

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-89809; File No. SR-OCC-2020-008)

September 10, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Enhance OCC's Stock Loan Close-Out Process

I. INTRODUCTION

On July 14, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2020-008 (“Proposed Rule Change”) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder to require Clearing Members that OCC instructs to buy-in or sell-out securities to execute such transactions and provide OCC notice of such action by the settlement time on the business day after OCC gives the instruction.³ The Proposed Rule Change was published for public comment in the Federal Register on July 30, 2020.⁴ The

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Notice of Filing infra note 4, 85 Fed. Reg. at 45943.

⁴ Securities Exchange Act Release No. 89393 (Jul. 24, 2020), 85 Fed. Reg. 45943 (Jul. 30, 2020) (File No. SR-OCC-2020-008) (“Notice of Filing”). OCC also filed a related advance notice (SR-OCC-2020-805) (“Advance Notice”) with the Commission pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled the Payment, Clearing, and Settlement Supervision Act of 2010 and Rule 19b-4(n)(1)(i) under the Exchange Act. 12 U.S.C. 5465(e)(1). 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The Advance Notice was published in the Federal Register on August 14, 2020. Securities Exchange Act Release No. 89515 (Aug. 10, 2020), 85 Fed. Reg. 49697 (Aug. 14, 2020) (File No. SR-OCC-2020-805).

Commission has received no comments regarding the Proposed Rule Change.⁵ This order approves the Proposed Rule Change.

II. BACKGROUND

OCC serves as the sole clearing agency for standardized U.S. securities options listed on Commission-registered national securities exchanges (“listed options”).⁶ OCC also operates two programs under which it clears stock loan transactions (the “Stock Loan Programs”).⁷ As described in more detail below, OCC proposes to align the timeframes for closing out the open stock loan and non-stock loan positions of a defaulting Clearing Member.

In the event of a Clearing Member default, OCC would close out the defaulting Clearing Member’s open positions, liquidate collateral, and deposit the proceeds from such a close-out into a Liquidating Settlement Account.⁸ Generally, OCC would seek to close out the defaulting Clearing Member’s open positions through an auction conducted, before market open, on the day after a default occurs. Under its rules, however, OCC may also seek to close out open positions cleared under its Stock Loan Programs by instructing non-defaulting Clearing Member

⁵ Since the proposal contained in the Proposed Rule Change was also filed as an advance notice, all public comments received on the proposal are considered regardless of whether the comments are submitted on the Proposed Rule Change or Advance Notice.

⁶ See Securities Exchange Act Release No. 85121 (Feb. 13, 2019), 84 Fed. Reg. 5157 (Feb. 20, 2019) (File No. SR-OCC-2015-02).

⁷ OCC’s two Stock Loan Programs are the “Stock Loan/Hedge Program” and the “Market Loan Program.” Under its Stock Loan/Hedge Program, OCC clears transactions initiated directly between Clearing Members on a bilateral basis. Under its Market Loan Program, OCC clears transactions initiated on either a broker-to-broker basis or anonymously through the matching of bids and offers.

⁸ See OCC Rule 1104; available at https://www.theocc.com/getmedia/9d3854cd-b782-450f-bcf7-33169b0576ce/occ_rules.pdf. See also Notice of Filing, 85 Fed. Reg. at 45944.

counterparties to the open position to execute buy-in or sell-out transactions by the end of the business day following the default.⁹ In the event that a Clearing Member counterparty fails to execute buy-in or sell-out transactions as instructed, OCC would terminate the relevant stock loan positions based on end of day prices from the business day following the default. Pursuant to the Proposed Rule Change, OCC proposes to change (1) the time by which buy-in or sell-out transactions for defaulted open stock loan positions must be executed and (2) the price at which OCC would terminate positions not closed out through the execution of buy-in or sell-out transactions.

Current rules. Under its Rule 2211 and Rule 2211A, OCC may instruct a Clearing Member who is a party to stock loan transactions with a defaulting Clearing Member to execute buy-in or sell-out transactions, as applicable, with respect to each open stock borrow or loan position of the defaulting Clearing Member.¹⁰ Currently, a Clearing Member so instructed is obligated to execute the required transactions and provide notice of such execution to OCC by the close of the business on the day following receipt of such an instruction. If a Clearing Member fails to execute buy-in or sell-out transactions as instructed, OCC may terminate the relevant stock loan transactions. OCC would terminate such transactions based on prices from the end of the day after OCC issued buy-in or sell-out instructions (i.e., the same day by which the Clearing Member was obligated to execute the buy-in or sell-out transactions).

