7(c)(2)(B) of the Exchange Act, the Commissions must establish margin requirements that are ''consistent'' with the margin requirements for ''comparable'' exchange-traded equity options and set initial and maintenance margin levels that are not lower than the lowest level of margin for the comparable exchange-traded equity options.

Under the proposal, unhedged security futures held in futures accounts and securities accounts that are not Portfolio Margin Accounts would be subject to the same initial and maintenance margin levels as unhedged security futures held in Portfolio Margin Accounts (*i.e.,* 15%). Thus, the proposed 15% initial and maintenance margin levels for unhedged security futures would bring security futures held in futures accounts and securities accounts that are not Portfolio Margin Accounts into alignment with the required margin level for unhedged security futures held in Portfolio Margin Accounts. At the same time, the amendments would not lower the required margin levels for unhedged security futures below the lowest required margin level for unhedged exchange-traded equity options (*i.e.,* 15%). As discussed below, margin levels for exchange-traded equity options are prescribed in rules promulgated by securities SROs.[43]

2. Comments and Final Amendments

One commenter stated that the proposed amendments would harmonize margin requirements, be simpler to administer and risk manage, and better align with customer use of security futures.[44] This commenter stated that it has long supported securities portfolio margining and has found the 15% margin level for unhedged positions sufficiently robust for intermediaries to risk manage their customer positions.[45] Other commenters, however, raised concerns with the proposal, as discussed below.

Addressing Commenters' Concerns That the Proposal Is Inconsistent With Section 7(c)(2)(B) of the Exchange Act

When proposing these amendments, the Commissions stated a preliminary belief that they would be consistent with Section 7(c)(2)(B) of the Exchange Act.[46] The Commissions noted that, under that section, customer margin requirements, including the establishment of levels of margin (initial and maintenance) for security futures, must be consistent with the margin requirements for comparable options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act.[47] The Commissions stated a preliminary belief that ''[c]ertain types of exchange-traded options, no matter what type of an account they are in, are comparable to security futures'' and therefore the ''margin requirements for comparable exchange-traded options and security futures must be consistent.'' [48] Finally, the Commissions—in proposing to lower the margin level for security futures from 20% to 15%—used the margin level for an unhedged exchange-traded equity option held in a Portfolio Margin Account to ''establish a consistent margin level for security futures held outside'' of a Portfolio Margin Account.[49]

Some commenters stated that the 15% margin level in a Portfolio Margin Account is prudent, given the requirements for these accounts (*e.g.,* risk management, account approval process, and minimum equity required).[50] However, these commenters stated that minimum margin levels for security futures held outside of a Portfolio Margin Account do not govern the levels of margin applicable for security futures held in a Portfolio Margin Account and, similarly, that the rules governing levels of margin for exchange-traded equity options held outside of a Portfolio Margin Account do not govern the levels of margin for exchange-traded equity options held in a Portfolio Margin Account. In the commenters' view, Section 7(c)(2)(B) of the Exchange Act requires initial and maintenance margin levels for security futures held outside of a Portfolio Margin Account to remain at 20% because the initial and maintenance margin levels for exchange-traded equity options held outside a Portfolio Margin Account are 20%.

Some commenters stated that the proposal ''may not be in line with the spirit or letter'' of the CFMA and asked the Commissions to outline how the proposal to lower the required initial and maintenance margin levels from 20% to 15% is consistent with the CFMA.[51]

Other commenters, while fully supportive of harmonizing margin requirements, urged the Commissions to reconsider the proposal or provide for a corresponding change to margin levels for exchange-traded equity options to ensure any final rule is consistent with Section 7(c)(2)(B) of the Exchange Act.[52] In making these comments, these commenters agreed with (or did not state a disagreement with) the Commissions' view that security futures are comparable to exchange-traded equity options in terms of their risk characteristics and uses.

After considering these comments, the Commissions continue to believe that it is appropriate to seek to align the required margin levels for unhedged security futures held in a futures account (or in a securities account that is not subject to Portfolio Margin Rules) with the 15% margin level for unhedged exchange-traded equity options held in a Portfolio Margin Account.[53] The primary benefit to customers of holding positions in a Portfolio Margin Account is the lower margin requirements (*i.e.,* margin levels less than 15%) that can result from grouping and recognizing the risk-reducing offsets between positions involving the same underlying equity security or narrow-based equity securities index. These lower margin requirements also can increase the amount of leverage available to customers who use Portfolio Margin

[41] *See* 2019 Proposing Release, 84 FR at 36438–40.

[42] *See* 2019 Proposing Release, 84 FR at 36439 (''The Commissions are proposing to decrease the margin requirement for unhedged security futures from 20% to 15% in order to reflect the comparability between unhedged security futures and exchange-traded options that are held in risk-based portfolio margin accounts.'').

[43] *See* 12 CFR 220.12(f); FINRA Rule 4210; Cboe Rule 10.3. *See also infra* note 56 and accompanying text (noting securities SROs typically set margin levels for exchange-traded equity options through rule filings with the SEC under Section 19(b) of the Exchange Act).

[44] Letter from Walt Lukken, President & Chief Executive Officer, Futures Industry Association (Aug. 26, 2019) (''FIA Letter'') at 2.

[45] FIA Letter at 2.

[46] *See* 2019 Proposing Release, 84 FR at 36439–40.

[47] *Id.*

[48] *Id.*

[49] *Id.* at 36440.

[50] Letter from Angelo Evangelou, Chief Policy Officer, Cboe Global Markets, Inc. and Shelly Brown, EVP, Strategic Planning & Operations, MIAX Exchange Group (Aug. 26, 2019) (''Cboe/MIAX Letter'') at 4–7.

[51] Letter from the Honorable Mike Bost and Rodney Davis, U.S. Congress (Nov. 13, 2019) (''Bost/Davis Letter'') at 1.

[52] Letter from the Honorable Jerry Moran, Thom Tillis, and M. Michael Rounds, U.S. Senate (Nov. 22, 2019) (''Moran/Tillis/Rounds Letter'') at 1–2.

[53] *See* 2019 Proposing Release, 84 FR at 36439.

Accounts to trade equity positions. To address the lower margin requirements and increased leverage that may result from grouping risk reducing equity positions, Portfolio Margin Accounts are subject to additional requirements, as compared to non-Portfolio Margin Accounts.[54]

An exchange-traded equity option that cannot be grouped with any other risk reducing offsetting equity positions in a Portfolio Margin Account (*i.e.,* an unhedged position) does not receive the benefit of a lower margin requirement and is subject to a 15% margin level. Therefore, the greater leverage that can be achieved by grouping offsetting positions is not available to the customer in the case of an unhedged position. Given the absence of risk-reducing offsetting positions, the risk of the unhedged position held in a Portfolio Margin Account generally is no different than if the unhedged position was held outside of a Portfolio Margin Account. The same is true with respect to an unhedged security futures position held in a Portfolio Margin Account as compared to an unhedged security futures position held outside of a Portfolio Margin Account.

Moreover, there is no comparable portfolio margin system for security futures held in a futures account. Therefore, an unhedged security futures position held in a futures account is subject to the required 20% margin level even though the risk of the position is generally no different than if the position was held in a Portfolio Margin Account, given the absence of risk-reducing offsetting positions. In addition, as discussed above, in 2002, securities SROs had not yet proposed portfolio margin rules for exchange-traded options. With the adoption of the Portfolio Margin Rules, the lower 15% margin level for unhedged security futures and exchange-traded options held in Portfolio Margin Accounts became available as an alternative.

For these reasons, it is appropriate to use the margin level for an unhedged exchange-traded equity option held in a Portfolio Margin Account to establish a consistent margin level for security futures held outside of a Portfolio Margin Account.

In addition, as discussed above, Section 7(c)(2)(B) of the Exchange Act provides that: (1) The margin requirements for security futures must be consistent with the margin requirements for comparable options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act; and (2) the initial and maintenance margin levels for security futures must not be lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded options. The statute requires that the Commissions establish customer margin requirements that are ''consistent'' with the margin requirements for ''comparable'' exchange-traded options. This provides the Commissions with some flexibility in establishing the margin levels for security futures, provided those margin requirements do not set initial and maintenance margin levels for security futures lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded options.

Further, Section 7(c)(2)(B)(iii)(II) of the Exchange Act provides that the initial and maintenance margin levels for security futures must not be lower than the lowest level of margin required for *any* comparable exchange-traded option. It does not specify that the initial and maintenance margin levels must not be lower than the lowest level of margin required with respect to a given type of account. Therefore, it is appropriate to consider the lowest level of margin for an unhedged exchange-traded equity option held in a Portfolio Margin Account when setting initial and maintenance margin levels for security futures held outside of a Portfolio Margin Account (*i.e.,* held in a futures account or a securities account that is not a Portfolio Margin Account).

As discussed above, commenters requested that the Commissions provide for a corresponding change to margin levels for exchange-traded equity options to ensure any final rule is consistent with Section 7(c)(2)(B) of the Exchange Act. This comment is outside the scope of this rulemaking, which is focused on margin levels for security futures. Margin levels for exchange-traded equity options are set forth in securities SRO rules.[55] Securities SROs typically set margin levels for exchange-traded equity options through rule filings with the SEC under Section 19(b) of the Exchange Act.[56]

Some commenters that raised concerns about the proposal's consistency with Section 7(c)(2)(B) of the Exchange Act also stated that the proposal would create a competitive advantage for security futures over exchange-traded equity options through preferential margin treatment for security futures held outside of a Portfolio Margin Account.[57]

These commenters noted that the Commissions recognized in 2001 that security futures can compete with, and be an economic substitute for, equity securities, such as equity options, and stated that the CFMA was specifically designed to avoid regulatory arbitrage between security futures and exchange-traded options.[58] These commenters believed that the proposal implies that exchange-traded options and security futures are not competing products and that the analysis in the proposal unfairly underestimates the utility of options.[59] They also stated that synthetic futures strategies are an important segment of today's options market, and could be used to compete with security futures. They stated that in June 2019 there were over 700,000 contracts traded on their exchanges that replicate long and short security futures.[60]

The Commissions acknowledge that security futures and exchange-traded equity options can have similar economic uses.[61] However, reducing the margin level for an unhedged security future held outside of a Portfolio Margin Account to 15% should not result in a competitive disadvantage for exchange-traded equity options, if security futures trading resumes. First, reducing the required margin levels for unhedged security futures to 15% will result in more consistent margin requirements between futures and securities accounts. Second, subject to certain requirements, customers may hold exchange-traded equity options in a Portfolio Margin Account, in which case the margin level for an unhedged position is 15%.

Finally, customers can hold security futures in a Portfolio Margin Account, in which case the required margin level is 15% for an unhedged position. Nonetheless, the vast majority of

[54] For example, in order to open a Portfolio Margin Account, a customer must be approved for writing uncovered options and meet minimum equity requirements (generally ranging from $100,000 to $500,000). In addition, Portfolio Margin Accounts are subject to enhanced risk management procedures and additional customer disclosure requirements. *See* FINRA Rule 4210(g) and Cboe Rule 10.4; *see also* FINRA Portfolio Margin FAQ, *available at www.finra.org.*

[55] *See* 12 CFR 220.12(f); FINRA Rule 4210; Cboe Rule 10.3.

[56] Under Section 19(b) of the Exchange Act, securities SROs generally must file proposed rule changes with the SEC for notice, public comment, and SEC approval, prior to implementation. 15 U.S.C. 78s(b). Section 19(b)(1) of the Exchange Act requires each securities SRO to file with the SEC ''any proposed rule or any proposed change in, addition to, or deletion from the rules of . . . [a] self-regulatory organization.'' 15 U.S.C. 78s(b)(1).

[57] Cboe/MIAX Letter at 6.

[58] Cboe/MIAX Letter at 6. *See also* 2001 Proposing Release, 66 FR 50721 at n.10.

[59] Cboe/MIAX Letter at 6.

[60] Cboe/MIAX Letter at 7.

[61] For example, commenters noted that to create a synthetic long (short) futures contract, which requires two options, an investor would buy (sell) a call option and sell (buy) a put option on the same underlying security with the same expiration date and strike price. Cboe/MIAX Letter at 6–7.

security futures traded in the U.S. were held in futures accounts subject to required initial and maintenance margin levels of 20% for unhedged positions.[62] Therefore, the relative advantage of a required 15% margin level as compared to a required 20% margin level did not cause customers to migrate their security futures trading to Portfolio Margin Accounts.

Some commenters that opposed lowering the required margin levels from 20% to 15% stated that industry solutions and rule changes that optimize the portfolio margining of security futures and exchange-traded equity options, including the portfolio margining of security futures in both securities and futures accounts, would be a more appropriate solution.[63]

As discussed above, lowering the required margin levels from 20% to 15% is appropriate, consistent with Section 7(c)(2)(B) of the Exchange Act, and should not disadvantage exchange-traded equity options markets if security futures trading resumes. Moreover, the Commissions remain committed to continuing to coordinate on issues related to harmonizing portfolio margining rules and requirements, as well as increasing efficiencies in the implementation of portfolio margining. Further, to the extent securities accounts are not operationally suited for holding security futures, the Commissions support industry efforts to address this issue. Finally, the realization of any potential harmonization efforts or operational improvements with respect to portfolio margining will depend on firms offering such programs to their customers.

Response to Commenters' Request To Use Risk Models To Calculate Margin

In response to the Commissions' request for comments in the 2019 Proposing Release,[64] some commenters stated that the Commissions' rules should permit the use of risk models to calculate required initial and maintenance margin levels for security futures [65]—similar to how DCOs calculate margin requirements for futures and the OCC calculates margin requirements for its clearing members.[66] One of these commenters—OneChicago—believed that the required margin levels for security futures and the proposal to modify them were too conservative.[67] OneChicago characterized the Commissions' proposal as—''at best''—''a first-step towards the risk-based margining that is needed in the [security futures] marketplace.'' [68] It further stated that 92% of the security futures traded on its exchange were ''margined at a level greater than is set by the clearinghouse for comparable products, which are equity swaps'' and that, under the proposal, 84% would still be margined at a greater level.[69] According to OneChicago's analysis, the Commissions' proposal to lower the required margin levels from 20% to 15% would have resulted in a 25% reduction in the value of margin collected (from $540 million to $410 million) for the period between September 1, 2018, and August 1, 2019; whereas using a margin model would have resulted in a 61% reduction (from $540 million to $210 million).[70]

OneChicago believed that the ''margin regime in place today and the proposed margin regime incentivizes market participants to transact in other environments.'' [71] OneChicago stated that the trading volume on its exchange ''has been plummeting in recent years.'' [72] In the exchange's view, these issues would be addressed if the Commissions adopted a risk model approach to calculate required margin levels for security futures. As a more limited alternative, OneChicago suggested the Commissions could adopt a risk model approach for a class of security futures paired transactions executed on its exchange and known as ''securities transfer and return spreads'' (''STARS'').[73]

Risk models calculate margin requirements by measuring potential future exposures based on statistical correlations between positions in a portfolio. For example, the OCC's risk model—known as the System for Theoretical Analysis and Numerical Simulations (''STANS'')—calculates a clearing member's margin requirement based on full portfolio Monte Carlo simulations.[74] The margin requirements in place today for exchange-traded equity options do not use risk models to calculate margin requirements for customer positions.[75] Rather, current rules prescribe margin requirements as a percent of a value or other amount of a single position or combinations of offsetting positions or, in the case of the Portfolio Margin Rules, stress groups of related positions across a preset range of potential percent market moves (*e.g.,* market moves of −15%, −12%, −9%, −6%, −3%, +3%, +6%, +9%, +12%, +15% in the case of exchange-traded equity options).

The Commissions' required initial and maintenance margin levels for security futures (*i.e.,* 20% of the current market value) are based on the margin requirements for exchange-traded equity options and are designed to be consistent with those requirements in accordance with Section 7(c)(2)(B) of the Exchange Act.[76] Consequently, implementing a risk model approach to calculate required margin levels for security futures would substantially alter how the required margin is calculated (or would be calculated under these amendments) and would substantially deviate from how customer margin requirements are calculated for exchange-traded equity options. It also could result in required

[62] In its petition, OneChicago stated that ''because of operational issues at the securities firms, almost all security futures positions are carried in a futures account regulated by the CFTC and not in a securities account. The proposed joint rulemaking would permit customers carrying security futures in futures accounts to receive margin treatment consistent with that permitted under the [portfolio] margining provisions of CBOE.'' *See* OneChicago Petition at 2 and 2019 Proposing Release 84 FR at 36440, n.67.

[63] Cboe/MIAX Letter at 5. More specifically, to the extent securities accounts are not operationally optimal for security futures, the options exchanges support industry efforts to make improvements. *Id.*

[64] The Commissions asked, ''[a]re there any other risk-based margin methodologies that could be used to prescribe margin requirements for security futures? If so, please identify the margin methodologies and explain how they would meet the comparability standards under the Exchange Act.'' 2019 Proposing Release, 84 FR at 36441.

[65] For purposes of this final rule, any references to using ''risk models'' or a ''risk model approach'' to calculate required initial margin levels is intended to mean the same thing. While there are different risk-based margin models, a key component of all such margin regimes is the use of modeling to generate expected potential future exposures that adjust over time in response to market conditions, credit risk, and other inputs.

[66] Letter from Thomas G. McCabe, Chief Regulatory Officer, OneChicago (Aug. 26, 2019) (''OneChicago Letter''); Letter from Thomas G. McCabe, Chief Regulatory Officer, OneChicago (Oct. 7, 2019) (''OneChicago Letter 2''); Letter from Thomas G. McCabe, Chief Regulatory Officer, OneChicago (Apr. 27, 2020) (''OneChicago Letter 3''); OneChicago, *April 27, 2020 OneChicago Comment Letter Summary* (''OneChicago Letter 3 Summary''); Letter from Mike Ianni, individual (Aug. 29, 2019) (''Ianni Letter''); Letter from Scott A. La Botz, individual (Dec. 4, 2019) (''La Botz Letter'').

[67] OneChicago Letter at 1.

[68] OneChicago Letter at 1.

[69] OneChicago Letter at 1. In this release, the term ''clearinghouse'' may refer to a clearing organization or a clearing agency.

[70] OneChicago Letter at 14. However, as discussed in more detail in section IV of this release, it is possible that under certain circumstances the margin requirement under a risk-based margin model may exceed the 15% of the current market value that is required under the final rules.

[71] OneChicago Letter at 2.

[72] OneChicago Letter at 14.

[73] OneChicago Letter at 19; *see also* Memorandum from the SEC's Division of Trading and Markets regarding a July 16, 2019, meeting with representatives of OneChicago.

[74] More information about the OCC's STANS model is available at *https://www.theocc.com/risk-management/Margin-Methodology/.*

[75] *See, e.g.,* FINRA Rule 4210 and Cboe Rule 10.3.

[76] *See* 2002 Adopting Release, 67 FR at 53156–61.

initial and maintenance margin levels for unhedged security futures that are significantly lower than the 20% margin level for unhedged exchange-traded equity options held outside a Portfolio Margin Account as well as the 15% margin level for unhedged exchange-traded equity options held in a Portfolio Margin Account.

For these reasons, implementing a risk model approach to calculate margin for security futures would be inconsistent with how margin is calculated for exchange-traded equity options at this time and may result in margin levels for unhedged security futures positions that are lower than the lowest level of margin applicable to unhedged exchange-traded equity options (*i.e.,* 15%). Consequently, because no exchange-traded equity options are subject to risk-based margin requirements, adopting a risk model approach at this time for security futures would conflict with the requirements of Section 7(c)(2)(B) of the Exchange Act that: (1) The margin requirements for security futures must be consistent with the margin requirements for comparable options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act; and (2) the initial and maintenance margin levels must not be lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded options.[77]

To address the conflict between a risk model approach and Section 7(c)(2)(B) of the Exchange Act, OneChicago argued that the Commissions could adopt a risk model approach because Section 7(c)(2)(B) of the Exchange Act can be read to require that the *level of protection* provided to the marketplace by the margin requirements for security futures must be consistent with the level of protection provided by the margin requirements for exchange-traded options.[78] Similarly, OneChicago argued that the statute can be construed to require that the level of protection provided by the margin requirements for security futures (rather than the margin levels) must not be lower than the lowest level of protection provided by the margin requirements for exchange-traded options.

OneChicago pointed out that Section 7(c)(2)(B)(iii)(I) of the Exchange Act provides that ''margin requirements'' for a security future product must be consistent with the margin requirements for comparable option contracts traded on any exchange registered under the Exchange Act. OneChicago further noted that Section 7(c)(2)(B)(iv) of the Exchange Act also uses the phrase ''margin requirements'' but then qualifies it by excluding ''levels of margin'' from its provisions regarding consistency with Regulation T. Thus, OneChicago concluded that the phrase ''margin requirements'' in Section 7(c)(2)(B)(iii)(I) of the Exchange Act can be read to mean all aspects of margin requirements, including margin levels and the type, form, and use of collateral for security futures products.

OneChicago also argued that futures-style margining includes daily pay and collect variation margining, and options-style margining—in its view—does not include variation margining.[79] Consequently, OneChicago believed that, if Section 7(c)(2)(B)(iii)(I) of the Exchange Act is read to relate to levels of margin, the Commissions would be required to implement a daily pay and collect variation margin feature for options (or to eliminate this feature from the security futures margin requirements) in order to achieve the consistency required by the statute. OneChicago argued that this does not make sense and, therefore, the better reading of the statute is that it requires the level of protection provided by the security futures margin requirements to be consistent with and not lower than the lowest level of protection provided by the margin requirements for comparable exchange-traded options. And, according to OneChicago, in analyzing the level of protection provided by futures-style margining, the Commissions can consider the daily pay and collect variation margin feature to find that a risk model approach to calculating margin would be consistent with Section 7(c)(2)(B)(iii) of the Exchange Act.

The Commissions agree with OneChicago that the phrase ''margin requirements'' in Section 7(c)(2)(B)(iii)(I) of the Exchange Act refers to all aspects of margin requirements, including margin levels and the type, form, and use of collateral for security futures products. However, the Commissions do not agree that the ''consistent with'' and ''not lower than'' restrictions in the statute do not apply to levels of margin. Section 7(c)(2)(B)(iii)(II) of the Exchange Act states, in pertinent part, that ''initial and maintenance *margin levels* for a security future product [must] not be lower than the lowest level of margin, exclusive of premium, required for any comparable option contract traded on any exchange'' registered under the Exchange Act (emphasis added).[80]

Moreover, the legislative history of the CFMA includes an earlier bill.[81] In that earlier bill, the provisions governing the setting of margin requirements for security futures did not include the ''consistent with'' and ''not lower than'' restrictions in Sections 7(c)(2)(B)(iii)(I) and (II) of the Exchange Act, respectively.[82] Instead, the earlier bill would have required that the margin requirements for security futures must ''prevent competitive distortions between markets offering similar products.'' [83] The Senate Report on the earlier bill explained that ''[u]nder the bill, *margin levels* on [security future] products would be required to be harmonized with the options markets.'' [84] Thus, while the text of the earlier bill was not as explicit in terms of articulating the ''consistent with'' and ''not lower than'' restrictions, the Senate Report indicates that the objective was to harmonize *margin levels* between security futures and options to prevent competitive distortions. This objective was clarified in the text of Section 7(c)(2)(B) of the Exchange Act, as enacted. In light of this statutory text and the legislative history, the best reading of the statute is that the ''consistent with'' and ''not lower than'' restrictions apply to levels of margin.

Consequently, the levels of margin for unhedged security-futures must be consistent with the margin levels for comparable unhedged exchange-traded equity options, and not lower than the lowest level of margin for comparable unhedged exchange-traded equity options. Currently, the margin levels for comparable unhedged exchange-traded

[77] In this adopting release, the Commissions are considering OneChicago's proposed alternative risk model approach for margining security futures. However, as the discussion herein reflects, this alternative is not a viable one because the Commissions are not persuaded that it would satisfy the requirements of Section 7(c)(2)(B) of the Exchange Act at this time.

[78] *See* OneChicago Letter at 30–35.

[79] For purposes of this discussion, the Commissions understand the phrase ''futures-style margining'' to refer to initial margin requirements based on the use of risk models, as well as the daily settlement of variation margin based on marking open positions to market. ''Options-style margining'' will refer to initial and maintenance margin requirements for exchange-traded equity options under the Exchange Act.

[80] The prefatory text of Sections 7(c)(2)(B)(iii)(I) and (II) of the Exchange Act also uses the term ''levels of margin.'' In particular, it provides that the Federal Reserve Board or the Commissions, pursuant to delegated authority, shall prescribe ''regulations to establish margin requirements, including the establishment of *levels of margin* (initial and maintenance) for security futures products under such terms, and at such *levels,*'' as the Federal Reserve Board or the Commissions deem appropriate (emphasis added).