Proposed change to execution time. OCC proposes to amend its Rules 2211 and 2211A

⁹ “Buy-in” refers to a non-defaulting lender purchasing replacement stock. “Sell-out” refers to a non-defaulting borrower selling the loaned securities in order to recoup its collateral. See Notice of Filing, 85 Fed. Reg. at 45943, n. 3.

¹⁰ See OCC Rules 2211 and 2211A. Typically, OCC issues such instructions on the day of default. See Notice of Filing, 85 Fed. Reg. at 45944.

with regard to the time by which a Clearing Member must execute buy-in or sell-out transactions and provide notice to OCC of such transactions. OCC would continue to require that such transactions be executed by or before the business day following receipt of the instruction to execute such transaction. OCC proposes, however, to move up the time by which the transaction must be executed from the close of business to “settlement time,” which OCC’s current rules define as 9:00 a.m. Central Time.¹¹

OCC considered requiring the execution of buy-in or sell-out transaction by the close of business on the day it instructed a Clearing Member to execute such transactions; however, Clearing Members expressed a preference for setting the deadline at 9:00 a.m. Central Time the following business day because doing so would allow a non-defaulting Clearing Member the opportunity to trade at market opening.¹² Because OCC typically issues buy-in or sell-out instructions on the day of default, the proposed rule would require such transactions to be executed by 9:00 a.m. Central Time on the business day following the default. The required transactions would, therefore, be executed on the same day on which OCC seeks to close out a defaulting Clearing Member’s other positions through its auction procedures. OCC believes allowing non-defaulting Clearing Members to trade at market opening on the morning following default would provide additional time to execute the buy-in and sell-out transactions in a manner consistent with OCC’s two-day liquidation assumption.¹³ The proposed change would provide OCC with authority under its rules to compel execution of buy-in or sell out transactions

¹¹ See By-Law Article I, Section 1.S.(16); available at https://www.theocc.com/getmedia/3309eceb-56cf-48fc-b3b3-498669a24572/occ_bylaws.pdf.

¹² See Notice of Filing, 85 Fed. Reg. at 45944-45.

¹³ See Notice of Filing, 85 Fed. Reg. at 45945.

designed to close out a defaulting Clearing Member's stock loan positions at a point in time closer to OCC's other default management processes (i.e., auctions) than is currently permitted under OCC's rules.

Proposed change to termination price. OCC also proposes to amend its Rules 2211 and 2211A with regard to the price on which termination of stock loan positions would be based if a Clearing Member fails to execute buy-in or sell-out transactions within the required timeframes. Under the proposal, OCC would close out such positions based on end-of-day prices from the same day on which OCC instructed the Clearing Member to execute buy-in or sell-out transactions (i.e., the day before the Clearing Member was obligated to execute the buy-in or sell-out transactions).¹⁴ Such a price would be the last settlement price captured in OCC's systems prior to the time by which the non-defaulting Clearing Member was required to execute buy-in or sell-out transactions.¹⁵ OCC believes that using such a price, already available in its system, would be superior to other options because it would allow for an automated process not susceptible to the delays and errors of manually pulling price information.¹⁶

III. DISCUSSION AND COMMISSION FINDINGS

Section 19(b)(2)(C) of the Exchange Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is

¹⁴ For example, OCC might rely on such end-of-day prices if Clearing Members were unable to execute buy-in or sell-out transactions to terminate open stock loan positions during the morning of the business day following the default because of circuit breaker activity. The use of the end-of-day prices from the day of default, as opposed to end-of-day prices following a full day of trading, would provide closer alignment of market conditions for OCC's auction and stock loan terminations than the current rules.

¹⁵ See Notice of Filing, 85 Fed. Reg. at 45944.

¹⁶ See Notice of Filing, 85 Fed. Reg. at 45945.

consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to such organization.¹⁷ After carefully considering the Proposed Rule Change, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Exchange Act¹⁸ and Rule 17Ad-22(e)(13) thereunder.¹⁹

A. Consistency with Section 17A(b)(3)(F) of the Exchange Act

Section 17A(b)(3)(F) of the Exchange Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.²⁰ Based on its review of the record, the Commission believes that the changes proposed in the Proposed Rule Change are consistent with the promotion of prompt and accurate clearance and settlement of securities transactions for the reasons described below.