[81] *See* S. Report 106–390 (Aug. 25, 2000).

[82] *See id.* at 39–40.

[83] *Id.* at 39.

[84] *Id.* at 5 (emphasis added).

equity options are determined through a percent of a value. Therefore, using a risk model approach for security futures would be inconsistent with how margin levels are currently determined for comparable exchange-traded equity options. Further, at this time, the lowest level of margin for comparable unhedged exchange-traded equity options is 15%. Accordingly, the margin levels for unhedged security futures cannot be lower than 15%.

OneChicago also cited legislative history to support its reading of the statute.[85] First, OneChicago cited statements that it believed demonstrated that ''Congress intended to prevent the market for security futures from being ceded to overseas competitors'' and that ''Congress wanted to ensure that U.S. exchanges had the potential to compete with these product offerings in overseas markets.'' [86] However, these statements do not bear on whether Sections 7(c)(2)(B)(iii)(I) and (II) of the Exchange Act apply to levels of margin. Rather, if OneChicago's view of Congressional intent is correct, it would support the notion that the CFMA was designed to establish a U.S. market for security futures to compete with overseas markets.[87] Further, Sections 7(c)(2)(B)(iii)(I) and (II) require a comparison of security futures margin requirements to U.S. exchange-traded option margin requirements—not to requirements of overseas security futures markets. For these reasons, these statements do not support OneChicago's reading of the statute or conflict with the Commissions' reading of the statute.

Second, OneChicago cited statements that it believed demonstrated ''[t]here was concern, especially from options industry participants that [security futures] would directly compete with options and Congress wanted to make sure that participants did not migrate between futures and options for regulatory reasons'' and that ''Congress wanted to avoid regulatory arbitrage.'' [88] It cited the following statements in support of this view:

> [T]he bill requires that margin treatment of stock futures must be consistent with the margin treatment for comparable exchange-traded options. This ensures that *margin levels* will not be set dangerously low and that stock futures will not have an unfair competitive advantage vis-a-vis stock options.[89]
>
> Our bill would also provide for joint jurisdiction with each agency maintaining its core authorities over the trading of single-stock users. The legislation would further require that *margin levels* on these products be harmonized with the options market.[90]
>
> The SEC has always been charged with protecting investors and providing full and fair disclosure of corporate market information and preventing fraud and manipulation. The CFTC regulates commercial and professional hedging and speculation in an institutional framework. CFTC cannot regulate insider trading. Margin requirements are different. I hate to see investors shopping as to which instrument to use or to buy for that reason. So neither regulation nor the lack of it should pick winners and losers among products or exchanges and fair competition should.[91]

OneChicago argued that these statements indicated that ''[b]ill sponsors made a point to emphasize that they wanted market forces and not margin levels to determine winners and losers'' and that ''[m]argin needed to be set at a level that prevented it from impacting a market participant's decision on what products to trade.'' [92] However, the Congressional concerns and statements identified by OneChicago—that security futures should not have an unfair competitive advantage over exchange-traded options—support a reading of Sections 7(c)(2)(B)(iii)(I) and (II) of the Exchange Act that is consistent with the approach the Commissions are adopting here, namely that the margin levels for security futures must be consistent with and not lower than the lowest level of margin for comparable exchange-traded options.

Contrary to OneChicago's view, the statute does not provide a mechanism that would permit the Commissions to recalibrate margin requirements for security futures to foster greater use of the product. Rather, it contains restrictions that were designed to ensure that the margin requirements for these products were consistent with the margin requirements for comparable exchange-traded options, and not lower than the lowest level of margin for comparable exchange-traded options. This reading of the statute is supported by the following statement from the legislative history of the CFMA that OneChicago did not cite:

> A provision in the bill directs that initial and maintenance *margin levels* for a security future product shall not be lower than the lowest level of margin, exclusive of premium, required for any comparable option contract traded on any exchange registered pursuant to section 6(a) of the Exchange Act of 1934. In that provision, the term lowest is used to clarify that in the potential case where *margin levels* are different across the options exchanges, security future product *margin levels* can be based off the *margin levels* of the options exchange that has the lowest *margin levels* among all the options exchanges. It does not permit security future product *margin levels* to be based on option maintenance margin levels. If this provision were to be applied today, the required initial *margin level* for security future products would be 20 percent, which is the uniform initial *margin level* for short at-the money equity options traded on U.S. options exchanges.[93]

Further, implementing a risk model approach in order to lower the margin requirements to levels in the way OneChicago suggested could create an incentive for market participants to trade security futures, if security futures trading resumes, rather than exchange-traded options precisely because of the more favorable margin treatment.

Based on the text of Section 7(c)(2)(B) of the Exchange Act and the legislative history (including the legislative history cited by OneChicago), the better reading of the statute is that it applies to levels of margin, and requires that initial and maintenance margin levels for security futures be: (1) Consistent with margin levels for comparable exchange-traded options; and (2) not lower than the lowest level of margin for comparable exchange-traded options. Currently, the lowest level of margin for an unhedged exchange-traded equity option is 15%. Consequently, a 15% margin level is the lowest level of margin permitted for an unhedged security future.[94]

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[85] OneChicago Letter at 30–32.

[86] OneChicago Letter at 30. The Commissions address comments relating to the competition with foreign securities markets in section IV below (including the CFTC's consideration of the costs and benefits of the amendments and the SEC's economic analysis, including costs and benefits, of the amendments).

[87] The CFMA ended the prohibition on trading security futures in the United States at a time when this product was traded in overseas markets.

[88] OneChicago Letter at 30.

[89] *See* 146 Cong. Rec. H12497 (daily ed. Dec. 15, 2000) (Commodity Futures Modernization Act of 2000, speech of Rep. Dingell, Dec. 15, 2000) (emphasis added).

[90] *See S. 2697—The Commodity Futures Modernization Act of 2000,* Joint Hearing Before the Committee on Agriculture, Nutrition, and Forestry United States Senate and the Committee on Banking, Housing, and Urban Affairs, (June 21, 2000) (''Senate Hearing'') at 3, statement of Sen. Lugar (emphasis added).

[91] *See* Senate Hearing at 28, statement of Sen. Schumer.

[92] OneChicago Letter at 30–31.

[93] *See* 146 Cong. Rec. E1879 (daily ed. Oct. 23, 2000) (Commodity Futures Modernization Act of 2000, speech of Rep. Markey, Oct. 19, 2000) (emphasis added). As discussed above, the Commissions implemented the CFMA establishing 20% initial and maintenance margin levels for security futures.

[94] OneChicago argued that the Commissions could compare unhedged security futures to unhedged long option positions. *See* OneChicago Letter at 35. In its view, the initial and maintenance margin requirement for a long option is 0% and, therefore, a margin level for security futures that is lower than 15% would be appropriate. As discussed earlier, the margin level is 75% for certain long unhedged options with maturities greater than 9 months. However, this margin requirement relates to financing the purchase of a

Continued

OneChicago argued further that ''the margins have not been harmonized and are not consistent'' because security futures ''have variation pay/collect while options do not, which makes a strict comparison of initial margin percentages inappropriate.'' [95] OneChicago stated that the concept of daily variation margin plays a critical role in the margin framework for security futures, and it believed that the failure to take variation margin into account biases the Commissions' margin rule against security futures.[96] OneChicago believed that variation margin rather than minimum initial and maintenance margin levels more effectively protects customers.[97] OneChicago argued that ''the level of initial and maintenance margin should be considered not lower than comparable options when it provides a level of protection against default that is not lower than comparable options'' and that this ''reading would support the Commissions considering variation margin when looking at the appropriate level of initial margin.'' [98]

The Commissions, when adopting the margin requirements for security futures in 2002, modified the proposal to incorporate the concept of daily pay and collect variation margining into the final rules.[99] Variation settlement is any credit or debit to a customer account, made on a daily or intraday basis, for the purpose of marking-to-market a security future issued by a clearing agency or cleared and guaranteed by a DCO.[100] Therefore, in prescribing the required initial and maintenance margin levels for security futures, the Commissions' rules also account for daily variation margining.[101]

The variation margin component of the futures and security futures margining regimes settles the mark-to-market gains or losses on the positions on a daily basis with FCMs collecting payments from their customers and DCOs collecting payments from FCMs. The margin requirements for exchange-traded equity options also account for daily mark-to-market gains or losses on an option position. In particular, margin rules for exchange-traded equity options require that a customer maintain a minimum level of equity in the account (*i.e.,* an amount that equals or exceeds the maintenance margin requirement). A mark-to-market gain will increase account equity and a loss will decrease account equity potentially generating a requirement for the customer to post additional collateral to maintain the minimum account equity requirement (*i.e.,* the maintenance margin requirement). In this way, the margin requirements for exchange-traded equity options cover the broker-dealer's exposure to the credit risk that arises when the customer's position incurs a mark-to-market loss, just as daily pay and collect variation margining protects the security futures intermediary.

Further, if a customer's security futures position has a mark-to-market gain, the clearing agency or DCO will pay the amount of the gain to the security futures intermediary. This is the pay feature of futures-style variation margining. However, if that variation margin payment remains in the customer's account at the security futures intermediary, the customer continues to have credit risk exposure to the intermediary. Similarly, if a customer's exchange-traded equity option has a mark-to-market gain that results in the account having equity above the maintenance margin requirement, the customer will have credit exposure to the broker-dealer with respect to the excess equity in the account.

For these reasons, the Commissions do not believe that the variation margin requirements for futures and security futures are a unique feature that is absent from the margin requirements for exchange-traded options insomuch as both requirements address mark-to-market changes in the value of the positions.[102] Further, there is no basis to conclude that the variation settlement process for security futures when coupled with a risk model approach to calculating required initial and maintenance margin levels for security futures would be consistent with the margin requirements for exchange-traded equity options. The margin requirements for exchange-traded equity options also account for changes in the mark-to-market value of the options, but they do not use risk models to calculate initial and maintenance margin levels.

Moreover, as acknowledged by OneChicago, a risk model approach to calculating required initial and maintenance margin levels for unhedged security futures could result in margin levels that are significantly lower than the 20% margin level for exchange-traded equity options held outside a Portfolio Margin Account as well as the 15% margin level for exchange-traded equity options held inside a Portfolio Margin Account.[103] Consequently, given the ''not lower than restriction'' of Section 7(c)(2)(B)(iii)(II) of the Exchange Act, it would not be appropriate to set initial and maintenance margin levels for security futures using a risk model approach insofar as exchange-traded equity options are not permitted to rely upon a risk model approach.

As an alternative to the statutory construction argument discussed above, OneChicago stated that ''the Commissions can recognize that the concern at the time of the CFMA, that options and [security futures] would trade interchangeably, was unfounded as options and [security futures] are not comparable products.'' [104] Consequently, Section 7(c)(2)(B)(iii)—in OneChicago's view—''was written into the Exchange Act in case the products proved comparable; because they have proven to not be comparable, it no longer needs to bind upon financial markets.'' [105] Relatedly, OneChicago also argued that there are no exchange-traded options that are comparable to security futures and, therefore, the ''consistent with'' and ''not lower than'' restrictions of Section 7(c)(2)(B)(iii) of the Exchange Act are not implicated.

The Commissions stated a preliminary belief when proposing the reduction of the required margin levels from 20% to 15% that an unhedged

long option position. Unlike the case with an unhedged short option, the margin does not serve as a performance bond to secure the customer's obligations if the option is assigned to be exercised. Initial margin for a security future serves as a performance bond. *See, e.g.,* OneChicago Letter at 4. Long options that do not meet the requirements to be subject to the 75% margin level must be paid in full. Thus, from a financing perspective, they have a 100% margin requirement (*i.e.,* they cannot be purchased through an extension of credit by the broker-dealer). For these reasons, the margin requirements for unhedged long exchange-traded options are not comparable to the margin requirements for security futures.

[95] OneChicago Letter at 31.

[96] OneChicago at 4–5; OneChicago Letter 2 at 5–6.

[97] OneChicago Letter at 7.

[98] OneChicago Letter at 34.

[99] *See* CFTC Rules 41.43(a)(32), 41.46(c)(1)(vi) and (c)(2)(iii), and 41.47(b)(1), and SEC Rules 401(a)(32), 404(c)(1)(vi) and (c)(2)(iii), and 405(b)(1).

[100] *See* CFTC Rule 41.43(a)(32) and SEC Rule 401(a)(32).

[101] *See* 2002 Adopting Release, 67 FR at 53157. *See also* FRB Letter (''The authority delegated by the Board is limited to customer margin requirements imposed by brokers, dealers, and members of national securities exchanges. It does not cover requirements imposed by clearing agencies on their members.'') and 2019 Proposing Release, 84 FR at 36435 at n.6 (describing variation settlement and maintenance margin).

[102] *See, e.g.,* SEC, *Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendments Thereto,* Exchange Act Release No. 22189 (June 28, 1985) at n.10 (''Maintenance margin in the securities industry and variation margin in the commodities industry are basically intended to serve the same purposes'').

[103] *See, e.g.,* OneChicago Letter at 1 and 14.

[104] *See* OneChicago Letter at 35.

[105] *Id.*

security future was comparable to an unhedged exchange-traded equity option held in a Portfolio Margin Account.[106] This belief was grounded on the Commissions' view—when adopting the margin requirements for security futures—that an unhedged short at-the-money exchange-traded equity option is comparable to a security future.[107]

OneChicago stated that security futures products are not comparable to exchange-traded equity options because the latter have different risk profiles than security futures, including dividend risk, pin risk, and early assignment risk.[108] Further, OneChicago stated that security futures are used for different purposes than exchange-traded equity options.[109] In this regard, OneChicago noted that security futures are delta one derivatives used in equity finance transactions and that they compete with other delta one transactions such as total return swaps, master security lending agreements, and master security repurchase agreements.[110] OneChicago commented that equity financing transactions can be used to provide customers with synthetic (long) exposure to a notional amount of a security, while the financing counterparty pre-hedges the position by accumulating an equivalent position in the underlying shares.[111]

OneChicago also provided statistical data and analysis to support its contention that security futures are not comparable to exchange-traded equity options.[112] In particular, OneChicago provided statistical data comparing trade size (number of contacts and notional value) between options and security futures and comparing security futures delivery rates with options exercise rates.[113] OneChicago stated that the delivery data makes ''clear'' that the ''markets view and use the products differently.'' [114] OneChicago also provided statistical data on correlations between open interest in security futures and equity options.[115] OneChicago stated that the data results show no correlation between changes in open interest in security futures and options.[116]

After considering these comments, the Commissions note that under Section 7(c)(2)(b)(iii)(I) of the Exchange Act, customer margin requirements for security futures must be consistent with the margin requirements for comparable exchange-traded options. The Commissions recognize that security futures may not be identical to exchange-traded equity options and that there are differences between the products in terms of their risk characteristics and how they are used by market participants. However, the Commissions continue to believe that the approach taken in this release, with respect to margin levels, is sound because these products generally share similar risk profiles for purposes of assessing margin insofar as both products provide exposure to an underlying equity security or narrow-based equity security index.[117] Thus, both products can be used to hedge a long or short position in the underlying equity security or narrow-based equity security index. Each product also can be used to speculate on a potential price movement of the underlying equity security or narrow-based equity security index. Consequently, a financial intermediary's potential exposure to a customer's unhedged security future or unhedged exchange-traded equity option position is based on the market risk (*i.e.,* price volatility) of the underlying equity security or narrow-based equity security index.

In addition, both short security futures positions and certain exchange-traded options strategies produce unlimited downside risk. Investors in security futures and writers of options may lose their margin deposits and premium payments and be required to pay additional funds. In addition, a very deep-in-the money call or put option on the same security (with a delta of one) is an option contract comparable to a security futures contract. Further, as discussed above, one commenter contends that synthetic futures strategies are an important segment of today's options markets, that could compete with security futures, if trading in security futures resumes.

The margin requirements for security futures and short unhedged exchange-traded equity options are designed to ensure that the customer can perform on the contractual obligations imposed by these products. For these reasons, security futures and short exchange-traded equity options can be appropriately considered to be comparable products for the purposes of setting appropriate margin levels for security futures consistent with the provisions of Section 7(c)(2)(B) of the Exchange Act.[118] OneChicago also argued that the Commissions should compare the customer margin requirements for security futures with the margin requirements for over-the-counter total return swaps, equity index futures, and security futures traded overseas.[119] In response, Section 7(c)(2)(B) of the Exchange Act provides that the margin requirements for security futures must be consistent with the margin requirements for comparable options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act. The statute does not directly contemplate comparisons with the margin requirements for the products and markets identified by OneChicago. Rather, it requires comparisons to comparable exchange-traded options.

In this context, an unhedged security future is comparable to an unhedged exchange-traded equity option held in a Portfolio Margin Account for the purposes of setting margin requirements under Section 7(c)(2)(B) of the Exchange Act.

As an alternative to implementing a risk model approach for all security futures, OneChicago suggested implementing it on a more limited basis for security futures combinations that result in STARS transactions.[120] A STARS transaction combines two security futures to form a spread position. The front leg of the spread expires on the date of the STARS

[106] *See* 2019 Proposing Release, 84 FR at 36435, 36438–40.

[107] *See* 2002 Adopting Release, 67 FR at 53157; 2001 Proposing Release 66 FR at 50725–26.

[108] OneChicago Letter at 2, 9; OneChicago Letter 2 at 1–2.

[109] OneChicago Letter at 2–3.

[110] Delta one derivatives are financial instruments with a delta that is close or equal to one. Delta measures the rate of change in a derivative relative to a unit of change in the underlying instrument. Delta one derivatives have no optionality, and therefore, as the price of the underlying instrument moves, the price of the derivative is expected to move at, or close to, the same rate. *See also* 2019 Proposing Release, 84 FR 36435, at n.14.

[111] OneChicago Letter at 2.

[112] The Commissions address the statistical data and analysis provided by OneChicago in more detail in section IV of this release. In addition to the statistical data and analysis discussed below, OneChicago provided statistical data and analysis on possible correlations between changes in price of the underlying security and changes in trading activity in security futures and equity options (*i.e.,* sensitivity to underlying price moves). OneChicago Letter 3 at 12–13. OneChicago stated that the results of this analysis were ambiguous. OneChicago Letter 3 Summary at 1.

[113] OneChicago Letter 3 at 9–11.

[114] OneChicago Letter 3 Summary at 1.

[115] OneChicago Letter 3 at 14–15.

[116] OneChicago Letter 3 Summary at 1.

[117] Derivatives may be broadly described as instruments or contracts whose value is based upon, or derived from, some other asset or metric. *See also Risk Disclosure Statement for Security Futures Contracts, available at https://www.nfa.futures.org/members/member-resources/files/security-futures-disclosure.pdf* and *Characteristics and Risks of Standardized Options, available at https://www.theocc.com/about/publications/character-risks.jsp.*

[118] *See* 2019 Proposing Release, 84 FR at 36436.

[119] OneChicago Letter at 11.

[120] OneChicago Letter at 19; *see also* Memorandum from the Division of Trading and Markets regarding a July 16, 2019, meeting with representatives of OneChicago (July 29, 2019).

transaction and the second (or back) leg expires at a distant date. OneChicago believed that a STARS transaction would be a substitute for an equity repo or stock loan transaction with the transfer of stock and cash accomplished through a security future transaction.[121] OneChicago suggested that it would be appropriate to margin STARS transactions at risk-based levels since they are exclusively used for equity finance transactions.[122] OneChicago also argued that risk-based margin treatment for a STARS transaction would be consistent with the Exchange Act and argued that there are no comparable options that trade as a spread on a segregated platform and no combinations of options can replicate the mechanics of a STARS transaction.[123]

The Commissions note that OneChicago has discontinued trading operations and is no longer offering STARS transactions. However, combining security futures into a STARS transaction does not change the fundamental nature of the security futures involved in the transaction—they remain security futures. In addition, as noted above, the front leg of the spread expires on the date of the STARS transaction, leaving only a single security future position in the customer's account until the expiration of the back leg at a later date. Consequently, for the reasons discussed above, it would not be consistent with Section 7(c)(2)(B) of the Exchange Act to implement a risk margin approach for security futures that are combined to create a STARS transaction.

To summarize, the Commissions are not persuaded by OneChicago's arguments that, at this time, implementing a risk model approach to calculating margin for security futures would be permitted under Section 7(c)(2)(B) of the Exchange Act. Moreover, implementing a risk model approach would substantially alter how the required minimum initial and maintenance margin levels for security futures are calculated. It also would be a significant deviation from how margin is calculated for listed equity options and other equity positions (*e.g.,* long and short securities positions). It would not be appropriate at this time to implement a different margining system for security futures, given their relation to products that trade in the U.S. equity markets. Implementing a different margining system for security futures may result in substantially lower margin levels for these products as compared with other equity products and could have unintended competitive impacts.[124] For these reasons, even if the Commissions were persuaded at this time that OneChicago's interpretation was permitted by the statute, the Commissions would not agree that it was the appropriate interpretation.

Consequently, the Commissions are adopting the amendments to reduce the required initial and maintenance margin levels for an unhedged security futures position from 20% to 15%, as proposed.[125]

The Commissions' margin requirements continue to permit SRAs and security futures intermediaries to establish higher margin levels and to take appropriate action to preserve their financial integrity.[126] OneChicago advocated for two modifications to this provision of the margin rules for security futures.[127] First, it suggested that only exchanges and clearinghouses that *list* and clear security futures products be given the authority to set higher margin levels, because they control the margin levels and thus the competitiveness of the competing venues.[128] In support of this suggestion, it identified an exchange that has prescribed 20% margin levels for security futures even though it does not list any security futures.[129] Relatedly, OneChicago recommended that the Commissions require that margin levels be set higher than the proposed 15% minimum level if justified by the risk of the security future and noted that while one SRA might set higher levels based on risk, another SRA may maintain the 15% levels.[130]

After considering these comments, the Commissions are not incorporating OneChicago's suggested modifications regarding establishing higher margin levels. The security futures margin rules establish minimum levels and do not set any limitations as to maximum levels. SRAs, including clearinghouses, and security futures intermediaries are permitted to raise margin requirements above 15% if justified by the risk of a security futures position. In addition, security futures intermediaries also are subject to rules that require them to raise margin requirements where appropriate to manage credit risk in customer accounts.[131] These rules provide SRAs and security futures intermediaries important flexibility to manage risk as they deem appropriate, including the ability to increase margin requirements for specific positions or customer accounts. Limiting the ability to increase margin requirements only to exchanges and clearinghouses that list and clear security futures would be inconsistent with this approach. For these reasons, it would not be appropriate to modify the provisions in the security futures margin requirements permitting SRAs and security futures intermediaries to set higher margin levels as suggested by OneChicago.

B. Conforming Revisions to the Strategy-Based Offset Table

1. The Commissions' Proposal

The Commissions' rules permit an SRA to set margin levels that are lower than 20% of the current market value of the security future in the case of an offsetting position involving security futures and related positions.[132] The SRA rules must meet the four criteria set forth in Section 7(c)(2)(B) of the Exchange Act and must be effective in accordance with Section 19(b)(2) of the

[121] OneChicago Letter at 19–20. OneChicago noted that the expiration of the front leg results in a transfer of securities for cash on the next business day following the trade date (T+1). When the back leg expires, OneChicago noted that a reversing transaction takes place that returns both parties to their original positions. OneChicago Letter at 19.

[122] OneChicago Letter at 19–20.

[123] OneChicago Letter at 36.

[124] *See* sections IV.A.6. (CFTC—Discussion of Alternatives) and IV.B.5. (SEC—Reasonable Alternatives Considered) (each discussing the use of risk-based margin models as an alternative to the final rule amendments in this release).

[125] The Commissions continue to believe that these amendments—because they relate to levels of margin—do not implicate the requirement in Section 7(c)(2)(B)(iv) of the Exchange Act that margin requirements for security futures (other than levels of margin), including the type, form, and use of collateral, must be consistent with the requirements of Regulation T. The Commissions did not receive any comments objecting to this view.

[126] *See* CFTC Rule 41.42(c)(1) and SEC Rule 400(c)(1). *See* 2019 Proposing Release, 84 FR at 36440.

[127] OneChicago Letter at 17.

[128] OneChicago Letter at 17.

[129] The NYSE has rules related to margin levels for security futures, but it does not list any security futures.

[130] OneChicago Letter at 17.

[131] *See e.g.,* FINRA Rule 4210(d) which requires FINRA members to establish procedures to: (1) Review limits and types of credit extended to all customers; (2) formulate their own margin requirements; and (3) review the need for instituting higher margin requirements, mark-to-markets and collateral deposits than are required by FINRA's margin rule for individual securities or customer accounts; *see also* FINRA Rule 4210(f)(8) (providing authority for FINRA, if market conditions warrant, to implement higher margin requirements). *See e.g.,* 17 CFR 1.11 (CFTC Rule 1.11) (requiring FCMs to establish risk management programs that address market, credit, liquidity, capital and other applicable risks, regardless of the type of margining offered). *See also* National Futures Association (''NFA'') Rule 2–26 *FCM and IB Regulations,* which states that any member or associate who violates CFTC Rule 1.11 (and other rules) shall be deemed to have violated an NFA requirement.

[132] *See* CFTC Rule 41.45(b)(2) and SEC Rule 403(b)(2). *See also* 2002 Adopting Release, 67 FR at 53158–61.

Exchange Act and, as applicable, Section 5c(c) of the CEA.[133] In connection with these provisions governing SRA rules, the Commissions published the Strategy-Based Offset Table.[134]

The Commissions stated the belief that the offsets identified in the Strategy-Based Offset Table were consistent with the strategy-based offsets permitted for comparable offsetting positions involving exchange-traded options.[135] The Commissions further stated the expectation that SRAs seeking to permit trading in security futures will submit to the Commissions proposed rules that impose levels of required margin for offsetting positions involving security futures in accordance with the minimum margin requirements identified in the Strategy-Based Offset Table. SRAs have adopted rules consistent with the Strategy-Based Offset Table.[136]

The Commissions proposed to re-publish the Strategy-Based Offset Table to conform it to the proposed 15% required margin levels.[137] The re-published Strategy-Based Offset Table would incorporate the 15% required margin levels for certain offsetting positions (as opposed to the current 20% levels) and would retain the same percentages for all other offsets.

2. Comments and the Re-Published Strategy-Based Offset Table

OneChicago recommended several changes to the Strategy-Based Offset Table, as proposed to be revised. First, OneChicago suggested reducing the margin requirement for ''delta-neutral'' positions from 5% to the lower of: (1) The total calculated by multiplying $0.375 for each position by the instrument's multiplier, not to exceed the market value in the case of long positions, or (2) 2% of the current market value of the security futures contract.[138] These recommended changes would not be appropriate. The 5% requirement was based on the minimum margin required by rules of securities SROs for offsetting long and short positions in the same security.[139] The 5% margin requirement for this strategy continues to exist in current securities SRO rules.[140] Accordingly, lowering the requirement as recommended by OneChicago would not be consistent with Section 7(c)(2)(B) of the Exchange Act.

OneChicago also requested that the Commissions incorporate total return equity swaps into the Strategy-Based Offset Table.[141] OneChicago stated that total return equity swaps are an exact substitute for security futures. OneChicago did not specify whether it was referring to cleared or non-cleared total return equity swaps. In either case, it would not be appropriate to include them in the Strategy-Based Offset Table. Securities SRO margin rules for options do not, at this time, recognize offsets involving these products. Therefore, adding them to the Strategy-Based Offset Table would not be consistent with Section 7(c)(2)(B) of the Exchange Act.

OneChicago further requested that offset positions margined at 10% should be lowered to 7.5% to mirror the magnitude of the reduction of minimum required margin levels from 20% to 15% for unhedged security futures.[142] This would make the margin requirements for offsets recognized in the Strategy-Based Offset Table lower than offsets for exchange-traded options currently permitted by securities SRO margin rules. Therefore, modifying the Strategy-Based Offset Table in this manner would not be consistent with Section 7(c)(2)(B) of the Exchange Act.

Finally, OneChicago suggested that the Commissions could simplify the Strategy-Based Offset Table by replacing it with an offset rule.[143] Under the suggested rule, offset positions would be margined at the greater of: (1) The total calculated by multiplying $0.375 for each position by the instrument's multiplier, not to exceed the market value in the case of long positions; or (2) 15% of the delta exposed portion of the portfolio. As discussed above, the Strategy-Based Offset Table is designed to permit offsets that are consistent with offsets recognized for comparable exchange-traded options under the securities SRO margin rules. For the reasons discussed above, the rule suggested by OneChicago would not be consistent with the permitted offsets for exchange-traded options and, consequently, would not be consistent with Section 7(c)(2)(B) of the Exchange Act.

For the foregoing reasons, the Commissions are re-publishing the Strategy-Based Offset Table with the proposed revisions.[144] The Commissions expect that SRAs will submit to the Commissions proposed rules that impose levels of required margin for offsetting positions involving security futures in accordance with the minimum margin levels identified in the Strategy-Based Offset Table.

Description of offset	Security underlying the security future	Initial margin requirement	Maintenance margin requirement
1. Long security future or short security future.	Individual stock or narrow-based securities index.	15% of the current market value of the security future.	15% of the current market value of the security future.
2. Long security future (or basket of security futures representing each component of a narrow-based securities index [1]) and long put option [2] on the same underlying security (or index).	Individual stock or narrow-based securities index.	15% of the current market value of the long security future, plus pay for the long put in full.	The lower of: (1) 10% of the aggregate exercise price [3] of the put plus the aggregate put out-of-the-money [4] amount, if any; or (2) 15% of the current market value of the long security future.
3. Short security future (or basket of security futures representing each component of a narrow-based securities index [1]) and short put option on the same underlying security (or index).	Individual stock or narrow-based securities index.	15% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any. Proceeds from the put sale may be applied.	15% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any.[5]

[133] Section 19(b)(2) of the Exchange Act governs SRA rulemaking with respect to SEC registrants, and Section 5c(c) of the CEA governs SRA rulemaking with respect to CFTC registrants.

[134] *See* 2002 Adopting Release, 67 FR at 53158–61.

[135] *Id.* at 53159.

[136] *See, e.g.,* FINRA Rule 4210(f)(10) and Cboe Rule 10.3(k).

[137] *See* 2019 Proposing Release, 84 FR at 36441–36443.

[138] OneChicago Letter at 15. This recommendation would apply to items 4, 10, 13, 17, 18, and 19 in the Strategy-Based Offset Table, as proposed to be revised. *See* 2019 Proposing Release, 84 FR at 36441–43.

[139] *See* 2002 Adopting Release, 67 FR at 53158, n.187.

[140] *See, e.g.,* FINRA Rule 4210(e)(1).

[141] OneChicago Letter at 16.

[142] OneChicago Letter at 16. The reduction in margin from 10% to 7.5% would apply to items 2, 8, 9, 11,12 14, 15 and 16 in the Strategy-Based Offset Table, as proposed to be revised.

[143] OneChicago Letter at 16–17.

[144] Item 1 of the revised Strategy-Based Offset Table lists the margin percentages for a long security future and a short security future. These percentages are the baseline, not offsets, but they are included in the table to preserve consistency with the earlier offset table.

Description of offset	Security underlying the security future	Initial margin requirement	Maintenance margin requirement
4. Long security future and short position in the same security (or securities basket [1]) underlying the security future.	Individual stock or narrow-based securities index.	The initial margin required under Regulation T for the short stock or stocks.	5% of the current market value as defined in Regulation T of the stock or stocks underlying the security future.
5. Long security future (or basket of security futures representing each component of a narrow-based securities index [1]) and short call option on the same underlying security (or index).	Individual stock or narrow-based securities index.	15% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any. Proceeds from the call sale may be applied.	15% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any.
6. Long a basket of narrow-based security futures that together tracks a broad based index [1] and short a broad-based security index call option contract on the same index.	Narrow-based securities index.	15% of the current market value of the long basket of narrow-based security futures, plus the aggregate call in-the-money amount, if any. Proceeds from the call sale may be applied.	15% of the current market value of the long basket of narrow-based security futures, plus the aggregate call in-the-money amount, if any.
7. Short a basket of narrow-based security futures that together tracks a broad-based security index [1] and short a broad-based security index put option contract on the same index.	Narrow-based securities index.	15% of the current market value of the short basket of narrow-based security futures, plus the aggregate put in-the-money amount, if any. Proceeds from the put sale may be applied.	15% of the current market value of the short basket of narrow-based security futures, plus the aggregate put in-the-money amount, if any.
8. Long a basket of narrow-based security futures that together tracks a broad-based security index [1] and long a broad-based security index put option contract on the same index.	Narrow-based securities index.	15% of the current market value of the long basket of narrow-based security futures, plus pay for the long put in full.	The lower of: (1) 10% of the aggregate exercise price of the put, plus the aggregate put out-of-the-money amount, if any; or (2) 15% of the current market value of the long basket of security futures.
9. Short a basket of narrow-based security futures that together tracks a broad-based security index [1] and long a broad-based security index call option contract on the same index.	Narrow-based securities index.	15% of the current market value of the short basket of narrow-based security futures, plus pay for the long call in full.	The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 15% of the current market value of the short basket of security futures.
10. Long security future and short security future on the same underlying security (or index).	Individual stock or narrow-based securities index.	The greater of: 5% of the current market value of the long security future; or (2) 5% of the current market value of the short security future.	The greater of: (1) 5% of the current market value of the long security future; or (2) 5% of the current market value of the short security future.
11. Long security future, long put option and short call option. The long security future, long put and short call must be on the same underlying security and the put and call must have the same exercise price. (Conversion).	Individual stock or narrow-based securities index.	15% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from the call sale may be applied.	10% of the aggregate exercise price, plus the aggregate call in the money amount, if any.
12. Long security future, long put option and short call option. The long security future, long put and short call must be on the same underlying security and the put exercise price must be below the call exercise price. (Collar).	Individual stock or narrow-based securities index.	15% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from the call sale may be applied.	The lower of: (1) 10% of the aggregate exercise price of the put plus the aggregate put out-of-the-money amount, if any; or (2) 15% of the aggregate exercise price of the call, plus the aggregate call in-the-money amount, if any.
13. Short security future and long position in the same security (or securities basket [1]) underlying the security future.	Individual stock or narrow-based securities index.	The initial margin required under Regulation T for the long stock or stocks.	5% of the current market value, as defined in Regulation T, of the long stock or stocks.
14. Short security future and long position in a security immediately convertible into the same security underlying the security future, without restriction, including the payment of money.	Individual stock or narrow-based securities index.	The initial margin required under Regulation T for the long security.	10% of the current market value, as defined in Regulation T, of the long security.
15. Short security future (or basket of security futures representing each component of a narrow-based securities index [1]) and long call option or warrant on the same underlying security (or index).	Individual stock or narrow-based securities index.	15% of the current market value of the short security future, plus pay for the call in full.	The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 15% of the current market value of the short security future.
16. Short security future, Short put option and long call option. The short security future, short put and long call must be on the same underlying security and the put and call must have the same exercise price. (Reverse Conversion).	Individual stock or narrow-based securities index.	15% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any, plus pay for the call in full. Proceeds from the put sale may be applied.	10% of the aggregate exercise price, plus the aggregate put in-the-money amount, if any.
17. Long (short) a basket of security futures, each based on a narrow-based securities index that together tracks the broad-based index [1] and short (long) a broad based-index future.	Narrow-based securities index.	5% of the current market value of the long (short) basket of security futures.	5% of the current market value of the long (short) basket of security futures.
18. Long (short) a basket of security futures that together tracks a narrow-based index [1] and short (long) a narrow based-index future.	Individual stock and narrow-based securities index.	The greater of: (1) 5% of the current market value of the long security future(s); or (2) 5% of the current market value of the short security future(s).	The greater of: (1) 5% of the current market value of the long security future(s); or (2) 5% of the current market value of the short security future(s).
19. Long (short) a security future and short (long) an identical security future traded on a different market [6].	Individual stock and narrow-based securities index.	The greater of: (1) 3% of the current market value of the long security future(s); or (2) 3% of the current market value of the short security future(s).	The greater of: (1) 3% of the current market value of the long security future(s); or (2) 3% of the current market value of the short security future(s).

[1] Baskets of securities or security futures contracts replicate the securities that compose the index, and in the same proportion.

[2] Generally, unless otherwise specified, stock index warrants are treated as if they were index options.

[3] ''Aggregate exercise price,'' with respect to an option or warrant based on an underlying security, means the exercise price of an option or warrant contract multiplied by the numbers of units of the underlying security covered by the option contract or warrant. ''Aggregate exercise price'' with respect to an index option means the exercise price multiplied by the index multiplier.

[4] ''Out-of-the-money'' amounts are determined as follows: (1) For stock call options and warrants, any excess of the aggregate exercise price of the option or warrant over the current market value of the equivalent number of shares of the underlying security; (2) for stock put options or warrants, any excess of the current market value of the equivalent number of shares of the underlying security over the aggregate exercise price of the option or warrant; (3) for stock index call options and warrants, any excess of the aggregate exercise price of the option or warrant over the product of the current index value and the applicable index multiplier; and (4) for stock index put options and warrants, any excess of the product of the current index value and the applicable index multiplier over the aggregate exercise price of the option or warrant.

[5] ''In-the-money'' amounts are determined as follows: (1) For stock call options and warrants, any excess of the current market value of the equivalent number of shares of the underlying security over the aggregate exercise price of the option or warrant; (2) for stock put options or warrants, any excess of the aggregate exercise price of the option or warrant over the current market value of the equivalent number of shares of the underlying security; (3) for stock index call options and warrants, any excess of the product of the current index value and the applicable index multiplier over the aggregate exercise price of the option or warrant; and (4) for stock index put options and warrants, any excess of the aggregate exercise price of the option or warrant over the product of the current index value and the applicable index multiplier.

[6] Two security futures are considered ''identical'' for this purpose if they are issued by the same clearing agency or cleared and guaranteed by the same derivatives clearing organization, have identical contract specifications, and would offset each other at the clearing level.

C. Other Matters

One commenter urged the Commissions to make clear, where appropriate, that margin rules of general applicability do not apply to security futures.[145] Specifically, this commenter requested clarification about the intersection of the security futures rules and CFTC general margin requirements under part 39 of the CFTC's regulations for DCOs.[146] The commenter cited to a CFTC rule proposal related to customer initial margin requirements as an example of a rule of general applicability that should be addressed by the Commissions. Earlier this year, the CFTC adopted changes to the DCO core principles, including 17 CFR 39.13(g)(8)(ii) (CFTC Rule 39.13(g)(8)(ii)) relating to customer initial margin requirements.[147] As the CFTC noted in the 2019 Proposing Release [148] and in the final rule adopting changes to DCO core provisions,[149] the CFTC's Division of Clearing and Risk issued an interpretative letter in September 2012 stating that the specific initial margin requirements under CFTC Rule 39.13(g)(8)(ii) do not apply to security futures positions.[150] CFTC Letter No. 12–08 is still in effect and may be relied upon by market participants. The CFTC believes that CFTC Letter No. 12–08 addresses the commenter's concerns, and the CFTC will not be revising the position taken by the CFTC's Division of Clearing and Risk in this rulemaking.

III. Paperwork Reduction Act

A. CFTC

The Paperwork Reduction Act of 1995 (''PRA'') [151] imposes certain requirements on Federal agencies (including the CFTC and the SEC) in connection with their conducting or sponsoring any collection of information as defined by the PRA. The final rule amendments do not require a new collection of information on the part of any entities subject to these rules. Accordingly, the requirements imposed by the PRA are not applicable to these rules.

B. SEC

The PRA [152] imposes certain requirements on Federal agencies (including the CFTC and the SEC) in connection with their conducting or sponsoring any collection of information as defined by the PRA. The final rule amendments do not contain a ''collection of information'' requirement within the meaning of the PRA. Accordingly, the PRA is not applicable.

IV. CFTC Consideration of Costs and Benefits and SEC Economic Analysis (Including Costs and Benefits) of the Proposed Amendments

A. CFTC

1. Introduction

These final rule amendments will permit customers in security futures to pay a lower minimum margin level for an unhedged security futures position. The final rules set required initial margin for each long or short position in a security future at 15% of the current market value. In connection with this change, the Strategy-Based Offset Table will be restated so that it is consistent with the reduction in the minimum initial margin.

Section 15(a) of the CEA requires the CFTC to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[153] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The CFTC considers the costs and benefits resulting from its discretionary determinations with respect to the Section 15(a) factors below. Where reasonably feasible, the CFTC has endeavored to estimate quantifiable costs and benefits. Where quantification is not feasible, the CFTC identifies and describes costs and benefits qualitatively.

The CFTC requested comments on all aspects of the costs and benefits associated with the proposed rule amendments. In particular, the CFTC requested that commenters provide data and any other information upon which the commenters relied to reach their conclusions regarding the CFTC's proposed considerations of costs and benefits.[154] The Commissions received comments that indirectly address the costs and benefits of the proposed amendments. Relevant portions of the comments are discussed in the analysis below.

The CFTC's consideration of costs and benefits includes a brief description of the economic baseline against which to compare the rule amendments, a summary of the amendments, and separate, detailed discussions of the costs and benefits of the amendments. Then, the CFTC examines alternatives offered by commenters. Finally, the CFTC considers each of the section 15(a) factors under the CEA.

2. Economic Baseline

The CFTC's economic baseline for this analysis is the twenty percent margin requirement on security futures positions that was adopted in 2002 and exists today in CFTC Rule 41.45(b)(1), along with the offsetting positions table under CFTC Rule 41.45(b)(2) (Strategy-Based Offset Table). In the 2002 Adopting Release, the Commissions finalized a set of security futures margin rules that complied with the statutory

[145] *See* FIA Letter at 2.

[146] *See* FIA Letter at 2; *see also* CFTC Letter No. 12–08 (Sept. 14, 2012); 2019 Proposing Release, 84 FR 36437, at n.40.

[147] *See Derivatives Clearing Organization General Provisions and Core Principles,* 85 FR 4800 (Jan. 27, 2020) (amending certain CFTC regulations applicable to registered DCOs).

[148] 2019 Proposing Release, 84 FR 36437, at n.40.

[149] *Derivatives Clearing Organization General Provisions and Core Principles,* 85 FR at 4812.

[150] CFTC Letter No. 12–08 (Sept. 14, 2012) at 10, *available at https://www.cftc.gov/csl/12-08/download.*

[151] 44 U.S.C. 3501 *et seq.*

[152] *Id.*

[153] 7 U.S.C. 19(a).

[154] The CFTC sought ''estimates and views regarding the specific costs and benefits for a security futures clearing organization, exchange, intermediary, or trader that may result from the adoption of the proposed rule amendment.'' 2019 Proposing Release, 84 FR at 36446–47.

requirements under Section 7(c)(2)(B) of the Exchange Act. The rules state that, ''the required margin for each long or short position in a security future shall be twenty (20) percent of the current market value of such security future.'' [155] The rules also allow SRAs to set margin levels lower than the 20% minimum requirement for customers with ''an offsetting position involving security futures and related positions.'' [156] In addition, the rules that were finalized under the 2002 Adopting Release permit certain customers to take advantage of exclusions to the minimum margin requirement for security futures.

The CFTC has considered the costs and benefits of the rule amendments as compared with the baseline of the current minimum initial and maintenance margin levels for unhedged security futures, which is 20% of the current market value of such security future. The CFTC notes that OneChicago, the only exchange listing security futures in the U.S., discontinued all trading operations on September 21, 2020. At this time, there are no security futures contracts listed for trading on U.S. exchanges. This release considers the costs and benefits that would occur if OneChicago were to resume operations or another exchange were to launch security futures contracts.

3. Summary of the Final Rules

The final rules lower the required initial and maintenance margin levels for an unhedged security futures position from 20% to 15% of the current market value of such a security futures position. In addition, the final rules make certain revisions to the Strategy-Based Offset Table in line with the revised margin requirement. These amendments to the security futures margin rules bring margin requirements for security futures held in futures accounts, or securities accounts that are not Portfolio Margin Accounts, into alignment with the required margin level for unhedged security futures held in Portfolio Margin Accounts. The final rules do not make any other changes to the security futures margin requirement regime.

4. Description of Costs

As a general matter, the CFTC believes that if security futures trading resumes, the final rules will reduce costs relative to existing CFTC Rule 41.45(b)(1) because the final rules decrease the level of margin required for an unhedged security futures position from 20% to 15%. The CFTC has determined that, because there is no security futures trading at this time, there may be new startup costs such as operational or technology costs associated with calculating security futures customer margin if a new exchange were to launch security futures trading. Such costs would be less significant for OneChicago, if it were to resume operations, given that the infrastructure for calculating such margin already exists and would not require major reprogramming or changes beyond costs that would be incurred to relaunch security futures contracts. One commenter noted that the final rules' ''margin requirements will be simpler to administer and risk manage for intermediaries that facilitate trading in the market, and better aligns with customer use of these products.'' [157] The Commissions received no other comments regarding this cost.

As set forth in the 2019 Proposing Release, the CFTC identified a number of risk-related costs that could result from the final rules and discusses each below.

i. Risk-Related Costs for Security Futures Intermediaries and Customers

One risk-related cost to consider, if security futures trading resumes, is the potential cost to security futures intermediaries and their customers that would result from a default of either an intermediary or a customer.[158] Reducing margin requirements for security futures could expose security futures intermediaries and their customers to losses in the event that margin collected is insufficient to protect against market moves. Pursuant to the OCC's bylaws, any security futures intermediary that is a clearing member of OCC grants a security interest to OCC for any account it establishes and maintains, and therefore a customer's assets may be obligated to OCC upon default.[159] As a result, security futures intermediaries that are FCMs could be exposed to a loss if the 15% margin rate for security futures is insufficient, to offset losses associated with a customer default. However, this risk is mitigated by the fact that if the FCM determines that a 15% margin level is insufficient to cover the inherent risk of the customer position, the FCM has the authority to collect additional margin from its customers, in excess of the minimum requirement, in order to protect its financial integrity.[160] Moreover, the FCM has an incentive to manage the risk of a customer's default and could collect additional margin to do that.

If security futures trading resumes, a similar risk-related cost might arise where an FCM collects only the minimum margin required from customers in order to maintain or expand its customer business, when it has determined or should have determined that additional margin is required to cover the inherent risk of the customer position. Lower margin requirements might facilitate an FCM permitting its customers to take on additional risk in their positions in order to increase business for the FCM. Such additional risks could put the FCM at risk if one of its customers defaulted on its payment obligations, and other customers of the FCM could face losses if the FCM or one of its fellow customers defaulted.

Another risk-related cost could stem from the possibility of increased leverage among security futures customers. Customers posting less initial margin to cover security futures positions might be able to increase their overall market exposure and thereby increase their leverage. Increased leverage in the security futures markets could increase risks to overall financial stability and result in costs to the broader financial markets insofar as security futures customers, security futures intermediaries, and DCOs participate in financial markets other than security futures.

As discussed in the proposal, the CFTC considered two final potential risk-related costs (incentives for FCMs to collect less margin and increased leverage at the customer level). The Commissions received no comments regarding these costs. The CFTC believes these theoretical costs are mitigated, to some degree, by regulations that apply to security futures intermediaries that are registered as FCMs. For example, FCMs are subject to capital requirements under CFTC regulations,[161] and in instances where

[155] CFTC Rule 41.45(b)(1), 17 CFR 41.45(b)(1). *See* CFTC Rule 41.43(a)(4), 17 CFR 41.43(a)(4) (defining the term ''current market value.'').

[156] CFTC Rule 41.45(b)(2), 17 CFR 41.45(b)(2).

[157] *See* FIA Letter at 2.

[158] In this context, an intermediary default describes a clearing member that experiences a default event under the terms of a clearinghouse's rules and procedures. Such default events generally include a failure to deliver funds in a timely manner (*e.g.,* failure to satisfy a margin call). *See* OCC Rule 1102(a)—Suspension, and OCC's Clearing Member Default Rules and Procedures, *available at https://ncuoccblobdev.blob.core.windows.net/media/theocc/media/risk-management/default-rules-and-procedures.pdf.*

[159] *See* OCC Bylaws, Article VI—Clearance of Confirmed Trades, Section 3—Maintenance of Accounts, Interpretations and Policies .07, adopted September 22, 2003, *available at https://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_bylaws.pdf.*

[160] *See* CFTC Rule 41.42(c)(1); SEC Rule 400(c)(1).

[161] *See* CFTC Rule 1.17, 17 CFR 1.17.

the security futures intermediary is jointly registered with the SEC as a broker-dealer FCM, the SEC's capital rules also apply.[162] In addition, FCMs are required to establish a system of risk management policies and procedures pursuant to CFTC Rule 1.11.[163] This risk management program is designed to incentivize the FCM to protect itself and its customers against a variety of risks, including the risk of inadequate margin coverage and increased leverage. The regulatory regime to which FCMs are subject is designed to require them to fully account for the potential future exposures of their customers' security futures positions in the form of initial and maintenance margin.