As a central counterparty and SIFMU,²¹ it is imperative that OCC maintain default management processes designed to contain losses. As described above, OCC may, in the event of a Clearing Member default, seek to close out stock loan positions by requiring Clearing Members to execute buy-in or sell-out transactions while closing out non-stock loan positions and liquidating collateral via an auction. Pursuant to the Proposed Rule Change, OCC proposes

¹⁷ 15 U.S.C. 78s(b)(2)(C).

¹⁸ 15 U.S.C. 78q-1(b)(3)(F).

¹⁹ 17 CFR 240.17Ad-22(e)(13).

²⁰ 15 U.S.C. 78q-1(b)(3)(F).

²¹ See Financial Stability Oversight Council (“FSOC”) 2012 Annual Report, Appendix A, available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

to more closely align the timeframe within which buy-in and sell-out transactions would occur with the timeframe of a default auction. In the event that such transactions do not occur within the required timeframes, OCC further proposes to terminate such stock loan transactions based on end of day prices from the same day on which OCC instructed the Clearing Member to execute buy-in or sell-out transactions. Such prices would likely represent the last market price received before OCC would auction off the rest of the defaulting Clearing Member's portfolio prior to the market open on the following morning.

Aligning the timeframes for closing out stock loan positions and non-stock loan positions and collateral would reduce the potential for significant market movements occurring between the time by which OCC closes out positions and liquidates collateral related to such positions. Avoiding the potential for such market movements would, in turn, increase the likelihood that such collateral would be sufficient to mitigate losses arising out of the close out of stock loan positions. Mitigating such losses would increase likelihood that OCC could liquidate a defaulting Clearing Member's portfolio without realizing severe credit losses.

OCC is the sole registered clearing agency for the U.S. listed options markets. Increasing the likelihood that OCC could liquidate a defaulting Clearing Member's portfolio without realizing severe credit losses strengthens OCC's ability to manage Clearing Member defaults, which, in turn, facilitates the clearance and settlement of listed options. The Commission believes that the Proposed Rule Change would promote the prompt and accurate clearance and settlement of securities transactions and is, therefore, consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.²²

²² 15 U.S.C. 78q-1(b)(3)(F).

B. Consistency with Rule 17Ad-22(e)(13) under the Exchange Act

Rule 17Ad-22(e)(13) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations.²³

As described above OCC, proposes to use its authority to alter the time when OCC will close out a defaulting Clearing Member's open stock loan positions. The proposed change would move the point in time by which OCC can close out open stock loan positions closer to the point in time by which OCC would seek to close the defaulting Clearing Member's non-stock loan positions and liquidate the defaulting Clearing Member's collateral via an auction. Aligning the timeframes for closing out stock loan positions and non-stock loan positions and collateral would reduce the potential for significant market movements occurring between the time by which OCC closes out positions and liquidates collateral related to such positions. Avoiding the potential for such market movements would, in turn, increase the likelihood that such collateral would be sufficient to mitigate losses arising out of the close out of stock loan positions.

OCC also proposes to terminate stock loan positions not closed out through buy-in or sell-out transactions based on end of day prices from the same day on which OCC instructed the Clearing Member to execute buy-in or sell-out transactions. As described above, such prices would likely represent the last market price received before OCC would auction off the rest of the defaulting Clearing Member's portfolio prior to the market open on the following morning. Similar to the change in the time by which Clearing Members would be instructed to execute buy-in or sell-out transactions, the proposed change in termination price would mitigate losses

²³ 17 CFR 240.17Ad-22(e)(13).

arising out of the close out of open stock loan positions by reducing the potential for significant market movements between the close out of positions and liquidation of related collateral. Taken together, the Commission believes that proposed changes regarding the close out a defaulting Clearing Member's open stock loan positions would enhance OCC's authority to take timely action to contain losses.

Accordingly, the Commission believes that Proposed Rule Change would be consistent with Rule 17Ad-22(e)(13) under the Exchange Act.²⁴

²⁴ 17 CFR 240.17Ad-22(e)(13).

IV. CONCLUSION

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Exchange Act, and in particular, the requirements of Section 17A of the Exchange Act²⁵ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,²⁶ that the Proposed Rule Change (SR-OCC-2020-008) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁷

J. Matthew DeLesDernier
Assistant Secretary

²⁵ In approving this Proposed Rule Change, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁶ 15 U.S.C. 78s(b)(2).

²⁷ 17 CFR 200.30-3(a)(12).