Finally, as explained in the 2019 Proposing Release, risk-related costs to the security futures intermediary have been further mitigated by the fact that the vast majority of OneChicago's open interest was held by eligible contract participants (''ECPs''), as defined in Section 1a(18) of the CEA.[164] OneChicago provided data to support this statement prior to the issuance of the 2019 Proposing Release. Generally speaking, ECPs are financial entities or individuals with significant financial resources or other qualifications that make them appropriate persons for certain investments.[165] The CFTC believes that because ECPs are well capitalized investors, they may be less likely to default and transmit risks throughout the financial system. According to the data provided by OneChicago, over 99% of the notional value of OneChicago's products was held by ECPs as of March 1, 2016, and March 1, 2017.[166] The Commissions received no comments regarding this data. However, the CFTC notes that an exchange that, in the future, launches security futures may decide to market such contracts to retail customers that are not ECPs.

ii. Appropriateness of Margin Requirements

If security futures trading resumes, a possible risk-related cost of lowering margin requirements for security futures is that a DCO may not have sufficient margin on deposit to cover the potential future exposure of cleared security futures positions. However, the risk management expertise at security futures intermediaries and DCOs, as well as the general applicability of CFTC Rule 39.13 to security futures,[167] supports the conclusion that DCOs and security futures intermediaries will continue to manage the risks of these products effectively even with lower minimum margin requirements.[168]

If security futures trading resumes, the risk security futures customers and/or intermediaries would face from reducing initial and maintenance margin would be addressed at the clearinghouse level because there are additional protections under CFTC regulations. For example, CFTC Rule 39.13(g)(2)(i) requires a DCO to establish initial margin requirements that are commensurate with the risks of each product and portfolio.[169] In addition, CFTC Rules 39.13(g)(2)(ii) and (iii) require that initial margin models meet set liquidation time horizons and have established confidence levels of at least 99%.[170] These DCO initial margin requirements are distinct from the margin requirements to which customers are subject pursuant to these final rules and, along with other risk-reducing measures, serve to mitigate the possibility that a DCO may default (possibly resulting in a systemic event). In the event that a DCO were to determine that a 15% margin level for security futures would be insufficient to satisfy a DCO's obligation under CFTC Rule 39.13, the DCO would be required to collect additional margin from its clearing members.[171]

The CFTC observes that customer margin requirements for security futures held by security futures intermediaries are materially distinct from initial margin requirements for DCOs. The initial margin requirements used by DCOs typically are risk-based, and CFTC rules are designed to permit DCOs to use risk-based margin models to determine the appropriate level of margin to be collected, subject to CFTC regulations in Part 39, as applicable.

In addition to the initial margin requirements at the DCO level, clearing members are required to satisfy certain financial resources requirements, including a ''capital'' requirement, to demonstrate that they can withstand certain risks under ''extreme but plausible market conditions.'' [172]

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[162] *See* SEC Rule 240.15c3–1, 17 CFR 240.15c3–1.

[163] Under CFTC Rule 1.11, FCMs are required to establish risk management programs that address market, credit, liquidity, capital and other applicable risks, regardless of the type of margining offered. *See also* NFA Rule 2–26 *FCM and IB Regulations,* which states that any member or associate who violates CFTC Rule 1.11 (and other rules) shall be deemed to have violated an NFA requirement.

[164] *See also* CFTC Rule 1.3, 17 CFR 1.3.

[165] For example, an individual can qualify as an ECP if the individual has amounts invested on a discretionary basis, the aggregate of which is in excess of: (i) $10,000,000; or (ii) $5,000,000 if the individual also enters into an agreement, contract, or transaction in order to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual.

[166] The CFTC sought comments on all aspects of its considerations of costs and benefits in the 2019 Proposing Release. In particular, the CFTC requested data and any other information and did not receive any comments questioning this data, or updated data from OneChicago. As a result, the CFTC continues to refer to the data provided by OneChicago relating to time periods in 2016 and 2017.

[167] As noted above and elsewhere, the general requirements of CFTC Rule 39.13 (17 CFR 39.13) are applicable to security futures intermediaries and DCOs with respect to security futures, however, the specific provision of CFTC Rule 39.13(g)(8)(ii) relating to customer initial margin requirements has been addressed separately by CFTC Letter No. 12–08 and that remains unchanged by this final rule.

[168] As discussed above, security futures intermediaries are authorized to collect margin above the amounts required by the Commissions. However, if security futures trading resumes, security futures intermediaries could be incentivized to lower their margin rates in order to compete for customer business as for-profit entities. If security futures intermediaries were to engage in competition for business based on margin pricing, it is possible that security futures intermediaries would collect only the required level of margin (*i.e.,* 15% under the final rule change), regardless of the market conditions, which could impair their ability to protect against market risk and losses.

[169] CFTC Rule 39.13(g)(2)(i) is not addressed in CFTC Letter No. 12–08.

[170] CFTC Rules 39.13(g)(2)(ii) and (iii) are not addressed in CFTC Letter No. 12–08. In accordance with these rules, OCC Rules 601(c) and 601(e) provide for initial margin for segregated futures customer accounts to be calculated pursuant to the Standard Portfolio Analysis of Risk (''SPAN'') on a gross basis, as well as calculating on a net basis initial margin requirements for each segregated futures accounts using STANS. OCC's scan ranges for the SPAN margin models provide coverage for a minimum 99% confidence level.

[171] The CFTC expects that any difference between the margin charged at the DCO and the margin charged by the security futures intermediary will be addressed by additional margin calls, if necessary. The DCO can require additional margin from its clearing members (which in some cases will be the security futures intermediary), to cover changes in market positions. DCOs and clearing members are familiar with margin call procedures and have established rules to efficiently transfer funds when needed. If a customer's account has insufficient funds to meet the margin call, its clearing member may provide the amount to the DCO and collect it from the customer at a later time. In this scenario, the clearing member may take on a liability or additional risk on the customer's behalf for a short period of time. The CFTC notes that this practice is the same for security futures as it is for other products subject to clearing and it does not view this temporary shifting of risk between the clearing member and the customer as a unique source of risk to security futures. Furthermore, this amendment lowering the required margin from 20% to 15% does not alter the relationship between DCOs and their clearing members, or the relationship between clearing members and their customers. The CFTC acknowledges that it is possible that DCOs and security futures intermediaries will collect different levels of margin, but it is not necessarily a result of the final rules. Moreover, the difference in margin collected is not an unmitigated source of risk for the security futures intermediaries because they have the authority to collect additional funds from their customers in the event of a margin call and can choose to set margin levels higher than the minimum level required by the Commissions.

[172] 17 CFR 39.12 (CFTC Rule 39.12(a)(2)) (defining the capital requirement for clearing

Continued

Furthermore, the DCO is required to maintain its own financial resources, which may include its own capital, guaranty fund deposits by clearing members, default insurance, assessments for additional guaranty fund contributions, and other financial resources, as permitted.[173] In combination, financial resource requirements for clearing members, initial margin contributions, guaranty fund contributions, and other resources provide additional protections at the DCO level against the risk that a default by a customer or security futures intermediary will create systemic risk.

In the event that a clearing member defaults on its obligations to the DCO, the DCO has a number of ways to manage associated risks, including transferring (or porting) the positions of the defaulted clearing member and using the defaulting clearing member's margin and other collateral on deposit to cover any losses. In order to cover the losses associated with a clearing member default, the DCO would typically draw from (in order): (1) The initial margin posted by the defaulting clearing member; (2) the guaranty fund contribution of the defaulting clearing member; (3) the DCO's own capital contribution; (4) the guaranty fund contribution of non-defaulting clearing members; and (5) an assessment on the non-defaulting clearing members. In the event that a DCO could not transfer the positions of the defaulted clearing member, it could liquidate those positions. Taken together, these mutualized risk mitigation capabilities are largely unique to clearinghouses, and help to ensure that they remain solvent when dealing with defaults of their members, their members' customers, and/or other periods of stressed market conditions.

As noted in the 2019 Proposing Release, the CFTC reviewed data from security futures markets under normal market conditions and concluded that a 15% level of margin would be sufficient to cover daily price moves in most instances (*i.e.,* more than 99.5%).[174] This is consistent with what the CFTC expects from risk-based margin regimes at DCOs. The Commissions received no comments regarding this data analysis. In addition, no commenters provided any quantitative data in support or refutation of the CFTC's risk analysis. Therefore, the CFTC continues to believe that the final rules will not have a substantial negative impact on (1) the protection of market participants or the public, (2) the financial integrity of security futures markets in the United States, if trading resumes, or (3) sound risk management practices of DCOs or security futures intermediaries.

iii. Potential Costs Related to Competition and Market Arbitrage

One commenter responded to the 2019 Proposing Release with concerns that a change in margin requirements for security futures would provide an advantage to security futures and create a competitive disadvantage for exchange-traded equity options.[175] This commenter explained that exchange-traded equity options are regularly used to establish synthetic long and short exposures that produce exposures that are nearly identical to exposure created by security futures.[176] According to this commenter, there exists the possibility that the lower margin requirements for security futures could result in customers shifting from trading in equity options to security futures, which in turn, could result in decreased liquidity and less price discovery in the equity options markets.

However, another commenter argued there may be reason to doubt that changes in trading behavior would be precipitated by the lower margin levels set forth in these final rules. OneChicago provided data to support its view that security futures (referred to as ''single stock futures'' in OneChicago Letter 3) and equity options did not trade interchangeably.[177] The five analyses that OneChicago conducted were valuable to the CFTC's consideration of costs and benefits.

In particular, OneChicago provided analysis comparing SPX (S&P 500) options to E-mini S&P 500 futures contracts.[178] This analysis indicates that the products do not trade interchangeably and that the ratios of SPX options open interest to E-mini futures open interest, and SPX options volume to E-mini futures volume are not correlated with the margin rate on the E-mini S&P 500 futures contracts.[179] The CFTC recognizes that there are many reasons why customers decide to trade in one product over another (including tax ramifications), and that security futures and equity options are not perfect substitutes. The CFTC acknowledges that if security futures trading resumes, lower margin requirements could increase trading in security futures above their historical volumes (and some of that activity could be from customers that previously traded equity options). However, a customer's choice of trading instrument is not determined solely by margin requirements.

Another reason to doubt the negative competitive impact of these final rules on exchange-traded equity options is that the 2008 adoption of Portfolio Margin Rules for exchange-traded equity options did not cause security futures customers to migrate their positions to those products, even though it arguably provided those options with a competitive advantage over security futures because of the lower minimum margin rate.[180] Moreover, the vast majority of security futures customers would have been eligible for lower margin requirements but did not move their positions from futures accounts to Portfolio Margin Accounts, which were margined under the Portfolio Margin Rules (*i.e.,* margin required was equal to 15% for an unhedged position). The CFTC believes that, if trading in security futures resumes, the final rules' amendments are unlikely to create a competitive disadvantage for exchange-traded equity options, as the 15% margin rate is already in effect for positions held in a Portfolio Margin Account.

OneChicago's closure after years of much lower trading activity than in exchange-traded equity options suggests that security futures in the U.S. may

members with cross-references to the CFTC's part 1 rules for FCMs and the SEC's rules for broker-dealers).

[173] *See generally* 17 CFR 39.11(a) through (e) (CFTC Rule 39.11(a) through (e)). *See also* 17 CFR 1.12 (CFTC Rule 1.12) (setting forth minimum financial requirements for FCMs and IBs).

[174] Conducting a value-at-risk analysis of 74 of the most liquid security futures contracts during a limited time-frame (November 2002–June 2010), CFTC staff found that there were 195 instances where a 15% margin was insufficient and 99 instances where a 20% margin was insufficient. For all observations, a 15% margin was sufficient for 99.81% of all observations while a 20% margin was sufficient for 99.91% of all observations. While the period covered by this study does include the high volatility exhibited in 2008, it does not include the comparably high volatility exhibited in early spring 2020.

[175] Cboe/MIAX Letter at 2.

[176] Cboe/MIAX Letter at 6.

[177] OneChicago Letter 3 at 2.

[178] The CFTC notes that the E-mini futures contracts are not security futures, but are futures regulated solely by the CFTC (*i.e.,* they are not jointly regulated by the CFTC and SEC). The comparison between E-mini futures contracts and SPX options is still helpful to understand the interplay between the futures and equity options markets.

[179] According to OneChicago's analysis, there is a statistically significant negative correlation between SPX options and E-mini futures. OneChicago Letter 3 at 6.

[180] A competitive advantage for options may have existed because options are held in a securities account by default. In contrast, most security futures positions were held in futures accounts, and in order for a trader to take advantage of the lower margin rate for a security futures position, such a trader would have to move those positions into a different type of account (*i.e.,* from a futures account to a securities account) with associated costs.

have been operating at a competitive disadvantage to related markets. However, based on publicly available Eurex volume data,[181] security futures trading on U.S. stocks in other jurisdictions is lower than trading in security futures on European companies, even on the Eurex exchange in Germany where margin requirements are calculated using risk-based methodologies.[182] Therefore, factors other than margin requirements may be influencing demand for security futures (*e.g.,* tax ramifications or availability of competing products). Nonetheless, the CFTC expects that lowering the security futures margin requirement to 15% from 20% will help mitigate this competitive disadvantage and could encourage a resumption of security futures trading in the U.S.

iv. Costs and Benefits Associated With Requested Changes to the Margin Offsets Table

The Commissions are updating and restating the table of offsets for security futures to reflect the new (15%) minimum margin requirement. The CFTC believes that if security futures trading resumes, lowering the margin requirements for certain offsets will not increase costs to customers, security futures intermediaries, or DCOs. The categories of permissible offsets will remain the same and there is no change to the inputs used to calculate the offset, other than to decrease the initial and maintenance margin on all security futures from 20% to 15%. Moreover, the same risk to the customers and security futures intermediaries will exist if the Commissions decrease the margin required for security futures trading combinations eligible for offsets as it will with security futures without an offset.

As discussed above, OneChicago suggested that the Commissions make a number of changes to the Strategy-Based Offset Table.[183] OneChicago asked that the Offset Table be amended to account for customers holding delta-neutral positions (*e.g.,* a customer holds an equal and opposite position in stock and/or a security future).[184] Although the CFTC agrees that it would make sense to account for a neutral position when setting margin levels, the CFTC believes the revised margin offset table included in this release balances the efficiencies of offsetting positions against the outstanding risks associated with these financial products in light of the fact that equity markets and security futures markets are subject to separate regulatory oversight. In addition, as explained above, the Commissions determined that lowering the offset table requirements further is inconsistent with current securities SRO rules, and thus would be inconsistent with the Exchange Act. For this reason, the Commissions are not adopting OneChicago's requested amendments to the Strategy-Based Offset Table.

OneChicago also asked that the Commissions add total return equity swaps to the Strategy-Based Offset Table.[185] Total return equity swaps serve a similar, if not identical, economic function to security futures contracts as commonly used at OneChicago. Providing an offset for swaps could incentivize customers to trade in either product, or this combination of products, and could result in increased liquidity. Adding a new product to the offset table would provide a benefit to customers trading in total return equity swaps and security futures because those customers would be subject to lower margin requirements. However, as stated above, the Commissions have determined that adding a total return swap offset to the Strategy-Based Offset Table would be inconsistent with securities SRO rules at this time and thus would be inconsistent with the Exchange Act. For this reason, the Commissions are not adopting this suggested change to the Strategy-Based Offset Table.

In addition, OneChicago recommended that the Commissions reduce the maintenance margin required for certain types of positions from 10% to 7.5%.[186] A lower margin requirement under the offset table would provide an individual customer with an offsetting position a small benefit. However, as stated above, the Commissions have determined that lowering the margin requirement for certain strategies from 10% to 7.5% in the Strategy-Based Offset Table would be inconsistent with securities SRO rules at this time and thus would be inconsistent with the Exchange Act. For this reason, the Commissions are not adopting this suggested change to the Strategy-Based Offset Table.

Finally, OneChicago requested that the Commissions simplify the Strategy-Based Offsets Table overall by replacing the table with a rule. The CFTC has not identified specific benefits associated with adopting a rule rather than updating the Strategy-Based Offsets Table. However, the CFTC believes that any structural change to the offset table that is adopted for the security futures regime but not for the equity options regime could introduce uncertainty and confusion in the markets, and could inhibit customers seeking the reduced margin benefits of offsetting positions. OneChicago stated that the rule change it identified would not result in margin levels that are lower than margin levels required under the Strategy-Based Offset Table for exchange-traded equity options under Portfolio Margin Rules. As stated above, the Commissions have determined that replacing the Strategy-Based Offsets Table with a rule would be inconsistent with the securities SRO rules at this time and thus would be inconsistent with the Exchange Act. For this reason, the Commissions are not adopting this suggested change to the Strategy-Based Offset Table.

Although the Commissions are not revising the Strategy-Based Offset Table as requested by OneChicago, the CFTC believes the offsets described in this release will, if security futures trading resumes, offer certain benefits and will not increase costs by materially decreasing protections or increasing risks. Again, as added assurance that there are multiple levels of risk protection for security futures, the CFTC notes that security futures intermediaries and customers will continue to be required to comply with daily mark-to-market and variation

[181] *See* Eurex statistics published daily, *available at https://www.eurexchange.com/exchange-en/data/statistics.*

[182] Trading by U.S. persons in security futures contracts listed on Eurex is subject to certain conditions under an SEC order and a CFTC staff advisory. Provided that a number of conditions are met, only qualified U.S. persons are permitted to trade security futures on a single security issued by a foreign private issuer or a narrow-based security index that is listed on a non-U.S. exchange that is not required to register with the SEC. *See* SEC's *Order under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption from Exchange Act Section 6(h)(1) for Certain Persons Effecting Transactions in Foreign Security Futures and under Exchange Act Section 15(a)(2) and Section 36 Granting Exemptions from Exchange Act Section 15(a)(1) and Certain Other Requirements,* Exchange Act Release No. 60194 (June 30, 2009), 74 FR 32200 (Jul. 7, 2009), and Division of Clearing and Intermediary Oversight Advisory Concerning the Offer and Sale of Foreign Security Futures Products to Customers Located in the United States, *available at https://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/ssproject/fsfpadvisory.pdf* (June 8, 2010).

[183] OneChicago Letter at 15–17.

[184] According to OneChicago's suggestion, margin for delta-neutral positions should be equal to the lower of: (1) The total calculated by multiplying $0.375 for each position by the instrument's multiplier, not to exceed the market value in the case of long positions, or (2) 2% of the current market value of the security futures contract. OneChicago Letter at 15.

[185] OneChicago Letter at 16.

[186] OneChicago Letter at 16. As suggested by OneChicago, the reduction in margin from 10% to 7.5% would apply to items 2, 8, 9, 11, 12, 14, 15, and 16 in the Strategy-Based Offset Table.

settlement procedures applied to security futures, as well as the large trader reporting regime that applies to futures accounts.[187]

5. Description of Benefits Provided by the Final Rules

The CFTC believes that the final rules will, if security futures trading resumes, produce significant benefits by reducing minimum margin requirements for security futures positions to levels equal to margin levels for exchange-traded options. The amendment to CFTC Rule 41.45(b)(1) will align customer margin requirements for security futures held in a futures or a securities account with those that are held in a Portfolio Margin Account. The CFTC believes this alignment may increase competition by establishing a level playing field between security futures carried in a Portfolio Margin Account and security futures carried in a futures account or a securities account that is not subject to Portfolio Margin Rules should OneChicago begin offering these products again or new market entrants emerge.

This benefit is expected to apply most directly to customers with security futures positions held in futures accounts because they cannot be margined under Portfolio Margin Rules. According to OneChicago, because of operational issues, almost all security futures positions were carried in futures accounts.[188] As a result, almost all, if not all, security futures were held in futures accounts and subject to the CFTC's customer account requirements. Therefore, any reduction in customer initial and maintenance margin requirements, if security futures trading resumes, would be expected to benefit all or close to all security futures customers because they historically held positions in futures accounts and did not benefit from Portfolio Margin Rules.

Additionally, the reduced minimum margin level could, if security futures trading resumes, facilitate more trading in security futures than would otherwise occur, which could enhance the likelihood a revival would succeed and increase market liquidity to the benefit of market participants and the public.[189] Increased liquidity could contribute to the financial integrity of security futures markets overall. For example, market liquidity may be particularly beneficial in the context of a customer default at an FCM, when the FCM must manage the defaulting customer's security futures positions through transferring or liquidating those positions.[190]

The lower minimum margin requirement also could, if security futures trading resumes, decrease the direct cost of trading in security futures. In response to the Commissions' request for comments providing data, OneChicago estimated that for the time period between September 1, 2018, and August 1, 2019, the notional value of margin collected on OneChicago positions would be reduced by $130 million if the lower 15% margin requirement had been in place.[191] This would have represented significant savings in the amount of margin required to be paid by and collected from customers in satisfaction of the CFTC's part 41 margin requirements. A decrease in trading costs, through lower minimum margin requirements should OneChicago begin offering these products again or new market entrants emerge, also may increase capital efficiency because additional funds would be available for other uses.

As noted above, the final rules may have beneficial competitive effects vis-à-vis domestic markets. In addition, lowering the minimum margin requirement may enable a U.S. security futures exchange to better compete in the global marketplace, where security futures traded on foreign exchanges are subject to risk-based margin model requirements that are generally lower than those applied to security futures traded in the U.S.[192] Apart from OneChicago's letters and a comment from one of its customers, the Commissions received no comments regarding benefits associated with increased domestic or global competition.

The final rules restate the table of offsets for security futures to reflect the proposed 15% minimum margin requirement. As discussed in detail above, these offsets will, if security futures trading resumes, provide the benefits of capital efficiency to customers because offsets recognize the unique features of certain specified combined strategies and would permit margin requirements that better reflect the risk of these strategies. Moreover, the same benefits of lowering margin costs for customers and increasing business in security futures could result from lowering margin requirements for offsetting security futures positions.

6. Discussion of Alternatives

Although the CFTC did not identify any alternatives in the proposal,[193] commenters suggested a number of alternative security futures margin options, along with other suggestions for the Commissions to consider. This discussion of those alternatives includes certain commenter proposals that the Commissions still do not believe are viable at this time for the reasons discussed by the Commissions in more detail above.

i. Reducing Contract Sizes for Security Futures

One commenter, citing a statement by SEC Commissioner Jackson, indicated that the Commissions failed to consider reasonable alternatives such as reducing the contract size for security futures.[194] According to Commissioner Jackson's Statement, ''reducing contract size could also increase access to single-stock futures for the most popular securities and improve efficiency.'' [195] The CFTC agrees that changing the contract size for security futures might make the products more attractive to a wider group of market participants, resulting in increased liquidity,[196] but

[187] Under the CFTC's large trader reporting regime, clearing members and FCMs (as well as foreign brokers) file reports with the CFTC containing futures and options position information for traders that have positions at or above certain reporting thresholds. *See* part 17 of the CFTC's regulations and 17 CFR 15.03(b) (CFTC Rule 15.03(b)).

[188] *See* OneChicago Petition at 2.

[189] OneChicago represented that one of its customers (Jurrie Reinders, Societe General) believed that the ''uncompetitive'' margin requirements for security futures have reduced trading volumes. OneChicago Letter at 29.

[190] As noted above, the FIA Letter stated that the final rules would help FCMs manage their risk. *See* FIA Letter, at 2. *See also* discussion of CFTC rules under parts 1 and 39, above.

[191] OneChicago estimated that between September 1, 2018, and August 1, 2019, the notional value of margin collected on OneChicago positions was approximately $540 million (under a 20% minimum margin requirement) compared to $410 million that would have been collected under the final rules (under a 15% minimum margin requirement). OneChicago Letter at 14.

[192] OneChicago stated that the Eurex exchange lists futures on U.S. stocks with risk-based margins that are lower than the 20% margin for futures on the same stocks that were listed at OneChicago (OneChicago Letter at 13). However, based on publicly available data, the volume on Eurex for futures on U.S. stocks is much lower than occurred at OneChicago even as security futures volume is high for stocks in European companies.

[193] *See* 2019 Proposing Release, 84 FR at 36446. In the proposal, the CFTC stated that it did not believe that there were any reasonable alternatives to consider given statutory constraints tied to current practices in the exchange-traded equity options market. *Id.* at n. 92.

[194] Letter from the Jeffrey Mahoney, General Counsel, Council of Institutional Investors (Aug. 26, 2019) (''CII Letter'') at 4. *See also* Commissioner Robert J. Jackson Jr., Public Statement, Statement on Margin for Security Futures (July 3, 2019), *available at https://www.sec.gov/news/public-statement/jackson-statement-margin-security-futures* (''Commissioner Jackson's Statement'').

[195] Commissioner Jackson's Statement.

[196] A security futures exchange could change the contract size for security futures by amending terms of the security futures contract such that one security futures contract represents only 50 shares of the underlying stock instead of 100.

would not change the overall amount of margin required for a given position. Thus, the CFTC believes that this alternative would be less effective at increasing liquidity than lowering margin requirements. Reducing the security futures contract size would lower the initial capital expenditure for a customer and could attract wider participation, but could possibly increase transaction costs, as a percentage of overall initial costs in putting on the position.[197] As explained above, the Commissions anticipate that these final rules may produce greater liquidity in security futures, as well as create more efficient capital distribution. Market participants will be able to reallocate funds that are saved on lower margin levels. Under this alternative, market participants would not benefit from any increased capital efficiencies. Because reducing contract sizes does not provide the same capital efficiency opportunities to customers, the CFTC does not believe it offers as many benefits as the final rules.

ii. Rules-Based Margin With Flexible Margin Collection Intervals

One commenter agreed with Commissioner Jackson's concern that the proposal did not consider other reasonable alternatives such as a rules-based margin regime that includes flexible margin collection, or settlement intervals, which is an idea proposed by former SEC economists.[198] According to the economists' research paper on this topic, security futures that are subject to strategy-based margining may be less sensitive to changes in market conditions.[199] The economists analyzed different margin collection time periods to determine whether risks to customers would be affected by the length of time that passed between contract execution and settlement. The economists found that a 1-day margin collection period (*i.e.,* initial and maintenance margins are required to be collected within 1 day of the trade) likely would lead to higher margin requirements than would otherwise be required under a risk-based margin regime. As a comparison, they also studied a 4-day collection period (*i.e.,* initial and maintenance margins are required to be collected within 4 days of the trade) and found that the additional time could lead to both significant over- and under-margining relative to a risk-based margin model regime.

This research explores how changes in the date on which margin is collected could provide different levels of protection for customer positions in security futures.[200] The paper suggests that such a rule change could produce adequate margin coverage, if calibrated correctly, to protect against default. On the other hand, one commenter opposed the alternative of changing the margin collection period, arguing that this could ''build up exposures'' and would remove one of the critical futures market protections (*e.g.,* paying and collecting margin to prevent customers from accumulating large exposures).[201]

The CFTC has not analyzed a particular program offered by an exchange or security futures intermediary, nor examined any rulebooks outlining how such a program would be implemented. However, if such a change were submitted for review, the CFTC would consider, among other things, how a change in the date of margin collection would affect how FCMs manage margin funds. CFTC rules govern FCM practices and require that FCMs take certain precautions with customer funds.[202] In some cases, customers may benefit from a more prompt payment of margin funds to FCMs because those funds will be subject to certain protections, and FCMs would encourage prompt payment of margin funds to protect against customer position risk. The CFTC also observes that changes to the collection period would depend on changes in contractual provisions between clearinghouses and their clearing members, and between the clearing members and their customers, as well as rule changes for exchange operating procedures.

The Commissions are adopting the final rules because they produce a desired policy outcome of aligning the minimum margin requirements for security futures held in non-Portfolio Margin Accounts with the margin required for security futures in a Portfolio Margin Account, for the reasons discussed above. The CFTC believes that any changes to the date of margin collection period are distinct from this policy objective, may not be uniformly adopted by security futures markets, and may result in an accumulation of risk for customers and security futures intermediaries. Accordingly, changing the margin collection period is not a viable alternative to the final rules adopted in this release.

iii. Use of Risk-Based Margin Models

In the 2019 Proposing Release, the Commissions specifically requested comment on ''any other risk-based margin methodologies that could be used to prescribe margin requirements for security futures.'' In response, a number of commenters expressed a preference for using risk-based models to margin security futures and argued that such a regime would be consistent with the Exchange Act.[203] As discussed in section II.A. above, implementing a risk model approach to calculate margin for security futures would be inconsistent with how margin is calculated for exchange-traded equity options at this time and may result in margin levels for unhedged security futures positions that are lower than the lowest level of margin applicable to unhedged exchange-traded equity options (*i.e.,* 15%). Consequently, because no exchange-traded equity options are subject to risk-based margin requirements, adopting a risk model approach at this time for security futures would conflict with the requirements of Section 7(c)(2)(B) of the Exchange Act.[204]

The CFTC is considering a risk-based model alternative solely for purposes of analyzing the potential costs and benefits of the final rules under a hypothetical future scenario. The CFTC has extensive familiarity and experience with overseeing entities that use risk-based margin model regimes for derivatives clearing.[205] Risk-based margin models produce efficiencies because the initial margin is calculated using certain macro-economic risk factor inputs that change with market

[197] The increase in transaction costs would be the result of the fixed cost staying the same, but the initial expenditure being lower.

[198] *See* Commissioner Jackson's Statement; *see also* CII Letter at 4.

[199] Hans R. Dutt & Ira L. Wein, *On the Adequacy of Single-Stock Futures Margining Requirements,* 10 J. FUTURES MARKETS 989 (2003).

[200] The CFTC notes that this research paper was published in 2003, before significant changes to the CFTC's regulatory regime were adopted pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is uncertain whether the alternatives considered and discussed in the research paper would comply with current CFTC requirements. Additionally, there are no programs offering this alternative, and whether such a program could comply with the statutory constraints under the Exchange Act is uncertain.

[201] OneChicago Letter at 6.

[202] *See* 17 CFR 1.20 through 1.30 (CFTC Rules 1.20 through 1.30).

[203] *See* La Botz Letter (''I request the Commission to please correct the margin discrepancy placed upon the [security futures] products by going to a risk based margining as utilized by clearinghouses on other [security futures] products worldwide.''). *See also* Ianni Letter, and OneChicago Letter.

[204] *See* section II.A. above (discussing a risk model approach and Section 7(c)(2)(B) of the Exchange Act).

[205] As a market regulator with jurisdiction over derivatives clearinghouses, one of the CFTC's primary functions is to supervise the derivatives clearing activities of DCOs, their clearing members, and any entities using the DCOs' services. The CFTC supervisory program takes a risk-based approach.

conditions. DCOs successfully manage the initial margin requirements for clearing members using risk-based margin models. Risk-based margin model regimes also provide effective protection against default for customers, intermediaries, and clearinghouses. While the CFTC is broadly supportive of risk-based margin models and believes there are benefits to those regimes, in the context of security futures, the costs and benefits require careful attention.

As seen in some of the data provided by OneChicago, risk-based margin does not necessarily mean that the margin collected will be lower than under current margin requirements for security futures or the amended final rules under part 41 of the CFTC's regulations. In fact, there may be reason to believe that it could be higher. OneChicago provided an example from the 2008–2010 financial crisis. During that time period, margin requirements on SPX options remained constant at 8% (the maximum initial margin), if held in a Portfolio Margin Account.[206] However, during that same time period, E-mini futures contracts were charged margin at levels higher than 8% because they were subject to risk-based margin and the volatility at the time required greater margin levels.[207] In this instance, the margin required under a risk-based model would be higher than the maximum initial margin that is set at a constant percentage rate. The CFTC observes that this comparison is informative, but not dispositive.

Importantly, because the security futures margin regime includes a minimum margin requirement only, it is less likely that there would be an instance in which a risk-based model results in greater margin levels than the margin charged to a customer under the final rules. As the Commissions have emphasized throughout this release, FCMs and DCOs may, if security futures trading resumes, charge additional margin above the 15% minimum level required, if it would be prudent to protect against increased risk. In practice, this means that in a period of market volatility a risk-based model may require higher margin levels to account for that volatility, but an FCM and/or DCO likely would require higher margin during such periods of market volatility under the current rules. Even under the initial and maintenance margin requirements today, FCMs and DCOs provide a backstop for margin purposes by being required to collect higher margins if market conditions or other circumstances change.[208] Use of a risk-based margin model would sometimes result in higher margins than the 15% minimum margin level adopted in this release, but it would not necessarily change the margin amount posted by a customer.

The CFTC recognizes there may be savings that can accrue under risk-based margin models for purposes of initial and maintenance margin, but notes that variation margining practices will not change for security futures.[209] Taken together, the overall margin regime for security futures under a risk-based margin model regime ultimately may at various times be equal to, greater than, or less than, the margin requirements set forth under the final rules.

However, as discussed in section II.A. above, the CFTC is not persuaded by commenters' arguments that, at this time, implementing a risk model approach to calculating margin for security futures would be permitted under Section 7(c)(2)(B) of the Exchange Act. Moreover, implementing a risk model approach would substantially alter how the required minimum initial and maintenance margin levels for security futures are calculated. It also would be a significant deviation from how margin is calculated for listed equity options and other equity positions (*e.g.,* long and short securities positions). It would not be appropriate at this time to implement a different margining system for security futures, given their relation to products that trade in the U.S. equity markets. Further, implementing a different margining system for security futures may result in substantially lower margin levels for these products as compared with other equity products and could have unintended competitive impacts. For this reason, the suggested alternative to permit risk-based margin models to determine customer margin requirements for security futures is not viable.

iv. Risk-Based Margin for STARS Transactions

Recognizing that the Commissions may not be able to adopt risk-based margin for all security futures, OneChicago asked the Commissions to consider the alternative of adopting risk-based margin for its STARS transactions only. The CFTC notes that OneChicago has shut down and is no longer offering STARS transactions. For purposes of this discussion of suggested alternatives, the CFTC will examine whether subjecting STARS transactions or similar products that may be offered in the future to risk-based margin requirements would provide additional costs or benefits when compared to the final rules.

STARS transactions represented a combination of two security futures contracts that formed a spread position. After combining the two legs of the spread in the customer's account, one leg expired, and a single security future position remained in the account. A STARS transaction resulted in a hedged transaction that involved two customers transferring either a stock position or a security futures position, and once the back leg of the transaction expired the parties returned to their original positions. According to OneChicago, there would be cost savings to structuring the transaction this way for purposes of facilitating equity repo or stock loan transactions.

As stated above, the Commissions have determined that because no exchange-traded equity options are subject to risk-based margin requirements, adopting a risk model approach at this time for STARS transactions would conflict with the requirements of Section 7(c)(2)(B) of the Exchange Act.[210] For this reason, as well as the recent announcements by OneChicago, this alternative is not viable.

7. Consideration of Section 15(a) Factors

This section analyzes the expected results of amending CFTC Rule 41.45(b)(1) to reduce the minimum initial and maintenance margin levels for each security future from 20% to 15% of the current market value of such contract, and adopting the Margin Offset Table changes as proposed, in light of

[206] OneChicago Letter 3 at 3.

[207] As noted above, E-mini futures contracts are not jointly regulated by the CFTC and SEC because they are broad-based equity index futures and do not fall under the definition of ''security futures'' under the CEA. However, for purposes of examining the relationship between futures contracts and options, the comparison may be relevant.

[208] For example, OneChicago provided a sample dataset that compares the margin level required under the current security futures margin rule (20%), the new rule (15%), and under a risk-based margin approach used by OCC. Out of the 20 security futures, 17 security futures would be subject to lower margin requirements under risk-based margining. One contract would be subject to a 17.7% margin requirement under the new rule and the risk-based model, because that contract is exposed to higher market risks. One contract would continue to be margined at a 20% level, even under the new rule and risk-based margining. Finally, one contract would continue to be margined at a 23% level regardless of the approach taken to determine margin requirements. Thus, the idea that risk-based margining would produce lower margin levels for all contracts at all times is incorrect. OneChicago Letter at 27.

[209] In the context of security futures, FCMs are required to continue daily mark-to-market valuations and exchange of variation margin.

[210] *See* section II.A. above (discussing a risk model approach and Section 7(c)(2)(B) of the Exchange Act).

the five factors under Section 15(a) of the CEA.

i. Protection of Market Participants and the Public

The CFTC believes that the final rules maintain the protection of market participants and the public from the risks of a default in the security futures market, if trading in that market resumes. The CFTC continues to believe that a 15% minimum initial and maintenance margin requirement in combination with other protections, such as certain provisions of CFTC Rule 39.13, applicable to DCOs that offer to clear security futures products,[211] will protect U.S. market participants, including security futures customers and security futures intermediaries, from the risk of a default in security futures markets.

In addition, security futures intermediaries, such as FCMs, are authorized to collect additional margin from their customers if the FCM believes a customer's positions may pose unmanaged risk.[212] In addition, any DCOs offering to clear security futures are required to maintain certain risk management procedures, which include measures to prevent potential losses from clearing member defaults and methods to limit risks to the DCO's financial resources.[213] The objective is that DCOs will always have sufficient financial resources to manage the risks presented by security futures.

One commenter expressed a concern that, based on the statutory criteria prescribed in the Exchange Act for determining security futures' margin requirements, lowering margin requirements for security futures could result in ''potential significant risks to the capital markets and investors.'' [214] Further, this commenter cited to the Commissions' discussions in the 2019 Proposing Release regarding margin's role in risk mitigation and the potential costs associated with reducing margin levels. As stated above, the CFTC continues to believe that the reduction in margin requirements under the final rules will not decrease the protection to market participants or the public because, although margin requirements are a critical component of any risk management program for cleared financial products, they are not the only risk management technique in place for DCOs or their clearing members.

ii. Efficiency, Competitiveness, and Financial Integrity of the Markets

The final rules are intended to enhance the efficiency and competitiveness of the security futures market in the United States by bringing the initial and maintenance margin requirements for security futures in line with requirements for security futures subject to Portfolio Margin Rules. Market participants trading in security futures will benefit from lower margin requirements. Furthermore, a decrease in initial and maintenance margin requirements from 20% to 15% of the current market value of each security futures contract may increase the attractiveness of security futures and help facilitate the revival of the security futures markets, whether at OneChicago, or at another exchange. However, even with lower margin requirements, customer decisions to trade in security futures would still be influenced by hedging demands and competition with substitutes or similar products.

The final rules also are expected to improve the competitiveness of security futures as compared to exchange-traded options. The final rules' amendments to reduce margin requirements also may facilitate a more competitive security futures market in the United States as compared with international markets.[215] Overall, the CFTC believes that the final rules will have a positive effect on competition in the U.S. security futures market without providing an undue competitive advantage to security futures over comparable exchange-traded equity options.[216]

The CFTC continues to believe that a 15% margin requirement for security futures will, if security futures trading resumes, be sufficient to protect customers and DCOs against the risk of default in greater than 99% of cases. According to economic data reviewed by CFTC staff, the CFTC believes that a 15% margin requirement for security futures will protect other customers and DCOs against most risks of default.

Furthermore, the final rules could enhance the financial integrity of any potential security futures market in the United States. Lowering the amount of initial and maintenance margin required for customers trading in security futures may facilitate the revival of security futures markets, and if that revival occurs, increase the number of customers trading in security futures and/or increase the amount of trading. An increase in the number of customers in the security futures market also could increase the number of FCMs offering to clear for such customers, which could lead to more efficient transfers of customer positions by a DCO in the event of a clearing member or customer default. Furthermore, a larger and more diversified customer base could reduce risks in the security futures market overall. For all of these reasons, enhanced liquidity would serve to strengthen the financial integrity of the security futures market.

Again, the CFTC notes that the DCOs that may clear security futures would be subject to CFTC regulations requiring the DCO to maintain adequate risk management policies and overall financial resources. DCOs may require additional margin, in an amount that is greater than 15%, on certain security futures positions or portfolios if the DCO notes particular risks associated with the products or portfolios. Accordingly, the CFTC believes that the final rules will maintain, or possibly improve, the financial integrity of the security futures markets in the U.S.

The CFTC believes that the final rules effectively address the need for market efficiency, competition, and financial integrity consistent with the statutory requirements under Section 7(c)(2)(B)(iii) of the Exchange Act. The CFTC also considered alternatives presented by commenters, as discussed above, but does not believe that there are any viable alternatives to the final rules at this time.

iii. Price Discovery

The lower margin requirements adopted under the final rules may facilitate the revival of security futures markets, and if that revival occurs, could increase competition and result in some new customers entering the security futures market along with increased trading by previously existing customers. In addition, trading from foreign markets could shift to the U.S. security futures market as a result of the change in margin requirements. All

[211] As discussed above, in response to the FIA Letter, under CFTC Letter No. 12–08, the CFTC's Division of Clearing and Risk interpreted certain sections of CFTC Rule 39.13 and stated that the customer margin rule under CFTC Rule 39.13(g)(8)(ii) does not apply to customer initial margin collected as a performance bond for customer security futures positions. CFTC Letter No. 12–08 at 10 (Sept. 14, 2012). However, there are other aspects of CFTC Rule 39.13 that offer protections such as other risk controls like risk limits that may prevent a clearing member from carrying positions with potential exposures above certain thresholds. *See* CFTC Rule 39.13(h)(1).

[212] *See* CFTC Rule 41.42(c)(1) and SEC Rule 400(c)(1). *See* 2019 Proposing Release, 84 FR at 36440.

[213] *See* CFTC Rule 39.13(f) and (h).

[214] CII Letter at 2.

[215] Data from OneChicago indicates that the risk-based margining system applied by Eurex (a non-U.S. security futures exchange), is consistently lower than the 15% margin requirement adopted in the final rules. *See e.g.,* Figure 2—Margin Levels for Dow Components at Eurex and OneChicago. OneChicago Letter at 25.

[216] *See also* the CFTC's analysis of anti-trust considerations in section VII. below. The CFTC has identified no anticompetitive effects of the final rules.

things being equal, this increased activity in the U.S. security futures market could have a positive effect on price discovery in the security futures market, if trading resumes. However, as the CFTC has noted before, price discovery in security futures markets most likely has occurred in the liquid and transparent security markets underlying previously existing security futures contracts, rather than the relatively low-volume security futures themselves.[217]

One commenter, citing to SEC Commissioner Jackson's Statement, shared the view that a serious economic analysis would have considered whether reducing margin requirements improves price discovery or, instead, incentivizes a shift toward futures markets in order to seek out leverage.[218] SEC Commissioner Jackson's Statement noted that if market participants shifted toward futures markets, it could result in less liquidity in related markets (*i.e.,* equity markets) without contributing to any additional price discovery. Although some portion of increased trading in security futures may be the result of customers switching from equity markets to security futures markets, the lower margin requirements for security futures may, if security futures trading resumes, facilitate arbitrage between the underlying security and security futures markets. This arbitrage between the two markets may enhance price discovery and provide a benefit to customers.

The CFTC notes that changes in price discovery may be difficult to measure.[219] However, the CFTC believes that the final rules' amendments are unlikely to harm price discovery and indeed may improve price discovery in the security futures market in the United States if security futures trading resumes.

iv. Sound Risk Management Practices

The final rules' amendments will lower the minimum initial and maintenance margin required for security futures positions. If security futures trading resumes, this may encourage potential hedgers or other risk managers to increase their use of security futures for risk management purposes. Moreover, a lower margin requirement could encourage new market participants to enter the security futures markets for potential hedging and risk management purposes. The final rules' amendments are consistent with sound risk management practices, especially to the extent that there is increased liquidity in potentially revived security futures markets.

In addition, as discussed in detail above, margin requirements are a critical component of any risk management program for cleared derivatives. Security futures have been risk-managed successfully through central clearing and initial and maintenance margin requirements for almost twenty years (including time periods of historic market volatility). [220] Current minimum margin requirements for security futures (20%) are higher than minimum margin requirements for comparable exchange-traded equity options held in a Portfolio Margin Account.

The CFTC recognizes the necessity of sound initial and maintenance margin requirements for DCO and FCM risk management programs. Initial and maintenance margin collected addresses potential future exposure, and in the event of a default, such margin protects non-defaulting parties from losses. The final rules maintain those protections. As noted above, based on past data, the 15% margin level is likely to cover more than 99% of the risks of default associated with security futures positions, if trading resumes.

v. Other Public Interest Considerations

The CFTC has not identified any additional public interest considerations related to the costs and benefits of the final rules.

B. SEC

1. Introduction

In the following economic analysis, the SEC considers the benefits and costs, as well as the effects on efficiency, competition, and capital formation that the SEC anticipates will result from the SEC's final rules.[221] The SEC evaluates these benefits, costs, and other economic effects relative to a baseline, which the SEC takes to be the current state of the markets for security futures products and the regulations applicable to those markets. The economic effects the SEC considered in adopting these rule amendments are discussed below and have informed the policy choices described throughout this release.

The final rule amendments will lower the required initial and maintenance margin levels for unhedged security futures from the current level of 20% to 15%. Furthermore, in connection with the SEC's rules which permit an SRA to set margin levels that are lower than 15% of the current market value of the security future in the presence of an offsetting position involving security futures and related positions, the SEC is re-publishing the Strategy-Based Offset Table with the proposed revisions, to conform it to the adopted 15% required margin levels.[222]

The SEC received a number of comments on the proposal. Some commenters supported the proposal,[223] while other commenters raised concerns.[224] The SEC has considered these comments, as discussed in detail in the sections that follow. This adopting release also revisits the benefits, the costs, and other economic effects identified in the 2019 Proposing Release.[225] Much of the discussion below on the costs, benefits, and other effects is qualitative in nature. Wherever possible the SEC has attempted to quantify potential economic effects, incorporating data and other information provided by commenters in its analysis of the economic effects of

[217] *See* Position Limits and Position Accountability for Security Futures Products, 84 FR 51020.

[218] CII Letter at 4.

[219] One commenter shared SEC Commissioner Jackson's view that the effects of a lower margin requirement on price discovery in financial markets could be studied by looking at relevant data. CFTC staff reviewed trading volume data at OneChicago to determine whether a change to increase the default maximum level of equity security futures products' position limits resulted in a change in trading activity in security futures products, but without additional data on related equity contracts it is not possible to draw a definitive conclusion about effects on price discovery.

[220] The CFTC staff notes that the VIX, which measures market expectations of near term volatility as conveyed by stock index option prices, has recently approached peak levels due to increased market volatility in March 2020 (the VIX measurement on March 16, 2020, was close to 83). Previously high volatility was measured in October and November 2008 during the financial crisis (when the VIX measurement reached the 80s). *See, e.g.,* VIX data available from the Federal Reserve Bank of Saint Louis at *https://fred.stlouisfed.org/series/VIXCLS.*

[221] The Exchange Act states that when the SEC is engaging in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the SEC shall consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. 15 U.S.C. 78c(f). In addition, Exchange Act Section 23(a)(2) requires the SEC, when making rules or regulations under the Exchange Act, to consider, among other matters, the impact that any such rule or regulation would have on competition and states that the SEC shall not adopt any such rule or regulation which would impose a burden on competition that is not necessary or appropriate in furtherance of the Exchange Act. *See* 15 U.S.C. 78w(a)(2).

[222] Conforming reductions to minimum margin percentages on hedged security futures positions will be reflected in a restatement of the table of offsets published in the 2002 Adopting Release. The Strategy-Based Offset Table is not part of the Code of Federal Regulations.

[223] *See* FIA Letter.

[224] *See* OneChicago Letter; OneChicago Letter 2; OneChicago Letter 3; Cboe/MIAX Letter; CII Letter; Bost/Davis Letter; Moran/Tillis/Rounds Letter.

[225] *See* 2019 Proposing Release, 84 FR at 36447.

the final rules. In addition to more detailed information on current activity in the security futures market, the SEC considered information supplied by commenters on the potential reduction in margin required to support security futures positions based on current levels of market activity and on the likelihood that investors migrated to the security futures market from related markets. However the SEC generally lacks the data necessary to estimate, among other things, the potential impact of the final rule amendments on overall investor participation in the security futures markets and bid-ask spreads in that market and related markets.

2. Baseline

The SEC evaluates the impact of final rules relative to a baseline that includes the regulatory regime applicable to the markets for security futures, as well as the current state of these markets. As discussed above, the term ''security future'' refers to a futures contract on a single security or on a narrow-based security index.[226] More generally, ''security futures product'' refers to security futures as well as any put, call, straddle, option, or privilege on a security future.[227]

Unlike futures markets on commodities or ''broad-based'' equity indexes, security futures have had a limited role in U.S. financial markets, which may be due in part to uncertainty relating to tax treatment [228] and competition from the more developed equity, equity swap, and options markets.[229] Incentives to participate in the security futures markets (rather than the markets for the underlying security, options, or swap markets) may stem from reduced market frictions (*e.g.,* short sale constraints), lower cost of establishing a short position compared to the equity market, and reduced counterparty risk due to daily resettlement, relative to comparable OTC instruments (*e.g.,* equity swaps).

As with other types of futures, both the buyer and seller in a security futures transaction can potentially default on his or her respective obligation. Because of this, an intermediary to a security futures transaction will typically require a performance bond (''initial and maintenance margin'') from both parties to the transaction. The clearing organization will also require such performance bonds from its clearing members (*i.e.,* the clearing intermediary of the security futures transaction). Higher margin levels imply lower leverage, which reduces risk. Private incentives encourage a broker-dealer that intermediates security futures transactions to require a level of margin that adequately protects its interests.

However, in the presence of market frictions, private incentives alone may lead to margin levels that are inefficient. For example, intermediaries may set margin levels that, while privately optimal, do not internalize the cost of the negative externalities caused by the potential high leverage level associated with low margins. Moreover, even when all parties are fully aware of the risks of leverage, privately negotiated margin arrangements may be too low. For example, the risk resulting from higher leverage levels can impose negative externalities on financial system stability, the costs of which would not be reflected in privately negotiated margin arrangements. To the extent that such market failures are not ameliorated by existing market institutions,[230] they provide an economic rationale for regulatory minimum margin requirements.[231]

i. The Security Futures Market

Security futures can provide a convenient means of obtaining delta exposure to an underlying security.[232] To effectively compete with other venues for obtaining similar exposures (*e.g.,* equity and equity options markets), security futures markets must reduce market frictions or provide more favorable regulatory treatment. Security futures markets may reduce market frictions by providing a lower cost means of financing equity exposures. They can simplify taking short positions by eliminating the need to ''locate'' borrowable securities.[233] Security futures can also be used to create synthetic equity repurchase agreements or equity loans, which carry similar terms as their over-the-counter counterparts.[234] Finally, security futures can also provide an opportunity for customers to gain greater leverage through lower margin requirements (relative to margin in securities or options transactions).

The one U.S. exchange that provided trading in security futures, OneChicago, discontinued all trading operations on September 21, 2020. As of the end of 2019, 13,792 security futures contracts [235] on 1,638 symbols were traded on the exchange. Of these 13,792 contracts, 343 had open interest at the end of the year. Total open interest at the end of the year was 602,276 contracts. Annual trading volume in 2019 was close to 7.4 million contracts, an increase of approximately 4% from the prior year. At this time, however, no security futures contracts are listed for trading on U.S. exchanges.

According to OneChicago, prior to the cessation of trading, almost all security futures positions were carried in futures accounts of CFTC-regulated FCMs.[236] Consequently, the SEC believes only a small fraction of security futures accounts previously fell under the SEC's customer margin requirements for security futures. The SEC believes that none of the accounts that were subject to the SEC's security futures margin rules used the Portfolio Margin Rules.[237] Therefore, the SEC believes that all of the securities accounts that previously fell under the SEC's margin rules would have been subject to the general initial and maintenance margin requirement of 20% and the associated Strategy-Based Offset Table.

[226] *See supra* note 1.

[227] *See* Section 1a(45) of the CEA and Section 3(a)(56) of the Exchange Act (both defining the term ''security futures product'').

[228] Specifically, the proposition that exchange-for-physical single stock security futures qualify for the same tax treatment as stock loan transactions under Section 1058 of the Internal Revenue Code has not been tested. *See e.g.,* Exchange Act Release No. 71505 (Feb. 7, 2014).

[229] Security futures markets face competition from equity and options markets because in principle, the payoff from a security futures position is readily replicated using either the underlying security, or through options on the underlying security.

[230] For centrally cleared markets, including the security futures market, clearinghouses may impose membership and minimum margin requirements that cause clearing members to internalize a greater share of the costs associated with customers' higher leverage.

[231] Monetary authorities may also rely on regulatory margin requirements as a policy tool. The SEC does not consider such motives here.

[232] The derivative of the theoretical price of a futures contract with respect to the price of the underlying (*i.e.,* the ''delta'') is 1. For a $1 increase (decrease) in the price of an underlying security, the theoretical price of its security future increases (decreases) by $1.

[233] In these respects, a security future functions like a cleared total return swap.

[234] This can be achieved by simultaneously entering into a security futures position that expires at the end of the trading day and another security futures position of the same size and on the same underlying security but in the opposite direction and expiring at a future date, compared to the other position. *See also* Memorandum from the SEC's Division of Trading and Markets regarding a July 16, 2019, meeting with representatives of OneChicago (including OneChicago's presentation on STARS as synthetic equity repos or equity loans).

[235] The typical contract is written on 100 shares of underlying equity.

[236] *See* OneChicago Petition.

[237] If security futures positions were held in a Portfolio Margin Account they would be included in the risk-based portfolio margin calculation and thus effectively subject to a lower (*i.e.,* 15%) margin requirement under the baseline. Based on an analysis of FOCUS filings from year-end 2019, no broker-dealers had collected margin for security futures accounts in a Portfolio Margin Account.

ii. Regulation

In the U.S., a security future is considered both a security and a future, so customers who wish to buy or sell security futures must conduct the transaction through a person registered both with the CFTC as either an FCM or an IB and the SEC as a broker-dealer.[238] In addition, an investor can trade security futures using either a futures account or a customer securities account.

As discussed in section I, Section 7(c)(2)(B) of the Exchange Act provides that the customer margin requirements must satisfy four requirements. First, they must preserve the financial integrity of markets trading security futures products.[239] Second, they must prevent systemic risk.[240] Third: (1) They must be consistent with the margin requirements for comparable options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act; [241] and (2) the initial and maintenance margin levels must not be lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded equity options.[242] Fourth, excluding margin levels, they must be, and remain consistent with, the margin requirements established by the Federal Reserve Board under Regulation T.[243]

Under existing SEC rules, the minimum initial and maintenance margin requirement for a customer's unhedged security futures position, not subject to an exemption is 20% of its current market value.[244] SRAs may allow margin levels lower than 20% for accounts with ''strategy-based offsets'' (*i.e.,* hedged positions).[245] Strategy-based offsets can involve security futures as well as one or more related securities or security futures position, consistent with the Strategy-Based Offset Table.[246]

Accounts subject to the Portfolio Margin Rules are also exempt from the customer margin requirements for security futures.[247] Under currently approved Portfolio Margin Rules, the effective margin requirement for an unhedged security futures position or an exchange-traded option on a narrow-based index or an individual equity is 15%.[248] Under current rules, only customer securities accounts held through SEC-regulated broker-dealers could potentially be subject to the Portfolio Margin Rules; however, the SEC is not aware of any broker-dealers offering such accounts. Margin requirements for security futures positions of clearing members (*i.e.,* their accounts at a clearing agency or DCO) are also exempt from the security futures margin requirements.[249]

3. Considerations of Costs and Benefits

Under the final rule amendments being adopted in this release, the initial and maintenance margin requirements for a security futures position will be reduced from 20% to 15% of the current market value of the position. This section discusses both the likely economic effects of the final rule amendments conditional on the resumption of trading in security futures, and the extent to which the final rule amendments may affect the likelihood that trading in security futures contracts resumes.

One commenter expressed concern that the SEC did not present any substantive analysis of the proposed amendment's possible benefits.[250] In response to this comment, as stated in the 2019 Proposing Release, the SEC cannot quantify the benefits to investors from the potential effects of the final rule amendments on investor demand, investor participation, price discovery and liquidity.[251] As discussed in more detail below, OneChicago provided information about the likely reduction in initial margin requirements it expected from the proposed rule amendments. Although this information supports the SEC's view that the final rule amendments could increase investor participation in the security futures market if trading resumes, it is not possible to meaningfully estimate the magnitude of any such increase, and related implications for the market for exchange-traded equity options without additional information about investors' sensitivity of demand for security futures and exchange-traded equity options positions with respect to changes in margin levels.[252] This sensitivity is difficult to estimate because it requires historical data on positions and associated margins from customer securities accounts, which broker-dealers currently do not report to the SEC.[253] While the SEC's analysis of the costs and benefits of the final rule amendments are qualitative in nature, the inability to quantify certain benefits and costs does not mean that the overall benefits and costs of the final rule amendments are any less significant.

Security futures prices reflect the aggregate demand for security futures of all participating investors, including those that are subject to margin requirements and those that are not. Among other things, this demand depends on the costs associated with margin requirements, such as the opportunity cost of the margin collateral. All else equal, higher margin levels may reduce individual demand because of potential higher trading costs.

As stated above, at the end of 2019, open interest in the U.S. security futures markets was 602,276 contracts. SEC staff understands that approximately 2% of these contracts were held in securities accounts subject to SEC margin requirements.[254] None of these accounts is believed to have been subject to Portfolio Margin Rules. This information, in combination with information supplied by commenters, can be used to construct a hypothetical estimate of the effect of the final rules on initial margin collected were security futures to continue to trade at OneChicago. According to OneChicago, the total reduction in margin collected (including margin collected on security futures held in futures accounts,) would have been $130 million.[255] Because the SEC estimates approximately 2% of these contracts were held in securities accounts, the margin reduction attributable to securities accounts would have been approximately $2.6 million.[256] The SEC expects this may overestimate the impact of the final rule, as broker-dealers may currently impose

[238] *See supra* note 12.

[239] *See* Section 7(c)(2)(B)(i) of the Exchange Act.

[240] *See* Section 7(c)(2)(B)(ii) of the Exchange Act.

[241] *See* Section 7(c)(2)(B)(iii)(I) of the Exchange Act.

[242] *See* Section 7(c)(2)(B)(iii)(II) of the Exchange Act.

[243] *See* Section 7(c)(2)(B)(iv) of the Exchange Act.

[244] *See* SEC Rule 403(b)(1).

[245] *See* SEC Rule 403(b)(2).

[246] *See* section II.B. above (discussing the Strategy-Based Offset Table).

[247] *See* CFTC Rule 41.42(c)(2)(i), 17 CFR 41.42(c)(2)(i); SEC Rule 400(c)(2)(i), 17 CFR 242.400(c)(2)(i).

[248] This follows from the methodology of current SRO Portfolio Margin Rules as applied to delta one securities. There is no comparable portfolio margining system for security futures held in a futures account and, therefore, these positions, if unhedged, are subject to the required 20% initial and maintenance margin levels.

[249] *See* SEC Rule 400(c)(2)(i) through (v), 17 CFR 242.400(c)(2)(i) through (v). Clearing members are instead subject to margin rules of the clearing organization as approved by the SEC pursuant to Section 19(b)(2) of the Exchange Act, 15 U.S.C. 78s(b)(2).

[250] *See* CII Letter at 3.

[251] *See* 2019 Proposing Release, 84 FR at 36449.

[252] This sensitivity is more formally known as the margin elasticity of demand.

[253] While the minimum margin requirements are set by regulation and therefore known, the actual margin associated with a position is set by a broker-dealer and may be different from the regulatory minimum.

[254] *See* 2019 Proposing Release, 84 FR at 36449.

[255] OneChicago Letter at 14.

[256] Calculated as $130 million × 0.02 = $2.6 million.

initial margin requirements exceeding 20% on certain security futures if they deem higher margin amounts necessary for risk management.[257]

i. Impact on Investor Participation

By lowering the minimum margin requirement for unhedged security futures positions held outside Portfolio Margining Accounts, the final rule amendments may affect participation in the security futures market, in the event that trading in security futures resumes in the United States. Reducing the trading costs for investors that hold these positions outside of Portfolio Margin Accounts may increase demand for security futures and may benefit investors by reducing the costs of taking on or laying off risk exposures.

The potential trading cost savings associated with the final rule amendments may also increase the competitiveness of security futures relative to certain potential close substitutes that are not directly affected by the margin requirements of the final rule amendments. As a result, if security futures trading resumes, the final rule amendments may encourage higher investor participation in the security futures market relative to what was previously observed under current initial margin requirements, to the benefit of financial intermediaries that offer security futures to their customers and exchanges that list security futures for trade, while potentially reducing fees earned by intermediaries and exchanges from services provided in related markets.

In addition to margin requirements, individual demand for security futures depends on the availability of other financial instruments (or strategies based on these instruments) that may be viewed by an investor as close substitutes to security futures. For example, certain OTC instruments that offer delta one exposure to the underlying security and certain security futures positions may be viewed as close substitutes.[258] Furthermore, certain option spread positions and certain futures positions may be viewed by some investors as close substitutes.[259] These potential substitutes exist on a continuum, and some alternative strategies have risk profiles and cash flows more similar to security futures than others.[260] In the presence of these alternatives, individual demand for a security futures position depends on the relative cost of alternative strategies, including the cost of financing the alternative position (*e.g.,* margin requirements) and the cost of bearing risk exposures that are incremental to the desired risk exposure obtainable through security futures.

The final rule amendments will also result in more consistent margining for identical unhedged security futures positions held within or outside Portfolio Margining Accounts. This will promote regulatory parity of security futures margin requirements between Portfolio Margin Accounts and securities accounts that do not offer portfolio margining, as well as between securities and futures accounts. To the extent that customers are currently unwilling to bear the costs of opening Portfolio Margin Accounts, they may decline opportunities to participate in the security futures market or may instead bear the costs of holding security futures in their securities accounts. If trading resumes, parity in margin requirements could result in efficiencies for customers who might otherwise open separate accounts to obtain security futures exposure in response to differing margin requirements across account types.

ii. Impact on use of Leverage and Investor Behavior

If security futures trading resumes, the final rule amendments may provide investors with opportunities to take on additional leverage. Because security futures allow investors to acquire 100% exposure in the underlying security (also known as ''delta one'' exposure) for a fraction of the cost of funding a position in the cash market, the final rule amendments may reduce the cost of financing leveraged exposures through security futures. In particular, the final rule amendments may increase the attractiveness of security futures as means to finance delta one exposure.

Increased leverage can result in larger investor losses, and may exacerbate the potential costs to investors from trading patterns that reflect behavioral biases. For example, in equity markets, retail investors may be subject to costs from certain trading patterns that are consistent with the so-called ''disposition effect''—an aversion to realize losses. To the extent that the final rule amendments lower the cost that retail investors bear when they participate in the security futures market and encourage more participation, the potential costs associated with the ''disposition effect'' and other behavioral biases could be exacerbated.

However, the potential costs associated with retail investors' behavioral biases are likely to be limited in aggregate, because (i) under the baseline, retail investors are believed to represent a very small fraction (less than 1%) of open interest in security futures; and (ii) broker-dealers may still impose higher initial margin requirements and other measures to manage risk exposures to their customers and meet clearing organization requirements.

One commenter noted that the daily variation settlement in the futures market would counter the disposition effect as it relates to security futures, while the current margining system in the options markets exacerbate the effect.[261] The SEC appreciates the analysis provided by this commenter. However, contrary to the conclusion of this analysis, both the margin on a futures position and the margin on an options position move in the same direction (as compared to opposite directions, as suggested by the commenter), because in the exchange-traded equity options market, the initial and maintenance margin generally applies to the short position only.[262]

iii. Impact on Financial Intermediaries

The final rule amendments may also provide benefits to financial intermediaries that facilitate trading in security futures, thereby providing incentives to list security futures. Broker-dealers and exchanges generally charge fees for purchases and sales of listed securities and derivatives contracts. To the extent that the final rule amendments increase future participation in security futures markets if trading resumes, security futures exchanges and broker-dealers that offer customers the ability to trade security futures in securities accounts may earn higher fees from security futures activity, than would be the case in the absence of the final rule amendments, although an increase in revenues in the security futures market may reduce fees earned from activity in related markets.

[257] *See* OneChicago Letter at 14 (stating that as of August 26, 2019, 92% of OneChicago security futures had a risk level above 20%).

[258] *See* OneChicago Letter (describing these OTC instruments, including equity swaps and stock loans).

[259] *See* section IV.B.4.ii.a *infra* (discussing comparability of exchange-traded options and security futures).

[260] One commenter specifically argued that that single stock futures and equity options are sufficiently distinct that they do not trade interchangeably, and supplied data to support its claim. *See* section IV.B.4.ii.a *infra.*

[261] *See* OneChicago Letter, Appendix A.

[262] Thus, when the option position increases in value for the long investor, the maintenance margin assessed to the short investor (the seller of the position) increases proportionally. Customers who buy long exchange-traded options generally must pay for them in full. *See supra* note 94 (discussing margin requirements for long exchange-traded options).

In turn, opportunities to earn higher fees from enabling transactions in security futures may encourage exchanges to list security futures. As a result, the final rule amendments could incrementally increase the likelihood that trading in security futures contracts resumes.

Lowering the regulatory minimum margin requirements for security futures margin could also impose costs on broker-dealers, their customers, and counterparties. To the extent that lower regulatory margin requirements cause some broker-dealers to impose lower margin requirements on customers if trading resumes, the final rule amendments could increase the default risk of the broker-dealer, and a broker-dealer default would likely impact the defaulting broker-dealer's customers and counterparties. However, broker-dealers participating in security futures markets would be subject to clearing organizations' margin requirements and the SEC's broker-dealer financial responsibility rules (including minimum capital requirements).[263] Such requirements are reasonably designed to mitigate the risk of a broker-dealer's default. In addition, in the event of such a default, the SEC's customer protection rule would protect customers' assets held in a securities account.[264]

iv. Resumption of Trading in the U.S. Security Futures Market

The final rule amendments may increase investors' willingness to participate in the security futures markets to an extent that is sufficient to result in resumption in exchange trading of security futures in the U.S. Although we expect the final rule amendments to have, at most, an incremental effect on the likelihood that trading resumes, the potential revitalization of the U.S. security futures market could produce economic consequences for investors, intermediaries, and financial markets.

A liquid U.S. security futures market could result in both costs and benefits for investors. Access to security futures could benefit investors by reducing the costs that investors incur to obtain risk exposures or finance other transactions. As discussed earlier, security futures can allow investors to obtain low-cost exposure to underlying securities.[265] In particular, security futures can simplify the process of taking short positions by eliminating the need to locate borrowable securities. Moreover, security futures can be combined to produce synthetic equity loans or equity repurchase agreements.[266] These activities, however, have attendant risks. As discussed above, an investor that uses security futures to obtain leveraged exposure to underlying securities also is exposed to the risk of larger losses.

Resumption of trade in the U.S. security futures market could permit intermediaries to earn additional revenues by serving investors that participate in the security futures market. Whether revenues from transaction services increase depends on whether investors transact in security futures in addition to cash market securities rather than simply reallocating their cash market activities to security futures markets.

v. Effects of Revisions to Strategy-Based Offset Table

As discussed in section II.B. above, the revised Strategy-Based Offset Table is being re-published as proposed.[267] The re-published Strategy-Based Offset Table incorporates the 15% required margin levels for certain offsetting positions and retains the same percentages for all other offsets. The revisions to the Strategy-Based Offset Table would promote consistency with the lower margin levels on unhedged security futures positions of the final rule amendments. If security futures trading resumes, the revisions would generally benefit investors from the lower cost of carrying offset positions. The SEC also expects any additional costs incurred by broker-dealers to incorporate the revised Strategy-Based Offset Table into their existing policies and procedures to be similarly insubstantial.

4. Effects on Efficiency, Competition, and Capital Formation

In addition to the specific costs and benefits discussed above, the reductions to minimum margin requirements on unhedged security futures that the SEC is adopting may have broader effects on efficiency, competition, and capital formation.

i. Efficiency

Should trading in security futures resume, the SEC expects the final rule amendments to result in incremental improvements in efficiency to the extent that they permit investors to obtain the risk exposures they desire at lower cost. The final rule amendments may also improve liquidity in the security futures market and impact the informational efficiency of security futures prices, as well as the prices for related financial instruments. Reducing minimum margin requirements could also impact the financial system more broadly though, as discussed below, we do not expect such effects to be substantial.

a. Efficiency and Transactions Costs

Under the current minimum margin requirements two identical security futures positions may be subject to different margin levels because they are held in different types of accounts. A potential concern with the current margin requirements in these situations, and more generally, is whether they can result in price distortions or introduce inefficiencies in how investors allocate funds.

Current margin requirements may not necessarily result in price distortions. This is because certain participating investors, such as market makers,[268] are exempt from the current margin requirements (which would still apply to any positions held on behalf of a customer), and they may step in to become the ''marginal investor'' in situations where current margin requirements might otherwise distort prices.[269] For example, if security futures trading resumes investors trading from outside a Portfolio Margin Account, who are not exempt from margin requirements, would face trading costs associated with margin requirements that may hinder their ability to trade with each other. A seller and a buyer who agree on the value of a security futures product may nevertheless fail to agree on a transaction price because the buyer demands a discount to compensate herself for the cost of meeting margin requirements, while the seller demands a premium to compensate herself for the same costs. On their own, these distortions would result in wider bid-ask spreads in security futures markets. However, because market participants such as market makers, who are exempt from margin requirements, bear minimal costs to transact, these investors have the ability to provide quotes that are

[263] 17 CFR 240.15c3–1.

[264] 17 CFR 240.15c3–3. The SEC acknowledges that any security futures held in futures accounts would benefit from the CFTC's customer protection rules found in part 1 of the CFTC's regulations.

[265] *See* section IV.B.2.i.

[266] *Id.*

[267] *See* 2019 Proposing Release, 84 FR at 36441–43.

[268] Market makers are subject to exemptions from margin requirements. *See* CFTC Rule 41.42(c)(2)(v); SEC Rule 400(c)(2)(v).

[269] A market participant or investor is considered ''marginal'' if they are willing to buy or sell security futures even for small deviations between the price of a security futures contract and the contract's fundamental value and thus sets the price of the contract. Such activities may be more profitable for market makers if they encounter lower trading frictions (including margin requirements) relative to other market participants.

generally more competitive than the quotes provided by other types of investors, reducing uncertainty in the value of security futures.

Nevertheless, current margin requirements may result in potential allocative inefficiencies. Trading costs associated with the current margin requirements may impact investor demand, and therefore willingness to take on or lay off risk exposures using security futures. In particular, risk sharing under the regulatory minimum margin requirements may be different relative to the case where margin levels are optimally determined to reflect the risks of security futures positions. The difference between the allocation of financial risk that result from current margin requirements and the allocation associated with the margin requirements that are optimally determined may be viewed as an allocative inefficiency. Allocative inefficiency may also manifest if trading costs in security futures drive investors to use alternative products to obtain financing or manage risk, which are less suited to their needs.

If security futures trading resumes, certain investors could reduce these potential allocative inefficiencies by trading out of a Portfolio Margin Account,[270] where margin requirements can result in much lower margin levels compared to those that apply outside such accounts. However, as of the fourth quarter of 2019, no investors appeared to be trading in security futures out of Portfolio Margin Accounts, despite the fact that they did trade significantly in exchange-traded equity options out of these accounts. This observation may indicate that investors that qualify for Portfolio Margin Accounts have not traded security futures.[271] Alternatively, such investors may have chosen to trade security futures outside of Portfolio Margin accounts, implying that the costs they faced as a result of the current margin requirements were not sufficiently large to discourage their participation or to persuade them to open a Portfolio Margin Account.

Nevertheless, because opening Portfolio Margin Accounts entails costs, not all investors can trade out of these accounts,[272] therefore some investors may face barriers to participation in the security futures market, if trading resumes. The potential inefficiencies associated with these barriers arise when the margin levels associated with current minimum margin requirements for security futures are larger than the margin levels associated with margin requirements that are optimally determined, and not because similar positions are margined differently in other markets.

The final rule amendments will lower the minimum initial margin requirements for certain security futures positions, and in turn reduce the trading costs for these positions. To the extent trading costs result in inefficiencies, the final rule amendments, by lowering trading costs, may reduce potential inefficiencies associated with the current initial margin requirements.

Furthermore, as discussed above, lower trading costs in certain security futures positions may increase investor demand for security futures, and may encourage greater market participation in this market if trading in security futures resumes. Greater participation may increase competition over prices, which in turn may result in improved price discovery and liquidity in the security futures market. However, the effect of the final rule amendments on price discovery and liquidity may be limited because, as discussed above, the marginal participant in this market is likely one that is currently exempt from the customer margin requirements for security futures and therefore, able to supply liquidity at relatively low cost.

One commenter stated that the lower minimum margin requirements combined with investors' search for sources of leverage, may increase liquidity in the security futures market while simultaneously reducing liquidity and price efficiency in other related markets.[273] The SEC acknowledges that the final rule amendments may encourage resumption of trading in the U.S. security futures market and, if trading resumes, may encourage arbitrageurs to rely more on the security futures market to take advantage of potential mispricing compared to other markets, or may increase the risk of adverse selection in equity markets if it encourages less-informed investors to migrate to the security futures market to obtain leveraged equity exposure at low cost.[274] However, the SEC does not believe that the resumption of trading in security futures or heightened focus on the security futures market would necessarily reduce informational efficiency or liquidity in aggregate across related markets. Markets that support trade in financial instruments that reference the same underlying security tend to be interconnected to a high degree.[275] Furthermore, investors may access security futures quotes and post-trade information. As such, even if trading in security futures resumes and the final rule amendments shift price discovery from related markets to the security futures market, information impounded in security futures prices may inform trading in those related markets.[276]

b. Systemic Considerations

The final rule amendments may also impact efficiency through their impact on risk management. As discussed above, broker-dealers likely weigh the costs associated with customer defaults against the benefits of lower margin requirements when setting margin requirements for their customers. Although such private considerations would produce market-determined margin levels that were optimal from a broker-dealer's perspective, market imperfections could lead broker-dealers to impose margin requirements on customers that are not efficient for the financial system as a whole. The relevant market imperfections in the context of margin requirements relate to

[270] Not all investors are eligible to open a Portfolio Margin Account. *See* Cboe/MIAX Letter at 4.

[271] With the exception of investors that are exempt from margin requirements, the investors that hold or are eligible to open a Portfolio Margin Account are best positioned to trade security futures at margin levels that could be substantially below the current minimum margin requirements. The extent to which they face low margin levels on a new security futures position depends on any offsetting positions—either security futures or exchange-traded options positions—that they hold in their Portfolio Margin Account at that time when they seek to enter the new security future position.

[272] *See* Cboe/MIAX Letter (describing potential costs and requirements associated with opening a Portfolio Margining Account).

[273] *See* CII Letter at 3.

[274] *See* Stewart Mayhew, Atulya Sarin & Kuldeep Shastri, *The Allocation of Informed Trading Across Related Markets: An Analysis of the Impact of Changes in Equity-Option Margin Requirements,* 50 J. FIN. 1635 (1995) (showing that a reduction in options margin requirements decreased options market bid/ask spreads and increased option market depth-of-book, while increasing equity market bid/ask spreads and decreasing equity market depth-of-book).

[275] *See, e.g.* Sugato Chakravarty, Huseyin Gulen & Stewart Mayhew, *Informed Trading in Stock and Option Markets,* 59 J. FIN. 1253 (2004) (showing that price discovery takes place both in the equity market and the equity options market, with the latter contributing by about 17%). Similarly, another study documents informational flows between credit default swap markets, equity options markets and equity markets. *See* Antje Berndt & Anastaysia Ostrovnaya, *Do Equity Markets Favor Credit Market News over Options Market News?,* 4(2) Q. J. FIN. 1 (2014).

[276] *See, e.g.* David Easley, Maureen O'Hara & P. S. Srinivas, *Option Volume and Stock Prices: Evidence on Where Informed Traders Trade,* 53 J. FIN. 431 (1998) and Jun Pan & Allen Poteshman, *The Information in Option Volume for Future Stock Prices,* 19 REV. FIN. STUD. 871 (2006) (both showing that equity options trading provide valuable information for equity markets).

externalities on financial stability arising from excessive leverage.[277]

Historically, a key aspect of the rationale for regulatory margin requirements on securities transactions was the belief that such requirements could improve efficiency by limiting stock market volatility resulting from ''pyramiding credit.'' [278] Leveraged exposures built up during price run-ups could lead to the collapse of prices when a small shock triggers initial and maintenance margin calls and a cascade of de-leveraging. The utility of such margin requirements in limiting such ''excess'' volatility and the contribution of derivatives markets to such volatility have been a perennial topic of debate in the academic literature, rekindled periodically by crisis episodes.[279] Most recently, the 2007–2008 financial crisis saw similar concerns (*i.e.,* procyclical leverage, margin call-induced selling spirals) raised in the securitized debt markets.[280] While lower margin requirements can increase the risk and severity of market dislocations—given the current limited scale of the security futures markets and the limited role played by SEC registrants in these markets—the adopted reductions to minimum margin requirements are unlikely to present a material financial stability concern.

One commenter expressed concern that the criteria for prescribing margin requirements under the Exchange Act to preserve the financial integrity of markets trading security futures products and preventing systemic risk appear to indicate potential significant risks to the capital markets and investors by lowering margin requirements.[281] This commenter noted that the 2019 Proposing Release specifically acknowledged that margin requirements are a critical component of any risk management program for cleared financial products and that higher margin levels imply lower leverage, which reduces risk.[282] As described in the baseline, the vast majority of security futures positions were held in futures accounts at CFTC-regulated entities, and, consequently, only a small fraction of the security futures accounts were subject to the SEC's margin rules. Therefore, even if trading in security futures resumes and participation in security futures markets were to increase modestly as a result of the final rule amendments, the adopted reductions to minimum margin requirements are unlikely to have a significant impact on the financial integrity of the security futures market and are unlikely to lead to systemic risk.[283]

ii. Competition

The SEC has considered the potential impact of the final rule amendments on competition. This section discusses those impacts in detail and considers the views of commenters on the extent to which reducing minimum margin requirements for certain accounts introduces or eliminates competitive disparities between markets for different types of financial instruments and markets in different jurisdictions.

a. Competition Among Related Markets

The 2019 Proposing Release stated that the proposed initial and maintenance margin requirements would establish a more level playing field between options exchanges and security futures exchanges, and between broker-dealers/securities accounts and FCMs/futures accounts.[284] Although the SEC continues to expect the final rule amendments to place these exchanges and account types on a more level footing, some commenters took issue with this view. One commenter argued that the final rule amendments would give unhedged security futures a competitive advantage over exchange-traded equity options when held outside a Portfolio Margining Account.[285] This commenter suggested that subjecting security futures and exchange-traded equity options to different margin requirements in this way may disrupt the regulatory parity that currently exists between security futures and exchange-traded equity options as the proposal would create preferential margin levels for unhedged security futures held outside of a Portfolio Margin Account.[286] This commenter also believed that the proposal implies that exchange-traded equity options and security futures are not competing products, stating that currently there is significant trading in option spread positions that ''replicate long and short security futures'' outside Portfolio Margin Accounts.[287]

The SEC agrees that security futures and exchange-traded equity options can have similar economic uses. Nevertheless, for the reasons discussed in section II.A.2 of this release, reducing the margin levels for an unhedged security future held outside of a Portfolio Margin Account to 15% is unlikely to result in a competitive disadvantage for exchange-traded equity options in practice if trading in security futures resumes.

The SEC acknowledges that because the adopted margin requirements apply only to unhedged security futures positions held outside Portfolio Margining Accounts, the final rule amendments may result in different margin requirements across security futures positions and exchange-traded equity options positions held in this type of account. To the extent some investors view a security futures position and an option spread position that replicates the contractual payoffs of the security futures position as close substitutes, the final rule amendments may result in different costs for these positions when held outside of a Portfolio Margining Account and may cause these investors to prefer the security futures position to the option spread position. From this perspective, the final rule amendments may potentially have an adverse competitive effect on exchange-traded equity options if trading in security futures resumes in the U.S. However, this potential adverse competitive impact likely would be small as a substantial portion of exchange-traded equity options are traded in Portfolio Margin Accounts where the margin requirement for an unhedged exchanged-traded option on a

[277] The SEC acknowledges that other market imperfections (*e.g.,* asymmetric information, adverse selection) may also play a role, although the SEC believes these to be less relevant to this context. Asymmetric information about market participants' quality can lead privately negotiated margin levels to be inefficient. For example, competition among broker-dealers may lead to a ''race to the bottom'' in margin requirements when customers' ''quality'' is not perfectly observable. *See e.g.,* Tano Santos & Jose A. Scheinkman, *Competition among Exchanges,* 116 Q. J. ECON. 1027 (2001). Alternatively, problems of adverse selection (*e.g.,* potential to re-invest customer margin in risky investments) or moral hazard (*e.g.,* expectations of government rescue) may also create incentives for broker-dealers to offer margin requirements that are too low. Asymmetric information about broker-dealer quality may make it impossible for customers to provide sufficient market discipline, leading to a problem similar to that faced by bank depositors. *See* Mathias Dewatripont & Jean Tirole, *Efficient Governance Structure: Implications for Banking Regulation, in* CAPITAL MARKETS AND FINANCIAL INTERMEDIATION 12 (Colin Mayer & Xavier Vives eds., 1993).

[278] *See* Thomas Gale Moore, *Stock Market Margin Requirements,* 74 J. POL. ECON. 158 (1966).

[279] *See id. See also* Stephen Figlewski, *Futures Trading and Volatility in the GNMA Market,* 36 J. FIN. 445 (1981). *See also* Franklin R Edwards, *Does Futures Trading Increase Stock Market Volatility?,* 44 FIN. ANALYSTS J. 63 (1988). *See also* Paul H Kupiec, *Margin Requirements, Volatility, and Market Integrity: What Have We Learned Since the Crash?,* 13 J. FIN. SERVICES RES. 231 (1998).

[280] *See e.g.,* Tobias Adrian & Hyun Song Shin, *Liquidity and Leverage,* 19 J. FIN. INTERMEDIATION 418 (2010).

[281] *See* CII Letter at 2.

[282] *See* CII Letter at 2.

[283] *See* 2019 Proposing Release, 84 FR at 36438, and 36449–50.

[284] *See* 2019 Proposing Release, 84 FR at 36451.

[285] *See* Cboe/MIAX Letter at 6–8.

[286] *See* Cboe/MIAX Letter at 2.

[287] *See* Cboe/MIAX Letter at 6–8.

narrow-based index or single-equity is 15%.[288]

OneChicago disagreed with the notion that security futures and exchange-traded equity options strategies could be comparable, noting that because security futures provide an investor with 100% exposure (*i.e.,* delta one exposure) to the underlying security, security futures should instead be compared to other financial instruments that offer delta one exposure, such as uncleared OTC equity swaps and cleared OTC stock loans.[289]

OTC total return equity swaps and stock loans may compete with security futures to provide delta one exposure at lower cost compared to outright acquisition of the underlying security. From this perspective, to the extent that security futures compete with these OTC instruments, the final rule amendments would increase the competitiveness of security futures relative to these OTC instruments. However, this potential competitive effect is limited, because, as OneChicago noted, under certain conditions, the costs of financing delta one exposure through OTC equity swaps and stock loans can be substantially smaller compared to the cost of security futures.[290]

OneChicago further argued that the risk profile of a security futures position cannot be replicated with exchange-traded equity options, and on this basis challenged the argument that lower margin requirements for security futures would reduce the competitiveness of exchange-traded equity options.[291] OneChicago stated that security futures products are not comparable to exchange-traded equity options because they have different risk profiles; exchange-traded equity options are subject to dividend risk, pin risk, and early assignment risk, while security futures are not.[292] Further, OneChicago challenged the concerns raised by other commenters that the proposed margin requirements would result in ''regulatory arbitrage,'' arguing that the many salient differences between security futures and exchange-traded equity options make it virtually impossible to replicate a security futures position using exchange-traded equity options.[293] OneChicago suggested that the comparison between a security futures position and an option spread position that ''replicates'' the security futures cannot be limited to a comparison between the contractual payoffs of these two positions. In particular, this commenter argued that a proper comparison should include payoffs that may occur throughout the life of the position, including payoffs from the security future's daily settlement of variation margin (*i.e.,* marking-to-market and paying or collecting variation margin) that differs from initial and maintenance margin requirements in options markets.[294]

The SEC acknowledges that even if the contractual payoffs of a security futures position could be perfectly replicated with the payoffs of an option spread position,[295] the risk profiles of the two positions may still be different.[296] For example, the daily variation margin settlement of the security futures position may give rise to payoffs throughout the life of the positions that could expose the holders of the position to funding risk. Similarly, the exchange of variation margin for the options spread position also exposes investors to funding risk, but to a lesser degree compared to a security futures position.[297] As noted by OneChicago, unlike a security futures position, an option spread position may be subject to a number of risks that reflect potential strategic behavior that is commonplace in the options markets, including dividend risk, assignment risk, and pin risk.[298] Because funding risks and the risks that reflect strategic behavior in options markets may affect the security futures and the option spread positions differently, the two positions may not have the same risk profile.

Notwithstanding these differences, under certain conditions, the risk profiles of the two positions may be sufficiently similar for some investors, and may be viewed by these investors as close (but not necessarily perfect) substitutes. These strategies are economic equivalents to a certain degree because both provide exposure to an underlying equity security or narrow-based equity security index outside the cash equity market.[299] Thus, both strategies can be used to hedge, at least partially, a long or short position in the underlying equity security or narrow-based equity security index. Similarly, each strategy can also be used to speculate on a potential price movement of the underlying equity security or narrow-based equity security index. Furthermore, both short security futures positions and certain exchange-traded equity options strategies produce unlimited downside risk. Investors in security futures and writers of options may lose their initial and maintenance

[288] *See* 2019 Proposing Release, 84 FR 36450.

[289] OneChicago Letter.

[290] OneChicago Letter. In addition, as discussed in section II.A. of this release, Section 7(c)(2)(B) of the Exchange Act provides that the margin requirements for security futures must be consistent with the margin requirements for comparable exchange-traded options. The Exchange Act does not directly contemplate comparisons with the margin requirements for the products and markets identified by OneChicago. Rather, it requires comparisons to comparable exchange-traded options.

[291] *See* OneChicago Letter; OneChicago Letter 2.

[292] OneChicago Letter at 2, 9; OneChicago Letter 2 at 1–2.

[293] *See* OneChicago Letter 2.

[294] *See also* OneChicago Letter (providing a more in depth analysis of these issues together with some data that outlines various payoff structures for different strategies based on currently traded contracts).

[295] It is well known that in theory a long security futures position can be perfectly replicated with an option spread position consisting of a long European call and a short European put. Both options have the same expiration, and each has a strike price equal to the futures price. This result is also known as the put-call parity. *See, e.g.* JOHN C. HULL, FUNDAMENTALS OF FUTURES AND OPTIONS MARKETS, (Pearson Prentice Hall, 2017).

[296] A number of practical factors challenge the extent to which security futures can be perfectly replicated using an options spread position. First, most stock options currently trading are American style rather than European style. American style options typically sell at a premium relative to European style options because of the value of exercising early. Second, if the strike price of these options (which is set to equal the futures price) falls outside the range currently trading, liquidity may be limited and these options may sell at a premium (or at a discount if short). Third, certain features of the futures and options markets may introduce payoffs throughout the life of these positions that may further complicate the replication strategy. For example, the daily settlement process in the futures market may result in additional payments or payouts to the holder of the futures position, relative to the contractual payoffs of the position. Similarly, the practice of exchanging variation margin in the options market may result in additional payments/payouts to the holder of the options positions. These additional payments generally help reduce the potential loss due to a counterparty failure, but may also expose a counterparty to funding risk. Finally, the option spread position may be subject to a number of risks that reflect potential strategic behavior that is commonplace in the options markets, including dividend risk, assignment risk, and pin risk (for definitions of dividend risk, assignment risk and pin risk, *see* OneChicago Letter 3, at n.23, 24, and 25). The futures position may also be exposed to some of these risks through the daily settlement process (for example, the price of a futures contract on a dividend-paying stock would reflect an unanticipated change in the dividend policy at the time when this change in policy is made public). The factors outlined above point to potential price disparities between the security futures and the option spread positions that cannot be arbitraged away. The last two factors also point to sources of potential risks, and therefore sources of potential losses, that may impact the two positions differently. In general, these factors may cause the risk profile of the security futures and the risk profile of the option spread positions to drift apart.

[297] The margin on the security futures position is calculated on the current market value of the position, while the margin on the option spread position is generally calculated on the value of the short leg of the position, outside of a Portfolio Margin Account.

[298] *See supra* note 296 (describing what these risks are). *See also* OneChicago Letter 3, at n.23–25.

[299] *See supra* note 117.

margin on deposit and premium payments and be required to pay additional funds in the event of a default of a broker-dealer or clearinghouse.

In addition, a deep-in-the money call or put option on the same security can have a delta approaching one if the underlying security takes values in a certain range of outcomes. Over such a range of outcomes, equity option contracts may be comparable to a security futures contract. Further, as stated by one commenter, synthetic futures strategies are an important segment of today's options markets competing everyday with security futures.[300]

OneChicago provided empirical analyses to support its claim that changes to security futures margin rates would not impact exchange-traded equity options. In one analysis, OneChicago observed data inconsistent with a statistically positive correlation between the E-mini margin rates and either the ratio of SPX (S&P 500) options open interest to E-mini S&P 500 futures open interest or the ratio of SPX trading volume to E-mini trading volume.[301] In another analysis, OneChicago provided statistical data on the correlation in open interest between security futures and exchange-traded equity options. This analysis shows that there is no significant correlation between the two types of open interest, and OneChicago saw this finding as supporting their conclusion that market participants have discrete uses for security futures and ''equity options and that the derivatives are not interchangeable.'' [302]

The SEC appreciates the empirical analyses provided by OneChicago, while also noting that the inferences in these analyses are subject to multiple limitations that make it difficult to conclude on the basis of these analyses that reducing minimum initial and maintenance margin requirements for security futures would not reduce the use of comparable options strategies. It is unclear to what degree results from the SPX options market and the E-mini futures market can be generalized to exchange-traded equity options and security futures. Unlike their single-stock counterparts, derivatives that are based on broad-based indices can be used by a wide range of institutional and retail investors for purposes broader than obtaining exposure to individual equities or obtaining cash to finance other positions. Participants in these markets may seek to efficiently hedge market risk or express views on the direction or volatility of equity indices. Moreover, the markets for futures and options that track the S&P 500 index or track an investable portfolio of S&P 500 equities include more than just the products that OneChicago analyzed. This makes it difficult to extrapolate results from these markets to the markets for exchange-traded options and security futures. Furthermore, OneChicago's analysis of security futures and exchange-traded equity options compares security futures to all equity options contracts, without focusing on those segments of the equity options market most comparable to security futures, such as strategies that approximate delta one exposure.

The final rule amendments may improve the ability of security futures intermediaries and exchanges to compete in the market for other financial services. Certain analyses submitted by OneChicago to the comment file support this view with evidence that security futures would be used for different purposes than exchange-traded equity options.[303] For example, OneChicago compared trade size (number of contacts and notional value) in security futures with trade size in options markets and security future delivery rates with options exercise rates,[304] and concluded that the higher trade size and higher delivery rates in security futures markets indicated that investors use the security futures market for financing purposes. When summarizing its findings, OneChicago stated that the delivery data makes ''clear'' that the ''markets view and use the products differently.'' [305] OneChicago further asserted that certain security futures strategies represent exchange-traded substitutes for securities lending and equity repo transactions.[306]

b. Foreign Markets for Security Futures

Finally, OneChicago noted that U.S. security futures markets faced competition from foreign markets that rely on risk-based initial margin that, in contrast to Portfolio Margin Accounts, do not have a strategy-based floor and in which ''naked positions are margined at risk-based levels.'' [307] OneChicago supplied initial margin requirements for security futures written on Dow Jones Industrial Average components at Eurex on July 25, 2019, ranging from 6.64% to 14.71%. The SEC acknowledges that other jurisdictions may choose to implement initial margin requirements for security futures under local legal regimes that differ from those of the United States. To the extent that customers may access a number of different markets, higher initial margin requirements in one jurisdiction may place intermediaries and exchanges regulated by that jurisdiction at a competitive disadvantage relative to others.[308] However, as discussed above, the SEC is not persuaded by arguments that implementing a risk model approach to calculating margin for security futures would at this time be permitted under U.S. law and, furthermore, notes that the final rule amendments may reduce the degree of competitive disadvantage if trading resumes in the U.S., at least insofar as foreign markets would draw away customers that would otherwise trade security futures outside of Portfolio Margin Accounts.[309]

iii. Capital Formation

As discussed above, the potential benefits to investors that flow from the final rule amendments including a lower cost of obtaining underlying securities, the opportunity to take on more leverage (relative to the baseline), and the potential increase in price competitiveness, may increase investor demand for access to security futures contracts. To the extent security futures trading resumes in the U.S., and investor participation causes the market for security futures to grow, the final rule amendments would have an impact on capital formation. An active security futures market can reduce the frictions associated with shorting equity exposures (making it easier for negative information about a firm's fundamentals to be incorporated into security prices) or financing securities exposures. This could promote more efficient capital allocations by facilitating the flow of financial resources to their most productive uses.

5. Reasonable Alternatives Considered

In the 2019 Proposing Release, the SEC stated it did not believe there are reasonable alternatives to the proposal to reduce minimum margin levels for unhedged security futures.[310] Two

[300] *See* Cboe/MIAX Letter at 6–7.

[301] OneChicago Letter 3 at 12–15.

[302] OneChicago Letter 3 at 15.

[303] OneChicago Letter at 2–3.

[304] OneChicago Letter 3 at 9–12.

[305] OneChicago Letter 3 Summary at 1.

[306] OneChicago Letter 3, at 22.

[307] OneChicago Letter, at n.54 and accompanying text.

[308] OneChicago submitted a customer letter supporting this point. *See* OneChicago Letter, Appendix C.

[309] *See supra* note 182 in section IV.A.4. (CFTC—Description of Costs) (noting that trading by U.S. persons in security futures contracts listed on Eurex is subject to certain conditions under an SEC order and a CFTC staff advisory).

[310] 2019 Proposing Release, 84 FR at 36451.

commenters took issue with this observation and suggested several alternatives for the SEC to consider.[311] One commenter suggested two alternatives: (1) Reduce the size of security futures contracts; and (2) rule-based margin with flexible settlement intervals.[312] The other commenter suggested two additional alternatives: (1) Risk-based margins for all security futures products; and (2) risk-based margins for select security futures products involving STARS transactions.[313]

The SEC addresses the suggested alternatives below. The discussion of those alternatives includes certain commenter proposals that the Commissions still do not believe are viable at this time for the reasons discussed by the Commissions in more detail above.

i. Reduce the Size of the Security Futures Contract

One commenter suggested that an alternative to lowering the margin on security futures could be to reduce the size of a security futures contract.[314] This commenter noted that a similar reduction in the size of the S&P e-mini futures contract that led to the creation of S&P micro e-mini futures could increase access to single-stock futures for the most popular securities and improve efficiency.[315] The SEC acknowledges that one way to reduce the dollar value of margin required for a position in a given contract is to reduce the size of the contract. However, an investor is more likely to determine her optimal exposure in terms of notional value or as a proportion of her available financial resources, rather than as a number of contracts. This alternative would not change the amount of margin that would be assessed on such an investor's optimal exposure. For example, if the size of the contract were reduced by half, so would the value of margin required, subject to certain caveats,[316] but the investor would need twice as many contracts to establish her optimal exposure. Thus, the total margin for this exposure would not change significantly from the baseline. However, a reduction in contract size is known to encourage market participation, and therefore, this alternative may spur demand for security futures.[317]

ii. Rule-Based Margins With Flexible Margin Settlement Intervals

The same commenter suggested another alternative that would maintain the current minimum margin requirements and reduce margins by changing the margin settlement intervals for security futures.[318] This alternative is based on the findings of one study, which quantifies the extent to which current margin requirements overmargin or undermargin a futures position relative to a risk-based margin requirement (*e.g.,* traditional futures).[319] This study finds that current margin requirements are overly conservative, and that increasing the length of the margin settlement interval may help alleviate the problem. The study further suggested that exchanges should be allowed to set the length of the margin settlement interval as a means of competing with one another.

While changing the length of the margin settlement interval may provide another way of reducing margins, it is not clear how feasible this method would be in practice. Allowing exchanges to set different margin settlement intervals for different products and update these over time would increase complexity and potentially impose operation costs on market participants. Because this alternative is not used currently in any equity markets (to the SEC's knowledge), and because there is uncertainty about how to calibrate the mechanism to deliver margin requirements in this context, the operational costs of this alternative could be large.

Moreover, the SEC recognizes that daily margin settlement is an important risk management tool in the markets for security futures, especially in light of recent market volatility. OneChicago—the only exchange trading security futures at the time the rule amendments were proposed—also cited risk management concerns, arguing that such an approach would remove a critical protection in futures markets.[320]

Finally, the Commissions are adopting the final rules because they produce a desired policy outcome of aligning the minimum margin levels for security futures held in non-Portfolio Margin Accounts with the margin levels for security futures in a Portfolio Margin Account, for the reasons discussed in section II.A. above. Modifying margin settlement intervals would not accomplish this policy outcome.

For these reasons, the SEC is not adopting an approach that includes rules-based margin requirements with flexible settlement intervals in this release.

iii. Risk-Based Margin for All Security Futures Products

OneChicago suggested the alternative of using risk-based margin requirements for security futures products. OneChicago stated that risk-based margin requirements would give security futures the best chance to compete with other products that provide delta one exposure to an underlying security, including products traded in overseas markets and that are subject to similar risk-based margin requirements.[321] According to OneChicago's analysis, the Commissions' proposal to lower the required margin levels from 20% to 15% would have resulted in a 25% reduction in the value of initial margin collected (from $540 million to $410 million); whereas using a risk-based margin model would have resulted in a 61% reduction (from $540 million to $210 million).[322] This suggests that the margin savings to investors from risk-based margin requirements may be economically significant.

OneChicago also supported its position that the Commissions should permit risk-based margin for security futures, presenting analysis that estimated that 92% of OneChicago products were ''overmargined'' (in the sense that the minimum margin requirement was greater than the level that would result from a risk-based margin calculation) at a 20% minimum margin requirement and 84% of OneChicago products would be ''overmargined'' at a 15% minimum margin requirement. This analysis suggests that the final rule amendments would set margin requirements for 8% of OneChicago products equal to the margin levels that would arise from risk-based margining but that a substantial majority of OneChicago products would have minimum margin requirements above risk-based levels, if security

[311] *See* CII Letter at 4; OneChicago Letter.

[312] *See* CII Letter at 4; *see also* Commissioner Jackson's Statement.

[313] *See* OneChicago Letter; OneChicago Letter 2; OneChicago Letter 3; *see also* Ianni Letter; La Botz Letter.

[314] *See* CII Letter at 4; *see also* Commissioner Jackson's Statement.

[315] *See* CII Letter at 4.

[316] There may be other factors that may affect whether the margin scales up or down with the size of the contract, in a linear fashion.

[317] *See, e.g.,* Lars Nordén, *Does an Index Futures Split Enhance Trading Activity and Hedging Effectiveness of the Futures Contract,* 26 J. FUTURES MARKETS 1169 (2006).

[318] *See* CII Letter at 4.

[319] Hans R. Dutt & Ira L. Wein, *On the Adequacy of Single-Stock Futures Margining Requirements,* 10 J. FUTURES MARKETS 989 (2003).

[320] OneChicago Letter at 6.

[321] *See* OneChicago Letter at 12–13.

[322] OneChicago Letter at 14.

futures trading at OneChicago resumes.[323]

The SEC acknowledges that risk-based initial margin requirements may result in more efficient levels of margin being collected compared with margin requirements based on fixed margin levels. Moreover, moving to risk-based margin requirement would likely achieve a larger reduction in competitive frictions between security futures and alternative means of financing delta one exposure (*e.g.,* use of OTC equity swaps and stock loans) than the final rules.

However, as discussed in section II.A. above, the SEC is not persuaded by OneChicago's arguments that, at this time, implementing a risk model approach to calculating initial margin for security futures would be permitted under Section 7(c)(2)(B) of the Exchange Act given that such risk-based margin models are not currently used to set initial margin for customers in the equity options markets. Moreover, implementing a risk model approach would substantially alter how the required minimum initial and maintenance margin levels for security futures are calculated. It also would be a significant deviation from how margin is calculated for listed equity options and other equity positions (*e.g.,* long and short securities positions). It would not be appropriate at this time to implement a different margining system for security futures, given their relation to products that trade in the U.S. equity markets. Further, implementing a different margining system for security futures may result in substantially lower margin levels for these products as compared with other equity products and could have unintended competitive impacts. For these reasons, this suggested alternative to permit risk-based margin models to determine customer margin requirements for security futures is not viable.

iv. Risk-Based Margin for a Subset of Security Futures Products

OneChicago suggested the alternative of using risk-based margin requirements for STARS transactions.[324] OneChicago stated that risk-based margin requirements would allow STARS transactions to compete with other transactions that market participants currently use to finance their activities.

The SEC's consideration of this alternative is similar to the alternative of permitting risk-based initial margin requirements for all security futures transactions. While the SEC acknowledges that risk-based initial margin requirements may be more efficient than margin requirements based on fixed margin levels, the SEC is not persuaded by OneChicago's arguments that, at this time, implementing a risk model approach to calculating initial margin for STARS transactions would be permitted under Section 7(c)(2)(B) of the Exchange Act. For this reason, as well as the recent announcements by OneChicago, this suggested alternative for STARS transactions is not viable.

V. Regulatory Flexibility Act

A. CFTC

The Regulatory Flexibility Act (''RFA'') requires that Federal agencies, in promulgating rules, consider the impact of those rules on small entities.[325] The final rules would affect designated contract markets, FCMs, and customers who trade in security futures, if security futures trading resumes. The CFTC has previously established certain definitions of ''small entities'' to be used by the CFTC in evaluating the impact of its rules on small entities in accordance with the RFA.[326]

In its previous determinations, the CFTC has concluded that contract markets are not small entities for purposes of the RFA, based on the vital role contract markets play in the national economy and the significant amount of resources required to operate as SROs.[327] The CFTC also has determined that notice-designated contract markets are not small entities for purposes of the RFA.[328]

The CFTC has previously determined that FCMs are not small entities for purposes of the RFA, based on the fiduciary nature of FCM-customer relationships as well as the requirements that FCMs meet certain minimum financial requirements.[329] In addition, the CFTC has determined that notice-registered FCMs,[330] for the reasons applicable to FCMs registered in accordance with Section 4f(a)(1) of the CEA,[331] are not small entities for purposes of the RFA.[332]

Finally, the CFTC notes that according to data from OneChicago, 99% of all customers that transacted in security futures as of March 1, 2016, and March 1, 2017, qualified as ECPs. The CFTC has found that ECPs should not be considered small entities for the purposes of the RFA.[333] Based on this information, an overwhelming majority of the customers that traded security futures in the past were ECPs and not small entities. Although it is possible that an exchange that launches security futures trading in the future may market these contracts to retail customers that are not ECPs, the CFTC believes that it is still unlikely that the final rules will affect small entities. Therefore, a change in the margin level for security futures is not anticipated to affect small entities.

Accordingly, the CFTC Chairman, on behalf of the CFTC, hereby certifies pursuant to 5 U.S.C. 605(b), that the final rules will not have a significant economic impact on a substantial number of small entities.

B. SEC

The RFA requires that Federal agencies, in promulgating rules, consider the impact of those rules on small entities.[334] Section 3(a)[335] of the RFA generally requires the SEC to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking on small entities unless the SEC certifies that the rule amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.[336]

Pursuant to Section 605(b) of the RFA,[337] the SEC certified in the 2019 Proposing Release, that the proposed amendments to reduce the required margin for security futures from 20% to 15% would not have a significant economic impact on any ''small entity'' for purposes of the RFA.[338] The SEC solicited comment on the RFA analysis

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[323] *Id.*

[324] OneChicago Letter at 19; *see also* Memorandum from the SEC's Division of Trading and Markets regarding a July 16, 2019, meeting with representatives of OneChicago.

[325] 5 U.S.C. 601 *et seq.*

[326] *Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act,* 47 FR 18618, 18618–21 (Apr. 30, 1982).

[327] *Id.* at 18619.

[328] *Designated Contract Markets in Security Futures Products: Notice-Designation Requirements, Continuing Obligations, Applications for Exemptive Orders, and Exempt Provisions,* 66 FR 44960, 44964 (Aug. 27, 2001).

[329] *Supra* note 326 at 18619.

[330] A broker or dealer that is registered with the SEC and that limits its futures activities to those involving security futures products may notice register with the CFTC as an FCM in accordance with Section 4f(a)(2) of the CEA (7 U.S.C. 6f(a)(2)).

[331] 7 U.S.C. 6f(a)(1).

[332] 2002 Adopting Release, 67 FR at 53171.

[333] *Opting Out of Segregation,* 66 FR 20740, 20743 (Apr. 25, 2001).

[334] 5 U.S.C. 601 *et seq.*

[335] 5 U.S.C. 603.

[336] 5 U.S.C. 605(b). The final rule amendments are discussed in detail in section II. above. The SEC discusses the economic consequences of the amendments in section IV. (Economic Analysis) above. As discussed in section III. (Paperwork Reduction Act) above, the final rule amendments do not contain a ''collection of information'' requirement within the meaning of the PRA.

[337] *See* 5 U.S.C. 605(b).

[338] *See* 2019 Proposing Release, 84 FR at 36452.

in the 2019 Proposing Release.[339] The SEC received no comments in response to this request. The SEC is adopting the amendments in this release, as proposed.

For purposes of SEC rulemaking in connection with the RFA,[340] a small entity includes a broker-dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a–5(d),[341] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[342] The final rule amendments will reduce the required margin for security futures from 20% to 15%. The final rule amendments will affect brokers, dealers, and members of national securities exchanges, including FCMs required to register as broker-dealers under Section 15(b)(11) of the Exchange Act, relating to security futures.[343]

IBs and FCMs may register as broker-dealers by filing Form BD–N.[344] However, because such IBs may not collect customer margin they are not subject to these rules. In addition, the CFTC has concluded that FCMs are not considered small entities for purposes of the RFA.[345] Accordingly, there are no IBs or FCMs that are small entities for purposes of the RFA that would be subject to the final rule amendments.

In addition, all members of national securities exchanges registered under Section 6(a) of the Exchange Act are registered broker-dealers.[346] The SEC estimates that as of December 31, 2019, there were approximately 873 broker-dealers that were ''small'' for the purposes of SEC Rule 0–10. Of these, the SEC estimates that there are approximately ten broker-dealers that are carrying broker-dealers (*i.e.,* can carry customer margin accounts and extend credit).[347] However, based on December 31, 2019, FOCUS Report data, none of these small carrying broker-dealers carried debit balances.[348] This means these ''small'' carrying firms are not extending margin credit to their customers, and therefore, the final rule amendments likely will not apply to them. Finally, OneChicago was the only U.S. national securities exchange listing security futures until it discontinued all trading operations on September 21, 2020. Therefore, while some small broker-dealers could be affected by the final rule amendments, the amendments will not have a significant impact on a substantial number of small broker-dealers.

Accordingly, the SEC certifies that the final rule amendments will not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

VI. Other Matters

Pursuant to the Congressional Review Act,[349] the Office of Information and Regulatory Affairs has designated these rules as not a ''major rule,'' as defined by 5 U.S.C. 804(2).

If any of the provisions of these final rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

VII. Anti-Trust Considerations

Section 15(b) of the CEA requires the CFTC to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any CFTC rule or regulation (including any exemption under Section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the CEA.[350] The CFTC believes that the public interest to be protected by the antitrust laws is generally to protect competition.

The CFTC has determined that the final rules are not anticompetitive and have no anticompetitive effects. In the proposal, the CFTC requested comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA. The objective of the proposal was to bring margin requirements for security futures held in futures accounts or securities accounts that are not Portfolio Margin Accounts, into alignment with the required margin level for unhedged security futures held in Portfolio Margin Accounts.

One commenter argued that the final rules could create a competitive disadvantage for exchange-traded equity options.[351] As explained in more detail above, if security futures trading resumes, these final rules will reduce the margin level for an unhedged security future held outside of a Portfolio Margin Account to 15% and should not result in a competitive disadvantage for exchange-traded equity options, as the 15% margin rate is already in effect for exchange-traded options held in a Portfolio Margin Account.

A different commenter argued that the current strategy-based margin regime does not level the playing field with options, but rather, acts as a barrier to entry for competition and puts security futures at a competitive disadvantage.[352] The CFTC notes that, given the statutory constraints that require the margin requirements for security futures to be consistent with the margin requirements for comparable exchanged-traded equity options, the CFTC has not identified any less anticompetitive means of achieving the purposes of the CEA.

VIII. Statutory Basis

The SEC is amending SEC Rule 403(b)(1) pursuant to the Exchange Act, particularly Sections 3(b), 6, 7(c), 15A and 23(a). Further, these amendments are adopted pursuant to the authority

[339] *Id.*

[340] Although Section 601 of the RFA defines the term ''small entity,'' the statute permits agencies to formulate their own definitions. The SEC has adopted definitions for the term ''small entity'' for the purposes of SEC rulemaking in accordance with the RFA. Those definitions, as relevant to this rulemaking, are set forth in SEC Rule 0–10 (under the Exchange Act), 17 CFR 240.0–10. *See Statement of Management on Internal Accounting Control,* Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982).

[341] SEC Rule 17a–5(d) (under the Exchange Act).

[342] *See* 17 CFR 240.0–10(c).

[343] *See* SEC Rule 400(a), 17 CFR 242.400(a).

[344] These notice-registered broker-dealers are not included in the 873 small broker-dealers discussed below, because they are not required to file FOCUS Reports with the SEC. *See* SEC Rule 17a–5(m)(4), 17 CFR 240.17a–5(m)(4).

[345] *See* 47 FR 18618, 18618–21 (Apr. 30, 1982). *See also* 66 FR 14262, 14268 (Mar. 9, 2001).

[346] National securities exchanges registered under Section 6(g) of the Exchange Act—notice registration of security futures product exchanges—may have members who are floor brokers or floor traders who are not registered broker-dealers; however, these entities cannot clear securities transactions or collect customer margin, and, therefore, the final rule amendments will not apply to them.

[347] These small broker-dealers file a FOCUS Report Part II on a monthly basis, which is required to be filed by broker-dealers that clear transactions or carry customer accounts and do not use models to calculate net capital. *See* 17 CFR 240.17a–5(a)(2)(ii).

[348] In addition, based on December 31, 2019, FOCUS Report data, none of these small broker-dealers posted margin to a clearing agency/DCO related to security futures positions written, purchased or sold in customer accounts (FOCUS Report, Line 4467).

[349] 5 U.S.C. 801 *et seq.*

[350] 7 U.S.C. 19(b).

[351] Cboe/MIAX Letter at 2 and 6.

[352] OneChicago Letter at 2.

delegated jointly to the SEC, together with the CFTC, by the Federal Reserve Board in accordance with Exchange Act Section 7(c)(2)(A).

List of Subjects

17 CFR Part 41

Brokers, Margin, Reporting and recordkeeping requirements, Security futures products.

17 CFR Part 242

Brokers, Confidential business information, Reporting and recordkeeping requirements, Securities.

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 41

For the reasons discussed in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 41 as set forth below:

PART 41—SECURITY FUTURES PRODUCTS

■ 1. The authority citation for part 41 continues to read as follows:

Authority: Sections 206, 251 and 252, Pub. L. 106–554, 114 Stat. 2763, 7 U.S.C. 1a, 2, 6f, 6j, 7a–2, 12a; 15 U.S.C. 78g(c)(2).

■ 2. In § 41.45, republish paragraph (b) heading and revise paragraph (b)(1) to read as follows:

§ 41.45 Required margin.

* * * * *

(b) *Required margin*—(1) *General rule.* The required margin for each long or short position in a security future shall be fifteen (15) percent of the current market value of such security future.

* * * * *

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 242

In accordance with the foregoing title 17, chapter II, part 242 of the Code of Federal Regulations is amended as follows:

PART 242—REGULATIONS M, SHO, ATS, AC, NMS, AND SBSR AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

■ 3. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k–1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd–1, 78mm, 80a–23, 80a–29, and 80a–37.

■ 4. Section 242.403 is amended by revising paragraph (b)(1) to read as follows:

§ 242.403 Required margin.

* * * * *

(b) * * *

(1) *General rule.* The required margin for each long or short position in a security future shall be fifteen (15) percent of the current market value of such security future.

* * * * *

By the Securities and Exchange Commission.

Dated: October 22, 2020.

Vanessa A. Countryman,

Secretary.

Issued in Washington, DC, on October 29, 2020, by the Commodity Futures Trading Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

CFTC Appendices to Customer Margin Rules Relating to Security Futures—Commission Voting Summary and Commissioners' Statements

Appendix 1—CFTC Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Statement of Support of CFTC Commissioner Brian Quintenz

I am pleased to support today's final rule lowering the minimum margin requirement to hold security futures, from 20% to 15% of a position's market value.[1] The lower margin requirement would apply to security futures held in a futures account and to positions held in a securities account not subject to portfolio margin rules. The new margin requirement would be consistent with the current margin requirements both for security futures positions held in a securities account subject to portfolio margin rules and for exchange-traded equity options.

I note that today's final rule indicates that OneChicago, the only exchange that has listed security futures in the United States, has recently discontinued trading operations. This underscores the determinative impact statutory provisions can have on the viability of both products and whole business lines. The Securities Exchange Act requires security futures to be margined comparably to options traded on an exchange registered with the SEC.[2] While the intent of that provision is understandable, the economics underlying it appear to be severely sub-optimal. Today's lowering of the required minimum margin, consistent with the Securities Exchange Act, should make trading this product more cost effective than it has been, but it still may not be sufficiently cost effective to make the product economically viable. From that perspective, I hope policy makers revisit this provision, to ensure its ultimate effect is consistent with its intent. I believe financial markets policy should appropriately balance concerns of safety and soundness with promoting a range of innovative products, and more can certainly be done in that regard on this issue.

Finally, as I noted above, this rule serves as a positive example of productive cooperation between the CFTC and the SEC, and I hope that additional joint actions arise in the future.

Appendix 3—Statement of CFTC Commissioner Dawn D. Stump

I am pleased to be a part of today's Joint Open Meeting of the Commodity Futures Trading Commission (''CFTC'') and the Securities and Exchange Commission (''SEC''). I commend:

- Chairmen Tarbert and Clayton for holding this Meeting to provide transparency into our work in jointly addressing issues of mutual interest to both our agencies;
- Commissioner Quintenz at the CFTC and Commissioner Peirce at the SEC for laying the groundwork for this Joint Meeting through their efforts to harmonize the regulatory regimes of the agencies, as these harmonization efforts benefit not only those we regulate, but also the public we all serve; and
- The staff of the agencies for putting before us a Joint Final Rule that will lower the margin level for an unhedged security futures position from 20% to 15%, which I firmly believe is sound public policy.

And yet, while I don't want to rain on today's parade, I nevertheless feel compelled to express a few regrets.

I regret, for example, that the Commissions did not take the common-sense step of reducing the security futures margin level from 20% to 15% years ago. After all, OneChicago, the only U.S. exchange that made a long-term effort to develop a market for security futures, asked us to take this step 12 years ago in 2008. And the self-regulatory organization rules establishing a 15% margin level for unhedged security futures held in a securities portfolio margin account (with which the action we are taking will align) have been in effect for at least 10 years since 2010. I appreciate that the global financial crisis and the ensuing regulatory focus on swaps and other reforms diverted attention from security futures. But it is nonetheless disappointing that it took the Commissions a decade to take the step we take today—and even more disappointing given that OneChicago did not survive to see it, as it discontinued all trading operations about a month ago on September 21.

I also regret that the adopting release does not recognize the unique circumstances presented by the recent exit of OneChicago and the fact that no U.S. exchange currently lists security futures for trading, and thus issues opinions on hypothetical questions that I do not believe we should be addressing here. By way of background, when the Commissions proposed to reduce the margin level of an unhedged security futures position from 20% to 15%, we also requested comment on whether there are any other risk-

[1] Amended CFTC regulation 41.45(b) and SEC rule 242.403(b).

[2] Section 7(c)(2)(B) of the Securities Exchange Act.

based margin methodologies that could be used to prescribe margin requirements for security futures.[1] In response, OneChicago urged the Commissions to permit the use of risk-based margin models for security futures—similar to what is done for other futures contracts. I am in complete agreement that we should not adopt such a sweeping change to the manner in which margin is calculated for security futures based solely on the response to a single request for comment in a proposal designed to address a wholly different type of margin calculation rule.

Unfortunately, though, the adopting release goes further, and rejects OneChicago's arguments regarding the Commissions' authority to adopt risk-based margining for security futures. Some of these arguments are fact-based, and thus a future change in facts could yield a different conclusion, which is appropriate.[2] But the adopting release also rejects OneChicago's interpretive arguments that the Commissions can adopt risk-based margining for security futures even absent a change in factual circumstances.[3] I think that is unfortunate, for three reasons.

First, I do not believe that we should be offering advisory opinions on interpretive questions that, in light of the demise of OneChicago, no CFTC- or SEC-registered exchange is currently asking. In my view, these hypothetical questions are not material given the circumstances before us, and should therefore be left to future CFTC and SEC Commissioners, to be decided in the context of a live request to list and trade security futures.

Second, risk-based margining for security futures is permitted in Europe, and while factors other than margin requirements may influence demand for security futures, its rejection in the adopting release creates a potential competitive disadvantage for U.S. exchanges vs. their international counterparts. The Commodity Exchange Act (''CEA'') specifies that one of its purposes is ''to promote *responsible innovation* and *fair competition* among boards of trade, other markets and market participants.'' [4] The interpretation in the adopting release fails to fulfill that purpose.

Third, it should be remembered that the trading of security futures on U.S. exchanges before the year 2000 was prohibited due to jurisdictional disputes over the treatment of products that have attributes of both SEC-regulated securities and CFTC-regulated derivatives. In the Commodity Futures Modernization Act of 2000 (''CFMA''), Congress repealed that prohibition and permitted security futures to trade on U.S. exchanges pursuant to a framework of joint regulation by the CFTC and the SEC.[5] Yet, the rejection of risk-based margining in the adopting release risks stifling the very security futures market that the CFMA intended to promote.

Nevertheless, it is my sincere hope that while the reduction in margin level for an unhedged security futures position from 20% to 15% may have come too late for OneChicago, it will incentivize another U.S. exchange to launch security futures. And in that event, it is my further hope that the Commissions will bring an open mind to any interpretive arguments the exchange may advance if it requests recognition of risk-based margining for its contracts.

In the meantime, I support the Joint Final Rule that is before us.

Appendix 4—Supporting Statement of CFTC Commissioner Dan M. Berkovitz

I support today's final rule on customer margin requirements for security futures (''Final Rule''), issued jointly with the Securities and Exchange Commission (''SEC''). The Final Rule ensures that margin requirements for unhedged security futures will be consistent regardless of the type of customer account in which they are held. The Final Rule presents no new risks to the financial system, and is an overdue effort to align margin requirements for security futures.[1]

Unhedged security futures held in a ''portfolio margin'' account have been subject to a 15 percent minimum margin amount since certain securities self-regulatory organizations (''SROs'') launched portfolio margining pilot programs starting in 2007.[2] In contrast, prior to this Final Rule, such unhedged security futures held in a futures account or in a securities customer account that is *not* subject to portfolio margining were subject to a 20 percent margin requirement. This structure produced disparate treatment of security futures based solely on the customer account class in which they were held.

The Final Rule addresses this disparate treatment with no increased risks to the financial system. It brings all unhedged security futures to the same 15 percent margin requirement, consistent with existing margin requirements for security futures and equity options held in portfolio margin accounts that have been in place for over a decade.

I support the two Commissions' efforts in today's Final Rule to address one aspect of trading in security futures, consistent with the CFMA's statutory requirements. Unfortunately, these efforts are too late to be of any near-term benefit. Notably, the only U.S. derivatives exchange that offered security futures products discontinued trading in September, 2020.

I look forward to continuing to work with staff and my fellow Commissioners at both the CFTC and the SEC on a viable margin regime for security futures going forward.

I thank my fellow Commissioners at the CFTC and the SEC, as well as staff of the two agencies, for their work on this Final Rule.

[FR Doc. 2020–24353 Filed 11–23–20; 8:45 am]

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[1] Customer Margin Rules Relating to Security Futures, 84 FR 36434, 36441 (July 26, 2019). The proposing release also asked commenters, if their answer to this question was yes, to ''please identify the margin methodologies and explain how they would meet the comparability standards under the [Securities] Exchange Act [of 1934].'' *Id.*

[2] The Securities Exchange Act of 1934 (''Exchange Act'') provides that margin levels for security futures must, among other things, be: (i) *Consistent with* the margin requirements for *comparable* options traded on any exchange registered pursuant to Section 6(a) of the Exchange Act; and (ii) *not lower than* the lowest level of margin, exclusive of premium, required for any *comparable* exchange-traded options. *See* Sections 7(c)(2)(B)(iii)(I)–(II) of the Exchange Act (emphasis added). The adopting release concludes that risk-based margining for security futures is inappropriate, in part, because it would substantially deviate from how margin requirements are calculated for exchange-traded equity options at this time. If risk-based margining were permitted for such equity options in the future, then risk-based margining for security futures might follow, too.

[3] OneChicago's interpretive arguments included that: (i) The Commissions' reading of Sections 7(c)(2)(B)(iii)(I)–(II) of the Exchange Act as focusing on margin levels is incorrect; and (ii) security futures contracts are not ''comparable'' to equity options and, therefore, the ''consistent with'' and ''not lower than'' margin restrictions in Sections 7(c)(2)(B)(iii)(I)–(II) of the Exchange Act do not apply.

[4] CEA section 3(b), 7 U.S.C. 5(b) (emphasis added).

[5] Commodity Futures Modernization Act of 2000, Public Law 106–554, 114 Stat. 2763 (2000).

[1] Congress established a framework for the trading and joint regulation of security futures in the Commodity Futures Modernization Act of 2000 (''CFMA''). Among other requirements, the CFMA specified that customer margin requirements for security futures products must be consistent with the margin requirements for comparable options traded on a registered securities exchange, and that the initial and maintenance margin levels must not be lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded options.

[2] Portfolio margining allows a broker-dealer to combine certain of a customer's securities and security futures positions held in a securities account for purposes of determining the margin requirements for those positions. Such portfolio margining began with a 2007 pilot program pursuant to the rules of CBOE Exchange. The program became permanent in 2008. FINRA adopted its own portfolio margining rules in 2010. Portfolio margining for security futures is not available in a futures customer account. Thus, prior to this Final Rule, the 15 percent treatment available to security futures held in a portfolio margined account was unavailable to security futures held in a futures account.